

EVALUATION OF SOCIAL ENTERPRISE STATUS CRITERIA IN LATVIA

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Abstract

Social entrepreneurship plays an increasing role in national and sectoral strategic policy documents, education, research and the business sector. The number of social enterprises in Latvia tends to increase; at the same time, however, a large number of enterprises were not granted social enterprise status, or the applicants refused the status. Therefore, the aim of the research is to analyse criteria for granting social enterprise status in Latvia. The research found that defining and measuring social impacts were the main challenges faced by social entrepreneurs in obtaining social enterprise status. The issue of non-distribution of profits is discussable because potential social entrepreneurs are not sufficiently motivated to apply for social enterprise status as well as face problems with the attraction of investors. Besides, the criterion of involvement of target groups in the executive or supervisory body of a social enterprise as well as the employment of employees is often formally met. Overall, it could be concluded that the entrepreneurs who have previous experience in administrative work or entrepreneurship do not face significant problems in meeting the criteria for granting social enterprise status when applying for the social enterprise status and filling in the relevant documents. However, most often the individuals who do not have previous experience in administrative work or entrepreneurship do not find it easy to meet the criteria and apply for the status.

Key words: social enterprise, social entrepreneurship, social enterprise status.

Introduction

In recent years, social entrepreneurship has become a focus in public policies, research, education and the business sector. Various kinds of social enterprises are established in the world, and in Latvia as well. Besides, there is a belief that social enterprises are the future of the economy; however, there are relatively few social entrepreneurs in Latvia. This could be explained by the fact that this field began to develop faster owing to purposeful activities only after 2015 when the Social Entrepreneurship Association of Latvia was established, which carried out educational and informative campaigns, while in 2018 the Social Enterprise Law entered into force. Besides, the fact that social entrepreneurship has now become a horizontal field and is used as an instrument in various areas to achieve certain goals represents some progress in this field. For example, social entrepreneurship is incorporated in the Resocialization Policy Guidelines for 2022–2027 to facilitate the integration of prisoners and probation clients into society and the labour market. Social entrepreneurship is also referred to in the informative report Circular Economy Strategy for Latvia stating that the reuse of goods as a business pattern creates opportunities for a new kind of social entrepreneurship. In addition, the educational standard SCHOOL 2030 stipulates that social entrepreneurship must be included in the curricula.

It is a positive fact that in recent years an increasing number of researchers in Latvia have focused on social entrepreneurship issues. It can be explained by the fact that today technological progress is reshaping global economic development and changing the overall welfare of societies (Grinberga-Zalīte & Hernik, 2019). In their research, scientists and young researchers analyse the nature of social enterprises

and focus on the definitions of the concept (Stupeņa, 2015; Dehtjare & Riashchenko, 2015; Kalve, 2012), the historical aspects of social enterprises and the role of social enterprises in the social economy (Dobeļe, 2014; Bikse, Rivza, & Riemere, 2020; Licite, Perkune & Auzina, 2020), international experience in social entrepreneurship (Freimanis, 2012), measurements of the social impacts of social enterprises (Kumačeva, 2018; Gintere, 2020), relevant legal frameworks (Groma & Licite, 2019) and support instruments for social enterprises (Veigure & Zorina, 2017; Aps, Ūlande, & Lipponen, 2018; Lis *et al.*, 2017). Overall, research on social entrepreneurship plays a key role in promoting the social entrepreneurship and educating the public on it. One of the last most important and comprehensive research studies on this field was the one commissioned by the European Commission; the research study identified the ecosystem in social entrepreneurship in the Member States of the European Union, incl. in Latvia (Līcīte, 2018). However, the scientific research done in Latvia has not performed in-depth examinations of the criteria for granting social enterprise status, which significantly affect the development of this field.

The criteria for granting social enterprise status are defined in the Social Enterprise Law that entered into force on 1 April 2018. The law defined not only the criteria for granting social enterprise status but also laid down the procedure for government support for this kind of entrepreneurship, as well as required that social enterprise statistics need to be started to be collected, and for this purpose the Register of Social Enterprises was established. Since the entry into force of the law, 155 enterprises have obtained the social enterprise status (140 of them are active social enterprises), while 50 enterprises were not granted the

status or the applicants refused the status (Ministry of Welfare Register of Social Enterprises, data as at 31 December 2020). This caused discussions on the reasons why the enterprises refused social enterprise status. A research study (Bogane, 2020) found that meeting the social enterprise criteria was one of the factors. Therefore, the aim of the research is to analyse the criteria for granting social enterprise status in Latvia. To achieve the aim, the following specific research tasks have been set: 1) to describe the process of granting social enterprise status; 2) to analyse the criteria for granting the social enterprise status.

