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# The Joys and Burdens of Multiple Legal Frameworks for Social Entrepreneurship. Lessons from the Belgian Case.\*

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Abstract

In the last two decades, several innovative legal frameworks for social entrepreneurship were developed across Europe. The differential success of these innovations raise certain questions. Is the intrinsic design of these legal frameworks optimal for social enterprises? Secondly, is the attractive capacity of these legal frameworks high enough to attract both new as existing social enterprises? And lastly, have these new legal frameworks reached full maturity? If this is not the case, these changes may well impede rather than encourage the development of social enterprises. In this paper, we look at the Belgian situation where an innovative framework was introduced and where multiple legal frameworks for social entrepreneurship coexist. By means of a multi-disciplinary approach involving law and economics, we investigate the joys and burdens of having numerous legal frameworks for social enterprises. We provide an introduction to the Belgian legal environment for social entrepreneurship, and argue that the current institutional design is suboptimal. Finally, we conclude with lessons that can be learned from the Belgian case relevant for other countries and contexts.

Keywords: legal design, social enterprise

JEL classification: K22, K23, L21, L31

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## 1 Introduction

Traditionally, enterprises are expected to maximize profits so as to ensure the long-term financial return on investment of its shareholders. But what if an entrepreneur wants to set up a business with social or mutual objectives, rather than profit-maximization? Throughout the last decade, social entrepreneurship and social enterprises received growing attention, both among practitioners as among academics (see e.g. Borzaga & Defourny, 2001 and Nyssens, 2006). Along with it, an extensive conceptual debate developed, giving rise to different definitions of social entrepreneurship and the social enterprise. A leading example that partly consolidates this debate is the definition of the EMES-network, which can be summarized as follows:

*“Social enterprises are not-for-profit organizations providing goods or services directly related to their explicit aim to benefit the community. They rely on a collective dynamics involving various types of stakeholders in their governing bodies, they place a high value on their autonomy and they bear economic risks linked to their activity”. (Defourny & Nyssens, 2008: 5).*

Other authors use the term ‘social entrepreneurship’ more freely to grasp the mere fact that entrepreneurs might not be interested in profit-maximization alone. Baron (2007), for example, uses ‘social entrepreneurship’ to identify firms that engage themselves in corporate social responsibility (CSR) and compares them with profit-maximizing firms in the sense of Friedman (1970). While we do not want to focus on the details of its definition, we will basically deal with enterprises that combine an economic activity with a not-for-profit calculus when we talk about social entrepreneurship.

Throughout the last decades, the scope and variety of activities in which social enterprises can be found, increased. Many new initiatives were established, dealing with new challenges and needs that were left unaddressed by the state, the market and traditional third sector organisations (Defourny & Pestoff, 2008: 4). The combination of a declining role of governments in the welfare mix, and a policy shift that increasingly considers many traditional non-profit activities as market activities, enlarged the scope for social entrepreneurship as well. Nowadays, we find social enterprises in many different fields such as health and social care, childcare services, housing, educational services, work integration for disadvantaged people, local development, social tourism and cultural services.

As many new initiatives were established and many existing non-profit organisations evolved to some form of social entrepreneurship throughout the last decades, legislative needs increased to capture this changing reality. Traditional alternatives, such as the association and the co-

operative, had their limitations. Associations were originally designed to focus on non-market activities. Traditional co-operatives, on the other hand, focused primarily on mutual interests instead of general interests. A sound legal framework, however, is important to let enterprises prosper. Therefore, many European countries developed specific innovative legal frameworks for social enterprises. Italy pioneered in 1991 with the 'social co-operative', offering a legal framework for those delivering social, health and educational services, and those providing work integration for disadvantaged people. Later, other European countries followed by introducing new legal frameworks to promote social enterprises (Defourny & Nyssens, 2008: 5). Most of these countries introduced distinct legal forms into corporate law. Other countries, such as Belgium and later on Italy, launched 'legal labels' that could be attached to existing corporate legal forms. See table 1 for an overview.

