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SOME ASPECTS OF SOCIAL INNOVATION AND LEGAL STATUS OF SOCIAL ENTERPRISE

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Abstract

Purpose. The purpose of this paper is to clarify the definition of social innovation and its relation to the status of social enterprise as a legal concept.

Design/methodology/approach. Methodologically this research focuses on the legislation of European Union and some recent initiatives that were undertaken by Lithuania and other EU Member States in the area of development and facilitation of social entrepreneurship.

This research utilizes the qualitative research methods. The textual analysis method has been used to examine the content and meaning of legal texts and other documents, as well as their structure.

Findings. The social economy and social enterprises offer specific tools that can be used to tackle important social challenges. Moreover, they can contribute to reducing the social divide and accelerating innovation while pursuing their overarching objective of providing a service to society.

Social enterprise is not a new organizational form, but a result of evolutionary development of non-profit or voluntary organizations. To create social value, social enterprises have developed innovative strategies, new resource configurations and governance structures. It should be stressed that usually innovation process in commercial enterprises means the creation of new products and services, however, in social enterprise innovation means the reconfiguration of existing products or services to create social value.

Research limitations/implications. The scope of the research covers the examination of the EU legislation regulating this area. It also covers the comparative analysis of social entrepreneurship legal regulation in the neighbouring Baltic countries – EU Member States – Latvia and Lithuania that shows current progress in development of legal basis for social entrepreneurs.

Practical implications. In 2015, the Ministry of Economy of the Republic of Lithuania adopted the Conception of Social Entrepreneurship. So far, this is the main document providing the common definition. However, it is rather broad and not very well known. Currently Lithuanian Government works on several initiatives to promote social entrepreneurship, i.e. Draft Law on Social Business, which, however, is not published yet. Therefore, the results of the research can be useful improving the national legal framework on social entrepreneurship.

Originality/Value. Social innovations and social entrepreneurship legal preconditions are quite new definitions that lack conceptual review to become more understandable. This research looks for the legal preconditions of social entrepreneurship and social innovation in order to clarify these definitions in the way that could be useful for further research and practical application.

Keywords: social innovation; social enterprise; social business; social entrepreneurship.

Research type: general review.

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Introduction

Social enterprises have gained in importance in European and national policies in recent years. There is a growing awareness that they create sustainable and inclusive growth and stimulate social innovation (GECES, 2016). By focusing on people as much as profit, they foster a sense of social cohesion and promote the common well-being.

The potential of the social economy and social enterprises has not yet been fully unleashed. Innovative approaches to the social challenges we face are especially important at a time of public budget challenges. Therefore, much more needs to be done at all levels of public policy to optimize the framework conditions and funding support for social enterprises.

In order to foster the social economy, we have to develop an environment that facilitates access to funding, adequate legal framework, and awareness on the national and local level. The definition of social innovation and its relation to the status of social enterprise as a legal concept can significantly contribute to this purpose.

The European Commission defines a social enterprise as an operator in the social economy whose main objective is to have a social impact rather than make a profit for its owners or shareholders. It operates by providing goods and services for the market in an entrepreneurial and innovative fashion and uses its profits primarily to achieve social objectives. It is managed in an open and responsible manner and, in particular, involves employees, consumers and stakeholders affected by its commercial activities.[1] It should be noted that the Communication of the Commission doesn't emphasize any specific form of legal entity as a social enterprise.

So far it is up to the particular country to decide whether the social enterprise is supposed to obtain special legal form or not. The main goal of this research is to clarify the definition of social innovation and its relation to the status of social enterprise as a legal concept.

Social enterprise and two elements of its definition

The social element of definition. One of the greatest challenges in understanding social entrepreneurship lies in defining the boundaries of what we mean by "social". Generally, the term "social" refers to initiatives, which aim to help people. Traditional entrepreneurship is commonly associated with profit motive, and social entrepreneurship, with an expression of altruism. Nevertheless, in reality, the motives for social entrepreneurship can also include less altruistic reasons (e.g., personal fulfillment). The distinctive social domain of social entrepreneurship can be distinguished through creatively combination of resources that usually social entrepreneurs themselves do not possess, in order to address a social problem and thereby alter existing social structures (Mair and Marti, 2005).

Some researchers stress that research of social entrepreneurship has matured beyond definitional debates and embraced the analysis of institutional and

[1] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Social Business Initiative. COM (2011) 682 final, 2.

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organizational processes associated with their creation and management (Doherty et al, 2014). It should be stressed that general analysis of social entrepreneurship literature contributes to important debates concerning the role of markets, government and social society. There is a need to build on existing research that distinguishes social enterprise as an organizational form and to use recent theoretical developments to find the ways of balancing the positive and negative effects of hybridity.