Materials and Methods

To identify challenges in relation to social enterprise criteria in Latvia, 13 interviews with social entrepreneurs were conducted in Latvia. To gain a comprehensive and in-depth understanding of the research problem, 13 social entrepreneurs were interviewed; the interviewees were selected according to the following criteria:

- economic activity in various areas: environmental protection, culture and art, education, retail, knitwear production, building an inclusive civil society, etc.;
- economic activity in various regions of Latvia;
- work integration social enterprises working with different target groups;
- production of goods and services;
- duration of the social enterprise – for analysis, both new social enterprises that have started their operation relatively recently (less than 3 years) as well as those that have been operating for about 20 years were selected.

In addition, the interviews were conducted with representatives of the Ministry of Welfare and the Social Entrepreneurship Association of Latvia (SEAL).

The research analysed papers from international journals on social entrepreneurship, data on social enterprises collected by the Ministry of Welfare, as well as the legal framework of the Republic of Latvia governing the field of social entrepreneurship in Latvia.

Results and Discussion

The process of granting social enterprise status. The Ministry of Welfare (MoW) is responsible for the promotion and development of social entrepreneurship in Latvia. It grants social enterprise status to an enterprise based on a decision by a specially established Social Enterprise Commission (consisting of 10 members). The Social Enterprise Commission is governed by several legal documents, with Cabinet Regulation No. 101 Regulations regarding the Social Enterprise Commission being the most important one. The commission consists of representatives of five ministries, as well as five candidates who have been nominated by associations and foundations on an open competitive basis. According to a representative of the SEAL, an assessment and decision by the commission is important – a social entrepreneur receives a multidisciplinary qualitative view of his/her enterprise, as well as each application for social enterprise status is assessed in essence and meaning. However, several social entrepreneurs indicated in the interviews that the commission used to ask them questions mostly about the social impacts, yet the

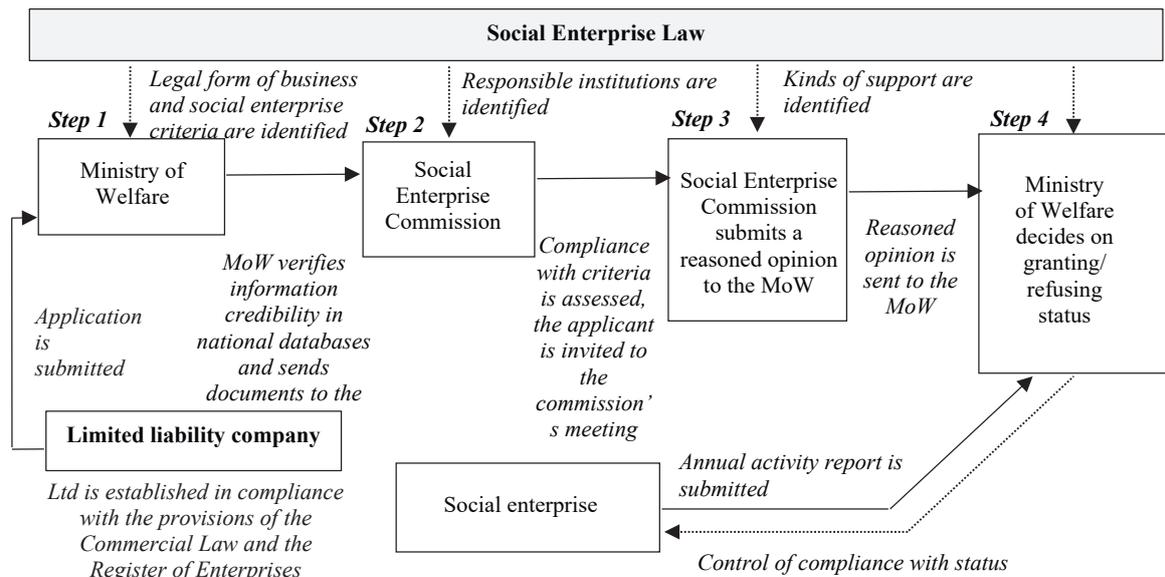


Figure 1. Scheme of granting social enterprise status in Latvia.

Source: authors' construction, 2020.

entrepreneurs would also appreciate the fact that the commission had a person from the entrepreneurial environment who would also assess the enterprise's economic viability. The process of granting social enterprise status is shown in Figure 1.