**Table 1** Overview of innovative legal frameworks for social entrepreneurship

Country	Legal Framework	Status	Year
Italy	social co-operative	legal form	1991
Belgium	social purpose company	label	1996
Portugal	social solidarity co-operative	legal form	1998
Spain	social initiative co-operative	legal form	1999
Greece	limited liability social co-operative	legal form	1999
France	collective interest co-operative society	legal form	2002
Finland	social enterprise	legal form	2003
UK	community interest company	legal form	2005
Italy	social enterprise	label	2005
Sweden	firm with limited profit distribution	legal form	2006
Poland	social co-operative	legal form	2006
The Netherlands	social company	legal form	<i>in preparation</i>

Source: Dunn & Riley (2004), Lindsay (2004), Thomas (2004), Defourny & Nyssens (2008), Dujardin, Mertens & Van Opstal (2008)

As indicated by Defourny & Nyssens (2008: 7), these newly created forms did not prevent most social enterprises across Europe adopting legal forms that have existed for a long time. As a result, social entrepreneurship across Europe is currently encompassed by a variety of legal forms, ranging from non-profit associations to co-operatives and related not-for-profit private forms of enterprises (Defourny & Nyssens, 2008). It is also noteworthy to mention that there are considerable differences between the success of the legal innovations presented in table 1. While the 'social co-operative' framework in Italy attracted more than 7,300 initiatives, employing some 244,000 workers (Defourny & Nyssens, 2008), and while more than 2,700 'community interest companies' were registered in the UK only a few years after the installation

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of this legal form<sup>4</sup>, most of the other legal innovations were left largely unused by their target group.

In Belgium, social entrepreneurship is largely encompassed by associations, (accredited) co-operatives and 'social purpose companies'. Traditionally, social enterprises in Belgium opt for the legal 'association' status. This legal form, however, is fraught with problems for those willing to engage in economic activities. Its alternative, the co-operative, does not face these drawbacks. However, the Belgian legal framework for co-operatives makes little reference to the co-operative principles, and can be applied by regular for-profit enterprises as well. A subset of them, governmentally accredited by the National Council for Co-operatives, confirms their accordance with the principles of co-operative entrepreneurship. However, only about 500 out of 40,000 Belgian co-operatives have applied for this accreditation. A supposedly attractive alternative was introduced into the Belgian Company Code in 1995: a new legal framework, specifically tailored to social enterprises, was born. Thanks to this 'social purpose company' (SPC), commercial corporations are allowed to define other goals than maximizing shareholders' profits. The SPC framework, however, has hardly been adopted.

In this paper, we provide a theoretical framework to assess the quality of an innovative legal framework for social entrepreneurship and address the joys and burdens that follow from the resulting multiplicity of legal frameworks. By means of an inter-disciplinary approach, we apply insights from law, economic theory, and focus group research<sup>5</sup>. After having laid out our theoretical framework, we provide an introduction to the Belgian legal environment for social entrepreneurship and apply our framework to evaluate the comparative advantages of the legal frameworks involved. Subsequently, we pay attention to the joys and burdens of having coexisting legal frameworks for social entrepreneurship. We conclude with lessons that can be learned from the Belgian case that may be relevant for the design of legal frameworks in other countries and contexts.

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4 [www.cicregulator.gov.uk](http://www.cicregulator.gov.uk)

5 We make use of the results of three focus groups that took place in 2008, dealing respectively with (1) the 'social purpose company', (2) non-profit associations and (3) unaccredited co-operatives. All participants were managers and directors of Belgian social enterprises and co-operatives, mostly situated in Flanders. Results from this focus group research are reported more extensively in Van Opstal, Gijssels & Develtere (2008) and are available from the authors on request.

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## 2. Theoretical framework

As indicated in the introduction, there are quite some differences between countries in the relative success of legal innovations for social entrepreneurship. The majority of legal innovations we mentioned in table 1 were actually left largely unemployed by their target group. Why do we observe these differences between countries?

To answer this question, it might be interesting to have a look at the bottlenecks and challenges that go with the design and implementation of specific legal frameworks for social entrepreneurship. We consider three relevant issues: (1) intrinsic optimality of design, (2) attractive capacity, both for existing initiatives as for new initiatives, and (3) maturity of design. These can be considered as conditions to be fulfilled for a successful implementation of new legal frameworks for social entrepreneurship. More strongly, if these conditions are not met, legal innovations may even impede rather than encourage the development of social enterprises.