The entrepreneurial element of definition. Various authors during different periods suggested that the focus of entrepreneurship research should be the entrepreneurial process and entrepreneurial behavior. Today we see, and lots of authors recognize that this phenomenon is far more complex and heterogeneous. Nowadays number of researchers study entrepreneurial process outside of the business sector, concentrating on the role of entrepreneurship in society. Researchers focus on the personality of social entrepreneurs, their behavior in particular processes. However, some of new researches argue that during the research on social entrepreneurship focus on the social entrepreneur is actually wrong and has to be put on the entrepreneurial process. A number of researchers emphasize that entrepreneurial process itself is more important than "how" entrepreneurs act. It allows us to differentiate between social initiatives and social – entrepreneurial initiatives (Mair and Marti, 2005).

We see that not only not-for-profit nature of social entrepreneurial activities should be researched as a distinctive feature of social entrepreneurship, because social entrepreneurship can take place equally well on a not-for-profit basis or on a for profit basis. Usually the set-up of social enterprise is dictated by the nature of the social needs addressed, resource availability, and the ability to capture economic value. Therefore both, social and entrepreneurial elements of the definition are important.

Hybridity and social innovation

Recent studies of management show that social entrepreneurship faces tensions because of its dual mission and conflicting institutional logics. Social enterprises usually pursue the dual mission of achieving both financial sustainability and social purpose and, therefore don't fit neatly into the conventional categories of private, public or non-profit organizations (Doherty et al, 2014). Therefore, focus on the nature of social enterprise organizational forms and how these forms are explained by hybridity, and social innovation, is important speaking about the phenomenon of social entrepreneurship.

Mair and Marti (2005) stress that the interaction of social enterprise and the context in which it operates is crucial to understand the process of social entrepreneurship. It is also important to understand the structure of social capital, how it can be built, increased, and maintained. Usually, social enterprises have their particular role within the system. Therefore, we see that the interaction between social enterprise and the context could help us to understand and explain why and how social change is possible.

We think that if a specific state does not have a well-established social business market, it is first necessary to focus on infrastructure formation, because in the

absence of proper infrastructure, individual social business initiatives lead to market failure.

Therefore, we have to bear in mind that hybrid organizational form means the organizational form as structure and practice that allow the coexistence of values from two or even more categories. Hybrid organizational forms therefore draw on at least two different sectoral paradigms and value systems and relate to the emergence of new institutional forms that shape traditional conceptions of economic organizations (Doherty et al, 2014). In this context we think that social innovation and hybridity of social enterprise are therefore the aspects of social enterprise that create the paradigm of social entrepreneurship.

Researchers as Fedele and Depedri (2016) remark that in the aftermath of the economic crisis, some organizations, such as cooperative and socially oriented enterprises may play a key role in restoring people's confidence. It is noticed that such organizations are less willing to exploit their workers, customers, and in general, stakeholders. Cooperative and socially oriented enterprises may help increase both the wellbeing of individuals and economic efficiency. So, the welfare of citizens and producers may be positively affected by the presence of different firm types in the same sector of production.

However, costs of collective decision making usually increase in the heterogeneity of a cooperative's members. Apart from the direct costs of the decision-making process, further costs can arise from influence activities in organizations (Herbst and Prüfer, 2016). It is quite common in the most countries that, shares of companies are traded on stock exchanges. Moreover, Mikami (2016) argues that shares of membership in cooperatives are rarely traded in an open market traditionally supposing that the trade of membership shares is inappropriate in terms of cooperative philosophy, which has been heavily influenced by ideology, and usually restricted by cooperative law.

Here we see that it is quite difficult to draw one tendency. However, the diversity of options brings social enterprise sector to more innovative approaches not only creating socially innovative services but also management procedures within the existing legal forms.

Researchers (Doherty et al, 2014) stress that significant growth in interest in social enterprise in many countries can be attributed to the changes in the nature of philanthropic giving. Formerly donor-dependent organizations have been pushed to seek more commercial sources of revenue. Also, new models of public service delivery have created market opportunities for new entrants, such as social enterprises. The other factor is that there is an interest in alternative economic systems and economic justice. We think, however, that only social innovation could become a solution to market failure in the environment of rising inequality and bring the nature of philanthropic giving to the new level.

European Commission (2016) examined that many social innovators operate mixed businesses models that attempt to combine financial sustainability with social motivations. European Commission's study shows that there is a significant variation in how non-state led activities address social challenges are defined across Europe. For this reason, social purpose collaborative economy should not be associated with a single organizational model. We see that the social purpose collaborative economy is not limited to a specific sector or societal issue – it can be applied to a range areas or challenges.