As shown in Figure 1, initially a Ltd is established (in compliance with the provisions of the Commercial Law and the Register of Enterprises), which submits a completed application form to the Ministry of Welfare that verifies the information in databases and assesses whether the potential candidate for social enterprise status meets the criteria and invites the applicant to a meeting of the commission. As a result, the Social Enterprise Commission sends a reasoned opinion to the Ministry of Welfare, which makes a decision on granting or refusing the status. The status is granted within one month from the submission of the application and relevant documents. After the social enterprise status has been granted, basic information on the enterprise is included in the public Register of Social Enterprises, which is available on the website of the Ministry of Welfare.

It is a positive fact that the enterprises that were granted social enterprise status are annually monitored, i.e. before 1 May each year, any social enterprise must submit to the Ministry of Welfare an activity report confirming that the requirements set for the social enterprise have been met and the tasks set in the statute to achieve the goal have been performed. The activity reports submitted facilitate the supervision of social enterprises (the reports contribute to meeting the requirements by the social enterprises, provide information on their social impacts, as well as their tasks performed and to be performed in the future) and contribute to the exchange of information on social enterprise activities, problems, suggestions as well as self-control and planning.

It should be noted, however, that previous research studies (Bogane, 2020) have established that the procedural part – obtaining social enterprise status – was not perceived positively by social enterprise representatives, which is mainly due to the fact that the process of obtaining the status was rather long and bureaucratic. The social entrepreneurs involved in the interviews conducted by the authors also pointed out this fact. In the interviews, the social entrepreneurs also noted that they were not sure whether they would be able to meet the criteria, especially with regard to measuring their social impacts. It could be concluded that, overall, the process of granting social enterprise status is well-developed, governed and understandable; however, there are some challenges in meeting the criteria, which are analysed in detail in the research.

Areas of economic activity and the legal form of a social enterprise. According to the Social Enterprise

Law, social enterprise status could be obtained by a limited liability company (Ltd) that implements creative economic activities with a positive social impact, e.g. it provides social services, forms an inclusive civil society, contributes to education, supports science, works on environmental protection, animal protection or cultural diversity. It could be concluded that the Social Enterprise Law, on the one hand, provides for a variety of economic activities to be carried out by social enterprises (with only a few exceptions to the kinds of activity defined in Section 9 of the Social Enterprise Law). It should be noted that the areas of economic activity mentioned in the law are only some examples, not a complete list, which means that social enterprises are not significantly limited in choosing the most appropriate kind of economic activity. The main thing is that social enterprises pursue social goals, which are divided into three categories by the law, giving each category specific performance indicators:

- employment of groups at risk of social exclusion – at least 50% of the employees are representatives of the target groups specified by the Ministry of Welfare (Cabinet Regulation No. 173 Regulations regarding Groups of Population at Risk of Social Exclusion and Procedures for Granting, Registering and Monitoring Social Enterprise Status);
- improvements in the quality of life of groups at risk of social exclusion by providing services to the representatives of these groups – not less than 30% of the total services provided are supplied to the target groups;
- other social goals – at least 50% of the self-defined social impact targets have been achieved.

As regards the first two categories of social enterprises, most of the entrepreneurs interviewed understood everything in relation to meeting the mentioned social goal criteria, whereas the social entrepreneurs that chose the 'other' category were often confused. This is partly due to the prevailing perception among the public that a social enterprise is only concerned with the employment of groups at risk of social exclusion or the provision of services to target groups; as a result, potential social entrepreneurs do not understand that they could apply for social enterprise status if their social goals are achieved in a different aspect. In addition, the research has found that the entrepreneurs who did not have previous experience and knowledge of social entrepreneurship as well as the definition and measurement of social goals faced more administrative challenges. The representative of the SEAL also pointed out that often social entrepreneurs lacked an understanding of social impacts, and the government had not defined generally

accepted principles for measuring the impacts. Besides, an analysis of the information collected by the Ministry of Welfare on the most common reasons for refusing social enterprise status reveals that entrepreneurs have most often inaccurately indicated the goal, the social problem was not clear or the planned activity made an insufficient social impact. This indicates that defining and measuring a social goal is one of the largest challenges faced by social entrepreneurs in Latvia.