### 2.1 Intrinsic optimality of design

First of all, legal frameworks for social entrepreneurship have to take into account characteristic features of social enterprises. We discuss some dimensions that are paramount to the question whether the design of a legal framework is intrinsically optimal or not.

#### *. Social goals*

As it is the main objective of social enterprises to achieve social goals, legal design should take into account some considerations on the services and semi-public goods that result from it. Typically, concerns for quality, accessibility and affordability are important to take care of. To address these concerns, organizational and legal design has to deal with asymmetric information (as the monitoring of quality delivery is often not straightforward<sup>6</sup>) and external effects (as these social goals often generate positive externalities).

Generally, a non-distribution constraint solves part of the problems that go with asymmetric information. Glaeser & Shleifer (2001) argue that a non-distribution constraint may soften incentives of not-for-profit managers, allowing them to put greater and credible focus on quality

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<sup>6</sup> Think for example of difficulties to assess the quality of residential elderly care for your parents, of the quality of nurseries you trust your pre-school children to, and of the labour conditions in a sheltered workshop in which your mentally-handicapped brother works. In all these cases, managers can shirk on the quality level, because quality cannot be enforced properly before court. Moreover, those who decide about the provider of these services (e.g. parents) are often not the same as those who experience the benefits of it (e.g. pre-school children).

provision. Consequently, stakeholders feel themselves protected by the non-profit status, resulting in higher employee commitment, customers willing to pay higher prices and donors willing to give more, providing the social entrepreneur with a competitive advantage. An obligatory limitation of dividend payments may have the same effect, albeit to a lesser extent. Herbst & Prüfer (2007) compare firms (outside ownership), nonprofits and co-operatives and compare both quality and efficiency of service provision in an environment of asymmetric information. They show that quality provision can be expected to be the highest in nonprofits, followed by co-operatives and firms. When taking into account efficiency considerations, however, nonprofits seem to be the most interesting as long as costs to reduce asymmetric information are sufficiently low (e.g. monitoring of quality is rather cheap) and possibilities to attract intrinsically motivated managers are relatively abundant. Otherwise, co-operatives dominate in terms of efficiency, at least as long as the cost of disagreement among members is not too high. When it becomes difficult to align preferences of members as well (e.g. due to an increased heterogeneity of preferences among members), firms start to dominate co-operatives in terms of efficiency<sup>7</sup>.

Positive external effects typically lead to an underprovision of goods, as social marginal benefits exceed private marginal benefits. Also here, the ability of mission-driven organizations to attract intrinsically motivated managers may partly solve this problem (Besley & Ghatak, 2005). Van Opstal & Gijssels (2009) show that a smooth matching of intrinsically motivated managers to these organizations provides a comparative organizational advantage for both nonprofits and co-operatives compared to firms.

In sum, the choice set of organizational forms (and resulting legal frameworks) for social entrepreneurship has an impact on incentives of social entrepreneurs and the managers they attract. Ignorance of these consequences of legal design may render ex-post monitoring of social goals very costly and increases the potential of abuse of these legal frameworks.

### *. Economic activity*

Social enterprises want to achieve social goals by means of providing goods and services. As there is an economic activity at hand, legal design should take into account the needs of social

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<sup>7</sup> Van Opstal & Gijssels (2009) extend the model of Herbst & Prüfer (2007) and show that the inclusion of non-user members will reduce the quality level of the co-operative towards that of the firm, while providing voting rights to non-owners (e.g. social organizations) will increase the quality level of the co-operative towards that of the non-profit organisation. Moreover, they show that a binding budget constraint equalizes the quality level of non-profits and co-operatives.

enterprises at the markets they operate in. More specifically, legal design should resolve issues such as liability, formal obligations and claims on (residual) income. In many of these issues, lawmakers can choose to regulate everything *ex ante* through legal design, or they may opt to allow for some freedom in the Articles of Association. Sometimes, however, entrepreneurs have to be protected against themselves, as they may have an incentive to limit obligations they will be restricted to.