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Also, we don't have to forget that social enterprises (e.g. cooperatives) increase the stakeholders involvement in their governance. So, the democratic principles and community-based structures are part of the innovative management of social enterprise. Two opinions could be found regarding that matter. Doherty (2014) stresses that stakeholder-involving structures facilitate greater accountability, on the other hand, it can cause some tensions that impact governance process of social enterprises. Really important is the impact of the respective values of different stakeholder groups (e.g. employees, volunteers, etc.), because different stakeholders could have different views concerning the balance between commercial and social mission. However, stakeholder theory states that incorporating of different stakeholders into decision-making process makes organization to be more likely responsive to broader social interests and not only the narrow interests of one group (Cornforth, 2004). We think that both theories have a right to exist because they reflect the most complicated part of social enterprise management caused by its hybridity. Only innovative approaches to management of social enterprise and clearer legal frameworks could help to solve this problem.

As a social policy implication, governments should take steps to introduce laws that encourage the entry of social enterprises in social services sectors, and the outsourcing of social services from public bodies to private social enterprises – a common feature of many European countries – should be further encouraged (Fedele and Depedri, 2016). We also think that the question should be raised how to make the existing legal environment more favourable starting with the identification of what legal forms businesses can be considered as social enterprises. and for each of these legal forms for businesses to prepare detailed guidance on how to run a social business, considering different legal forms.

The innovation in social entrepreneurship affects access to social services (education, healthcare, and others) and general welfare. Fedele and Depedri (2016) found out that individuals are more likely to have access to social services within mixed economy. Usually general welfare is larger within mixed economy. Where public policies in support of social enterprises are developed, the access to social services is further enhanced.

Generally speaking, social enterprise is not a new organizational form, but a result of evolutionary development of non-profit or voluntary organizations. To create social value, social enterprises have developed innovative strategies, new resource configurations and governance structures (Doherty et al, 2014). Usually innovation process in commercial enterprises means the creation of new products and services, in social enterprise innovation means the reconfiguration if existing products or services to create social value.

Fedele and Depedri (2016) stressed that mixed economies are both more effective and efficient than market economies when the ideological costs are relatively high and individuals' preferences for different types of firms are heterogeneous. We can agree on that. However, the behaviour of individuals can be different during the economic upturn and economic downturn.

The same authors suggest that policies in support of social enterprises would help clients satisfy their ideological preferences. Often, governments play an active role by guaranteeing tax exemption, subsidies and public transfers to social enterprises. These measures have redistributive effects. A downside of this is that subsidies distort

market and decrease the efficiency of the economic system. Nevertheless, when the public funding shrinks due to crisis, efficiency becomes of central importance for governments. Public transfers from for-profit firms to social enterprises are not desirable since they harm efficiency, so governments must find alternative solutions that encourage voluntary transfers to social enterprises rather than magnifying taxation on for-profit enterprises. This way, for-profit enterprises may increase the mixed economy effectiveness without compromising efficiency.

Therefore, we think that social economy and inclusive economy could decrease income and wealth inequalities, and contribute to sustainable job creation and social innovations.

The role of institutional support for social innovations

Some authors notice that social entrepreneurship research lags behind practice (Stephan et al, 2015). The importance of social entrepreneurship varies across countries, but generally, there is lack of information about innovation in this area and factors that may drive national differences of social innovation.

Social enterprises are often partly dependent on grants, financial aid, or loans issued under favourable conditions by governments, charities or philanthropists. Therefore, it is important to align the supply and demand of capital for social enterprises. Generally, the issues relating to the funding of social enterprises are not of a legal nature, but the need for funding and the relationship between shareholders'/stakeholders' interests and a social mission will lead to legal consequences. The second challenge: balance of the interests usually is tackled by setting out according rules in various corporate documents (Timmerman et al, 2011). Here we can ask if the institutional support for social innovations has such importance.

Stephan et al (2015) argue that the institutional configuration perspective recognizes that human behavior is usually shaped by the constraints, incentives, and resources provided by formal and informal institutions. In respect to this concept, some researchers provide the results of quantitative research in order to check several hypotheses. One of their hypotheses is that government activism at the national level is negatively associated with the likelihood of individuals engaging in social entrepreneurship. The researchers find out that in contrast to this hypothesis, government activism by providing resource support for social entrepreneurs can enhance social entrepreneurship. These resources can include grants, subsidies, and other direct funding, also assistance, endorsements, networking, etc. In this way, governments and social enterprises can be regarded as natural partners to achieve social goals, because a key role of government is to provide public goods and to look after the welfare of citizens, while social enterprises are being created to address social needs of society. Of course, we can agree that support for social entrepreneurs can enhance social entrepreneurship. Nevertheless, we do not have to forget that according to the European Commission, social enterprise operates by providing goods and services for the market in an entrepreneurial and innovative fashion and uses its profits primarily to achieve social objectives.[1] Therefore, we think that only limited support can trigger the entrepreneurial and innovative capacities of social enterprise.

[1] Ibid.