In Latvia, the legal form of social enterprises, which may only be a limited liability company, should be indicated as a relative restriction in the criteria for identifying social enterprises. Although there was a lot of discussion on the most appropriate legal form for a social enterprise (Brencis & Šīna, 2016) before the entry into force of the Social Enterprise Law, which suggested granting the status of social business operator instead of social enterprise status irrespective of whether the organization is a Ltd, an NGO, a municipal institution or an agency. However, given the fact that the operation of any social enterprise is based on economic activity, associations and foundations were not included in the law as potential beneficiaries of social enterprise status because, according to the Law on Associations and Foundations, they were allowed to perform economic activity only in the form of auxiliary activities.

On the one hand, the fact that in Latvia the issue of a specific legal form for a social enterprise is governed by law is positive; however, as acknowledged in previous research studies (Bogane, 2020), such a restriction has narrowed the definition of a social enterprise and 'left overboard' the entities that also operated in public and national interests, thereby helping to tackle various social problems. Besides, although the introduction of the law was aimed at defining the boundaries and content of social entrepreneurship, it has insignificantly contributed to the identity of social entrepreneurs and social enterprises. The representatives of the Ministry of Welfare pointed out that they had no plans to change or supplement the list of legal form entities that could apply for social enterprise status in the coming years.

Irrespective of the subjective view of the scope of social enterprises, an enterprise needs the legal form of a limited liability company – either it is an existing limited liability company that adapts its activities to the requirements set by the law, or a new limited liability company is established, which complies with the requirements set by the law – in order to officially join the community of social entrepreneurs. It should be noted that associations may establish limited liability companies that may apply for social enterprise status and become the owner of a social enterprise. It could be concluded that the Social Enterprise Law does

not oblige existing associations and foundations to establish a new limited liability company and/or to stop their economic activity. It is up to each organization to decide which way to choose and how to continue their activity. As the representatives of the Ministry of Welfare pointed out in the interviews, in the future it might be necessary to consider some incentives and a transition period for associations that could qualify for social enterprise status in order to make the procedure of application for it more understandable and easier.

Social enterprise criteria. To obtain social enterprise status, not only the criteria for the legal form of a limited liability company but also other criteria must be met (Section 5 of the Social Enterprise Law):

- the statute of the Ltd defines the company's social goal as the only and main goal of the company's activity;
- a meeting of Ltd participants has made a decision on obtaining social enterprise status;
- the Ltd does not distribute the profit, but invests to achieve the goals set in the statute;
- the Ltd employs at least one employee;
- the Ltd implements a democratic (participatory) management style: a representative of the target group is included in the executive or supervisory body or an advisory body for the Ltd is established, which includes a representative of the target group or a representative of the association or foundation representing the interests of the target group, or an expert in the relevant field.

Development of a statute. Previous research studies suggest that creating or adapting relevant statutes is not an easy job (Bogane, 2020). The research conducted by the authors also reveals various situations regarding adapting a statute and meeting the requirements for other documents. For some social entrepreneurs, it was not difficult, whereas others hired a lawyer or a consultant to help to do the paperwork (especially in situations where a Ltd is re-established and has no previous experience in drafting a statute). Some other entrepreneurs indicated that they used the support provided by the Social Entrepreneurship Association of Latvia to understand the overall situation regarding documentation and the nature of social entrepreneurship.

Paid employees. In Latvia, social enterprises are mostly micro or small enterprises with a small number of employees (Licite, 2018). This is mainly due to the limited experience of social enterprises and their recent emergence in the country, yet overall meeting this criterion did not cause significant problems for social enterprises, as the definition of the criterion in the legal framework is clear and understandable. However, at the same time, testing this criterion was a challenge for the Ministry of Welfare because in

practice dishonest situations were identified, i.e. a social entrepreneur employed an employee and paid a salary of 0 EUR, as a result of which the criterion was formally met, yet the practical implementation did not make any sense.

Reinvestment of profits in the enterprise. One of the biggest subjects of discussion on the criteria among social entrepreneurs is the non-distribution of profits or reinvestment in the enterprise. On the one hand, Santos' theory (Santos, 2012) could be emphasized. According to the theory, the main goal of a social enterprise is to gain social influence as opposed to making a profit, which is the main goal in business, thereby defining the main difference between the two business models. However, other theorists criticize Santos' theory (Agafonow, 2014) because profit is needed to create social impacts. A similar situation has been found in previous research studies analysing this problem in Latvia (Bogane, 2020). Santos' theory is more often agreed with by those social entrepreneurs in Latvia whose companies had social enterprise status for a relatively shorter period or it was their first experience in business. This could be explained by the fact that most social enterprises in Latvia are young and do not make a profit in the first years of their operation; therefore, meeting this criterion is not perceived as a significant obstacle. The kind of economic activity in which social entrepreneurs are engaged often generates no high profits, and it is mentioned as an argument for non-distribution of profits; therefore, the reinvestment of profit is considered an acceptable criterion.