A first issue is that of limited versus unlimited liability. Limited liability may spur entrepreneurs to undertake risks and may stimulate innovations, as it protects entrepreneurs from the risks they have to take for the social enterprise. Formal obligations, such as registration requirements, minimal accounting standards or provisions concerning minimum capital may be either supportive or distortive for social enterprises. If the scale of social entrepreneurial activities is rather small and capital requirements are limited, the underlying legal framework should allow for an easy registration with soft requirements on equity provision, accounting standards and audit requirements. If not, the benefits of applying this framework do not outweigh the costs of doing so and the legal framework will be left aside by the sector. On the other hand, if activities at hand require a considerable amount of capital, severe legal provisions concerning minimal capital may prevent social enterprises from being undercapitalized and protect both founders, clients, suppliers and capital providers. Rigorous audit and accounting obligations improve signalling possibilities concerning the quality of social enterprises, which may be important to attract capital. If capital requirements are limited, however, these obligations only result in a deadweight loss for the social enterprise.

Maybe the most important determinant for a social enterprise to be able to attract capital is the way claims on (residual) income are resolved. In an association, members typically do not have any claims on the (residual) income of the association. First of all, there is a non-distribution constraint, prohibiting the association to pay out dividends to its members. Secondly, if a member leaves, he has no claim on any part of the assets of the association. Firms and co-operatives, on the other hand, mostly issue shares. For co-operatives, these shares mostly keep their nominal value, resulting in a residual claim of members equal to this nominal value. Together with the fact that dividend payments are mostly allowed (albeit limited in some legislations for co-operatives), this results in a greater attractive capacity of these organisational forms for capital. Members of a co-operative mostly do not have any claim on the reserves that are accumulated throughout the years. This may lead to problems with regard to fair entry fees for new members of co-operatives that already existed for a long time, as they may free ride on the risks and efforts of the older members of the co-operative (Rey & Tirole, 2007). In firms,

shareholders often have a claim on their relative share of the assets of the enterprise, including its accumulated reserves. Some legal frameworks for social entrepreneurship, however, limit this claim by requiring that reserves can only be allocated to social goals in case of dissolution and winding up. Combined with the concerns described earlier to safeguard social goals of the social enterprise, legal design therefore has to balance the advantages of limitations on dividend payments and residual claimancy with its disadvantages.

### *. Stakeholder management*

Social enterprises are characterised by a specific attention for their stakeholders. This may vary from an increased responsiveness towards stakeholders focused at in the social goals of the enterprise (e.g. the attention of a sheltered workshop towards the concerns of persons with disabilities) to the inclusion of multiple stakeholders into the governing bodies of the social enterprise (e.g. as meant in the EMES-definition of a social enterprise described earlier). Again, legal design should take into account the kind of stakeholder management policymakers want to see implemented by social enterprises. However, lawmakers should be aware of incentive compatibility concerns of different stakeholder notions if they want to see their new legal framework being implemented by social enterprises as well. Therefore, lawmakers should also evaluate both the desirability and feasibility of an obligatory multi-stakeholder structure.

In a regular stock-listed firm, the only stakeholder notion that is feasible in the long term is a weak one, i.e. taking care of stakeholder considerations as long as they enhance profit maximization without granting any governing powers to other stakeholders than shareholders. Tirole (2001) provides an overview of reasons why a strong stakeholder notion, i.e. granting governance powers to other stakeholders than shareholders, is not feasible in the long term for stock-listed firms. First, equity providers have no reason to share control with other stakeholders - if they are forced to do so, they can withdraw their money and invest in more interesting alternatives. Secondly, it is near impossible to design managerial incentives to let them serve other stakeholders together with shareholders. Thirdly, accepting parties with diverging if not diametrically opposed interests in governance processes may cause a deadlock in decision making.

Leys, Van Opstal & Gijssels (2009) extend this framework to analyse the ability of co-operatives to cope with a strong stakeholder notion. They find that single-stakeholder co-operatives dominate stock-listed firms in the implementation of a strong stakeholder notion as they are able to involve at least one extra stakeholder type into their governing bodies, namely

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the user of the co-operative, whose set is ideal-typically the same as the set of member-owners. However, in a single-stakeholder co-operative, there is no reason to expect a strong stakeholder notion to be implemented towards other stakeholders than their users<sup>8</sup>, the ICA Principles of co-operative identity notwithstanding<sup>9</sup>. Co-operatives, however, have other problems concerning corporate governance. Firstly, co-operatives can only be vibrant if there is a sufficient alignment of preferences among its members<sup>10</sup>. Secondly, as most co-operatives have many shareholders, each with little voting power, it is difficult for an individual shareholder to exert pressure on the management. Furthermore, this may result in an internal free rider problem of exerting control of the management (Hart & Moore, 1998). According to Ben-Ner (2002), stakeholders of non-profits demonstrate a similar lack of interest in controlling the non-profits' management.