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The findings of Stephan et al (2015) suggest that national context drives individual engagement in social entrepreneurship mainly through resource-based mechanisms and supply side motivational influences and less through incentives arising from demands.

We think that in case of Lithuania and some other states it can be illustrated by the example that despite the lack of legal recognition of social business as such, there is a movement of so-called *de facto* social businesses. They represent the market subsector of social economy, i.e. economic activity seeking social benefit by selling the goods or services on the market at economically significant prices, being exposed to economic risk.

Current progress in development of legal basis for social entrepreneurs

Legal and institutional frameworks bring clarity by defining the nature, mission and activities of social enterprises. By granting to social enterprises recognition and visibility through the creation of framework laws or the implementation of national strategies, they help policy makers to more effectively target their support (OECD/EU, 2017).

Recently updated the European Commission report on social enterprises and their eco-systems in Europe illustrates the state and development of social enterprise, and pays attention to the findings of recent empirical and theoretical research on social enterprise at the international level.

The report shows that in the year 2016 social enterprises are still conceived in significantly different manners by national legislatures, policy strategies, academics and social entrepreneurs. In addition, there is a tendency to mix two main approaches. The first approach aims to identify the key features of social enterprises. The second approach designates general entrepreneurial dynamics oriented to social innovation and social impact, and addresses the issues of social entrepreneurship in general more than the issues of social enterprise (European Commission, 2016).

Therefore, we think that social business development in Lithuania also should take place in the following two directions. Firstly, it could be involvement in dealing with social problems for the purposes of promoting social enterprise as private business initiative. Secondly, it could be application of business models, as well as social innovations, for the purposes of encouraging non-governmental organisations and companies of other legal structures to get involved in social entrepreneurship.

From the legal point of view, the European Commission (2016) states that legislation designed for social enterprises could succeed in boosting social enterprise replicability if a deep understanding of social enterprise dynamics backed discussion on new legislation. Therefore, strong engagement by the social enterprise community in the process of drafting of new laws is required. On the other hand, it could fail boosting social enterprise replicability if it would introduce a top-down approach, with no active engagement on the part of the social enterprise community, and if legislation introduced excessively rigid constraints or would transplant from other countries/contexts with a significantly different history/tradition.

Recently, the Lithuanian Government adopted several measures to promote the social entrepreneurship. The Government's Action Plan foresees the adoption of the

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Draft Law on the Social Business.[1] This way the Government seeks to define the criteria and forms of social business, as well as the support measures in order to boost social economy. So far, it is difficult to say whether the adoption of new law will define a new form of legal entity, i.e. some kind of social business enterprise, or it will define some legal status of social enterprise without creating of new legal form.

Some new initiatives took place recently and in other countries. In 2017, the Latvian Parliament adopted new Law on Social Business, which foresees that a social enterprise is a limited liability company that has received the status of social enterprise pursuant to this law and that performs operations with a positive social impact. The status of social enterprise can be assigned to any limited liability company as far as the majority stake of it does not belong to one or more public entities (Latvijas Respublikas Saeima, 2017).

In comparison, both, Lithuanian and Latvian initiatives are timely, but so far Latvian development of social entrepreneurship is more advanced. Latvian Parliament already recognized the status of social enterprise by adopting special law. The actions, foreseen in Lithuanian Government's Action Plan, so far are far less concrete, because the Draft Law on the Social Business is not published yet.

So far, the above-mentioned initiatives are absolutely new and have no results that could by objectively analysed yet. Nevertheless, these initiatives show proper attention of the governments towards the development of social enterprise and social innovation in general.

Conclusions

Despite the innovation in commercial enterprises means the creation of new products and services, the social innovation can be described as the reconfiguration of existing products or services to create social value.

The status of social enterprise depends on social innovation whether it is recognized as a specific legal entity, or not, because social enterprise is not a new organizational form, but a result of evolutionary development of non-profit or voluntary organizations. To create social value, social enterprises have developed innovative strategies, new resource configurations and governance structures that allow social enterprises to contribute to reducing the social divide and accelerating innovation while pursuing their overarching objective of providing a service to society.

The comparative analysis of social entrepreneurship legal regulation in selected EU Member States showed that the legal preconditions of social entrepreneurship and social innovation exist, and current progress in development of legal basis for social entrepreneurs is positive. However quite underdeveloped and have to be developed further in order to allow social enterprises effectively use specific tools to tackle important social challenges.

Social economy and inclusive economy could decrease income and wealth inequalities, and contribute to sustainable job creation and social innovations. Therefore, future research should focus on not only formal institutions, but also informal institutions/culture, and configurations of both types of institutions in order to understand the scope and the content of social innovation.

[1] The Implementation Plan of the Programme of the Government of the Republic of Lithuania. *TAR*. 2017, No. 4172.

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