At the same time, it should be emphasized that there was a discussion among social entrepreneurs on the future of this criterion. On the one hand, it was emphasized that the withdrawal of a certain share of profits in the form of dividends could encourage more individuals to engage in social entrepreneurship, as well as contribute to entrepreneurship, as profit reinvestment is typical of the nongovernmental sector. In addition, it might make it more difficult to attract potential investors in the future. However, on the other hand, the social entrepreneurs interviewed also admitted that it was difficult for them to make a profit in Latvia, and many of the entrepreneurs had been working without profit for several years. Accordingly, changing this criterion (allowing a certain proportion of profits to be withdrawn in the form of dividends) would not significantly change their activity. The representative of the SEAL also pointed out that international experience has proved that profits should be reinvested in the company; however, she indicated that the distribution of some profits could be allowed in the future, or a specific period of operation (age) or the development stage of the enterprise could be stipulated for the distribution of profits.

Involvement of target groups in the enterprise's executive or supervisory body. The social entrepreneurs involved in the research indicated that the involvement of the target groups was in place, yet it was mostly formal, i.e. the representatives of the target group were informed about the enterprise's plans and activities. The formal involvement of target groups was mainly due to the fact that the entrepreneurs assume financial obligations, as well as responsibility for the enterprise's economic activity; therefore, the target groups were often informed about decisions rather than directly involved in decision-making. Overall, it was also noted that the role of executive/supervisory bodies was not clearly defined in the Social Enterprise Law. The entrepreneurs agreed that it was a good idea to encourage social entrepreneurs to take into account the interests of the target group, yet they did not see the point in imposing an obligation to create an appropriate institution. Several entrepreneurs emphasized that they had formally met the criterion by involving friends, acquaintances or family members in the relevant institution, who theoretically performed the relevant functions. At the same time, the social entrepreneurs involved in the research also gave some positive examples of target group involvement, e.g. renovating rooms and setting up a café, inviting a disabled person (in a wheelchair) to see whether the place is suitable for people with reduced mobility, thereby improving and changing the environment to be adapted for people with reduced mobility. The entrepreneurs also often consulted with target group representatives on implementing better activities for the target groups.

It could be concluded that, overall, the criteria stipulated in the Social Enterprise Law do not significantly restrict social entrepreneurs, yet the experience in meeting the criteria was different. For those who had previous experience in administrative work, this was not a problem, while some of them hired a specialist, a consultant, or used the support of the Social Entrepreneurship Association of Latvia to meet the criteria. In addition, meeting the criteria was also influenced by the size of the enterprise (including available human resources and their competencies and level of knowledge).

Conclusions

1. The criteria for granting social enterprise status are stipulated in the Social Enterprise Law. For those entrepreneurs who have previous experience in administrative work or business, meeting the criteria does not cause significant problems when applying for social enterprise status and filling in the relevant documents. However, most often those who do not have such previous experience have some difficulties in meeting the criteria and making an application.

2. The process of granting social enterprise status is regulated by law and easily to be understood. The challenges relate to relatively complex and lengthy administrative processes for obtaining social enterprise, which could discourage the applicants from applying for the status.
3. One of the largest challenges for social enterprises is to identify and describe the social goal of their activity. The authors recommend that the Ministry of Welfare develops guidelines for measuring social impacts, as well as gives some examples of how social enterprises engaged in different fields measure their social impacts, thereby facilitating the measurement of social impacts by potential social entrepreneurs.
4. With regard to the reinvestment of profits, the authors propose allowing some part of the profits to be distributed in the form of dividends in the future, thereby providing some incentive for entrepreneurs to apply for social enterprise status as well as attract investors in the future.
5. Taking into account unfair situations where a social enterprise concludes an employment contract with an employee and pays a salary of 0 EUR, thereby only formally meeting the criterion of employees, the authors recommend supplementing the list of social enterprise criteria with the following criterion: 'a social enterprise applies the principle of social justice to its employees, thereby ensuring fair pay', as well as setting a minimum workload or minimum working hours for the employees of target groups employed in a work integration social enterprise.
6. The involvement of target groups in the executive or supervisory body of a social enterprise is an essential criterion for social enterprises, which ensures democratic governance. However, the authors suggest that the owner or manager of the enterprise could be in place of the representatives of the target groups if s/he has previous experience in working with the specific target group.

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