All these problems may turn out to be less severe if there is a sufficient alignment of interests among different stakeholders, which can be expected to be easier to achieve in areas of public services (e.g. health and social care) than in the production of private goods and services. Yet, it remains important to notice another practical element that may be paramount to the feasibility of a multi-stakeholder structure: formal requirements for entry of stakeholders (e.g. employees) to the social enterprise should be kept to a minimum if lawmakers want to stimulate multi-stakeholdership through ownership. In many countries, associations and co-operatives have clear advantages concerning the ease of entry, compared to other corporate legal forms.

Difficulties to implement a strong stakeholder notion should not hinder lawmakers to prescribe some tools to implement at least a weak stakeholder notion. Nothing precludes, however, the possibility that those stakeholders may be not interested at all in playing a role, neither in the strong sense, nor in the weak sense of stakeholder management. Therefore, legal design has to consider carefully incentives of different stakeholders to engage themselves in the social enterprise.

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8 For example, from a corporate governance perspective, there should be no reason to expect a consumer co-operative to allow its workers to participate in the board of directors, or to expect a producer co-operative to grant governing rights towards its consumers.

9 The ICA Principles of Co-operative Identity provide an ideal-typical framework co-operatives should adhere to. These principles are defined by the international co-operative movement and provided a basis for legal frameworks for co-operatives in many countries. See [www.ica.coop](http://www.ica.coop).

10 As members of co-operatives are both financial partners as users of the co-operative, it may be cumbersome to agree on the specific characteristics of the goods or services to be provided by the co-operative. Moreover, co-operatives have to maximize both financial and user value for its members, which is more difficult to agree upon compared to profit maximization (where all shareholders would agree that 'more is better'). Costs of disalignment of preferences are expected to be lower as preferences of members become more homogeneous.

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### *. Autonomy*

Lastly, several definitions of social entrepreneurship pay attention to the autonomy of social enterprises. This, however, is a challenging field of tension, as many social enterprises are active in the provision of semi-public services and goods. Given the 'merit-good' nature of their activities, governments often like to see social enterprises as a leverage for their own policies. If governments want to stimulate social enterprises by granting accreditation and subsequent subsidization, legal design should take this into account and focus on the effects such side-payments have on the efficiency and the quality provision of alternative organisational and legal frameworks. Such side payments may be provided by other parties as well, like charities, social organisations, and philanthropists. Glaeser & Shleifer (2001) and Van Opstal & Gijssels (2009) notice that side payments will result in an increase of quality provision by non-profits<sup>11</sup>, as budget restrictions become softer, whereas the opposite holds for firms. The effect of side payments on quality provision by co-operatives remains undecided, however. A legal framework that conditions subsidies on a restriction of dividend payments would in any case incur a greater inclination of the co-operative to translate these side payments into an increased quality provision. In the same spirit, tax advantages will incline nonprofits to spur quality provision. For co-operatives, the same result holds true as long as dividend payments are restricted or prohibited (Van Opstal & Gijssels, 2009).

Talking about taxation, the tax regime of a legal form also has its implications on the use of debt capital and thus on the autonomy of social enterprises towards banks and other providers of debt capital. As pointed out by Wedig, Hassan & Morrissey (1996) and many others, tax-exemption results in a higher solvability of non-profit enterprises. This makes sense since these enterprises do not enjoy any financial leverage from debt capital and existent equity capital is cheap as dividend payments are not allowed. Also here, legal design should take care of these concerns.

## **2.2 Attractive capacity**

While the design of a new legal framework may be intrinsically optimal for social entrepreneurship, this is, however, not a sufficient condition to guarantee the widespread use of it. First of all, the advantages of the framework have to be clear. Furthermore, the existence of switch costs and dynamic economies of scale may cause traditional alternatives to remain the

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<sup>11</sup> Glaeser & Shleifer (2001) point at an unintended side effect as non-profits may overcommit resources to become cash poor, so as to let side payments have a real effect on their incentives.

default option for social enterprises, both for existing as for new initiatives. Speaking in terms of a cost benefit analysis, the first argument describes the necessity to have clear benefits, while the latter two focus on the costs involved<sup>12</sup>.

#### *. Distance to existing frameworks*

Innovative legal frameworks are only interesting to apply if they have something to offer that really makes a difference compared to existing legal frameworks. If this legal framework truly fills in a gap of legal needs, the probability that it will be implemented is higher than in the case where substitutability with existing frameworks is very high. The more existing legal frameworks have already been adapted to the needs of social enterprises, as happened in many countries where the association allowed for an increasing degree of freedom for selling goods and services, the smaller will be the incentive for social enterprises to make the switch to a new legal framework when it comes into play.

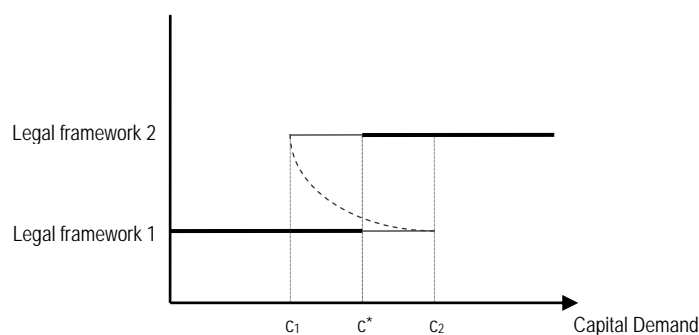
#### *. Switch costs<sup>13</sup>*

For existing social enterprises, switch costs may play an important role in their reluctance to change the legal framework they are operating in. These switch costs include legal costs, registration costs, time costs to fulfil all formation procedures, costs of collecting information and hiring additional advice, costs to modify documents, website, logos, etc. Such switch costs may cause suboptimal equilibria, i.e. situations where social enterprises are not applying the legal framework that is the most favourable for them. Figure 1 provides a graphical representation of this argument.

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12 On this item, our work has some similarities with that of Heine & Kerner (2002), who analyse path dependence in the competition among European company laws. While they analyse these issues from the perspective of lawyers, we focus on the calculus of social entrepreneurs. Furthermore, we could also apply both frameworks to the question why we hardly see any enterprises embracing the legal form of a European Co-operative Society (Societas Cooperativa Europaea, SCE) three years after its legal establishment.

13 Heine & Kerner (2002) also use the term 'switch costs', albeit in another setting. In our framework, we consider switch costs for existing social enterprises, while they consider switch costs for lawyers and specialists. We will pick this up when we discuss dynamic economies of scale.



**Figure 1** Switch costs and path dependency of the utilization of legal frameworks

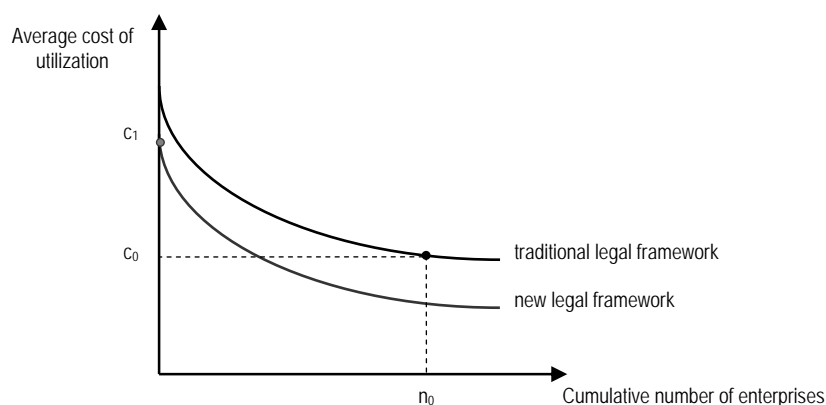
In figure 1, the y-axis gives a nominal representation of two possible legal frameworks, indexed by 1 and 2. On the x-axis, we place a variable that has an impact on which legal framework is optimal for a given enterprise. For didactical purposes we have chosen capital demand as an example of such a variable. The bold horizontal lines indicate the legal framework that is optimal for a given capital demand. In this case, as long as capital demand is rather low, legal framework 1 seems to be the optimal choice. However, if capital demand exceeds a critical value,  $c^*$ , legal framework 2 becomes the optimal choice. Without switch costs, enterprises would smoothly change the legal framework they operate in as soon as it would be optimal to do so. Switch costs, however, extend these bold horizontal lines, depicted by grey tin lines. Now, enterprises that apply legal framework 1 will change their legal framework only if capital demand exceeds  $c_2 > c^*$ , and conversely, enterprises that apply legal framework 2 will only switch if capital demand falls below  $c_1 < c^*$ . The existence of switch costs thus generates path dependence. Notice that the larger switch costs are, the wider the range of  $(c_1, c_2)$ , and the larger the efficiency losses to be borne.

### *. Dynamic economies of scale*

Another argument that affects both new as existing initiatives are dynamic economies of scale. This concept was introduced by Posner (1961)<sup>14</sup> in the context of international trade and technological change and captures the effects of 'learning by doing'. Applied to legal design it clarifies why new legal frameworks are not always able to attract enterprises, even if their intrinsic design dominates that of traditional frameworks. In figure 2, we provide a graphical representation of our arguments.

<sup>14</sup> Not to be confused with Richard Posner, who is a scholar in law and economics.

The x-axis depicts the cumulative number of enterprises that ever adopted a legal framework. The y-axis represents the average cost of utilization of a given legal framework. These costs include legal costs, costs linked to accounting and audit obligations, costs to train administrative staff, accountants, business lawyers, etc. to work with the legal framework, etc. It is quite reasonable to assume that this average cost function is concave and declining with respect to the cumulative number of enterprises that ever adopted that given legal framework. The more enterprises that ever adopted a legal framework, the greater the know-how available, both internal and external to the enterprise, concerning this framework. The greater the supply of know-how, the lower its cost.



**Figure 2** Dynamic economies of scale in the average cost of utilization of legal frameworks

Now, suppose a new legal framework is introduced. Notice that we assume that the average cost function of the new framework is lower than that of the old framework<sup>15</sup>. At the time a new framework comes into play, there are obviously no enterprises that apply it. Therefore, there is a reasonable chance that the average cost of utilization of this new framework is much bigger than that of the traditional framework. In figure 2, we depicted this situation as  $c_1$ , being the average cost of utilization of the new framework, which exceeds  $c_0$ , being the average cost of utilization of the old framework. This is entirely due to the fact that  $c_0$  can only be this low because of the fact that  $n_0$  enterprises apply this framework, while at the beginning no single enterprise applies the new legal framework. We give some clarifications for the form of this average cost function.

<sup>15</sup> This assumption follows from the fact that we evaluate the case of a new legal framework whose intrinsic design dominates that of traditional legal frameworks. In the opposite case, the outcome of this analysis would be straightforward as the old framework would dominate the new one anyway.

Managers, consultants, accountants, lawyers and legal officers tend to favour the legal frameworks they are familiar with. Heine & Kerber (2002) provide two reasons for this. Firstly, they are uncertain about new legal frameworks because they do not know whether they will really fit the needs of its users. Secondly, they have invested in specific human capital to become specialists in existing legal forms. Applying a new legal framework devalues their investment. Next to this, as the number of enterprises that applies a legal framework becomes large enough, many information on this legal framework becomes publicly available (e.g. on websites, starters guides for enterprises, etc.) and the most important aspects of it become part of curricula at schools, colleges and universities. Also, sectoral umbrella organisations and business groups only start with capacity building on a new legal framework if the number of enterprises that applies it becomes large enough. This, in turn, makes the average cost of utilization smaller, reinforcing the growth path (or conversely the insignificance) of a new legal framework.

Yet another clarification is rather a psychological one, as people tend to like default options when they have to take decisions under uncertainty (like starting up a business) (Samuelson & Zeckhauser, 1988; Kahneman, Knetsch & Thaler, 1991). This preference for default options may render the larger alternative more attractive than the smaller one. Also here, path dependency applies, so basically the challenge of lawmakers is to design a legal framework that easily attracts enough enterprises to exceed a given threshold value and subsequently manages to attract the majority of social enterprises. As mentioned earlier, we can see readily from figure 2 that it would be helpful if the distance between other legal frameworks is large enough (at least in terms of their resulting cost functions).

### **2.3 Maturity of design**

A third issue that may be vital for the success of a new legal framework is its maturity. This includes legal complementarity, coherence of public support, and the adaptive capacity of legal design. Problems of a lack of maturity will not necessarily hinder the initial success of new legal frameworks, at least when their intrinsic design and attractive capacity are adequate. Most problems that come with an immature design only appear after a while, as it is pretty impossible to foresee every contingency during the initial stage of legal design. However, paying attention to this issue may be essential for the viability of both the social enterprises that adopted it as for the legal framework itself.

### *. Legal complementarity*

As specified by Heine & Kerber (2002), the effect of one legal rule depends on other legal rules as well. Therefore, the body of law on social enterprises, in which legal rules are complementary, has to be consistent. Legal complementarity implies that the value of an innovative legal framework for social entrepreneurship depends not only on its intrinsic design, but also on the specific mixture of the rules and the degree upon which they match. Münkner (2001, 2006) provides some specific domains to pay attention to during the design of legal frameworks for social enterprises, including law of organisations, tax law, labour law, and competition law. In countries where legislative work is done by multiple jurisdictions (e.g. the federal state, regions and provinces), legal complementarity is harder to attain.

### *. Coherence of public support*

Policy makers and legislators should stimulate public authorities at all levels to pay attention to new legal frameworks and try to achieve a coherent approach of public support for it. Recognition and accreditation by these public authorities are often a necessary condition for access to public subsidies, or even a necessary condition to be allowed to carry out some activities. Likewise, policy makers should strive for a coherent view on fiscal treatment and eligibility to 'social clauses' in the procurement policy of public authorities. Again, the presence of multiple jurisdictions makes this issue more cumbersome to solve.

### *. Adaptive capacity of legal design*

Often, problems caused by an immature legal framework are only noticed after its implementation. Some of these problems even only become visible after a number of years. Therefore, the quality of a legal framework depends on its adaptive capacity as well. Attributes of adaptive capacity may be timely and rigorous evaluations of the legal framework and possibilities to correct for legal uncomplimentary and unclear passages in the law. Also frequent interchange of ideas and experiences between legislators and representative umbrella organisations and other key players may foster the adaptive capacity of legal design.

### 3. The Belgian case - three legal frameworks for social entrepreneurship

If legal scholars were given the choice, most of them would agree that the Belgian classical company forms are not the most evident choice when it comes down to social entrepreneurship. The reason for this seems obvious: until recently, a company was characterized by profit making. According to article 1 of the pre-1995 Belgian Company code, the incentive of a company was to “gain profit, with the aim of distributing a direct or indirect capital benefit to the partners.”

The (non-profit) association, on the other hand, is characterized by the absence of a profit making aim; the intention of the organisation is to pursue its social purpose and not to share profits among its members. This should safeguard the social purpose pursuit and should prevent mission drift towards profit maximization. While this organisational form was initially not designed for commercial activities, both legal doctrine and jurisprudence gradually modified the legal interpretation of its status in order to allow social entrepreneurship. However, this situation has caused confusion and has proven to be inadequate. Nevertheless, the non-profit association is still the most popular choice for social entrepreneurship in Belgium.

Of all company forms, the co-operative is often mentioned as the best alternative to the association for social entrepreneurs. After all, current notions of ‘social entrepreneurship’ and ‘social economy’ embrace many principles of co-operative identity (ICA, 1995), including ‘democracy’, ‘autonomy’, and ‘concern for community’. Moreover, the co-operative also has some ‘associative’ characteristics, such as voluntary and open membership. Whilst a Belgian legal framework for co-operatives exists since 1873, little reference has been made to these co-operative principles. Subsequently, many entrepreneurs use this legal form for its legal flexibility, while only a minority genuinely adheres to its underlying principles. This subset may apply for governmental accreditation by the National Council for Co-operatives, confirming their accordance with the principles of co-operative entrepreneurship. Unfortunately, stipulations regarding this governmental accreditation are not included in the Company Code, but are only regulated by Royal Decree. Only about 500 out of 40,000 Belgian co-operatives have applied for this accreditation.

A supposedly attractive alternative was therefore introduced into the Belgian Company Code in 1995: a new legal framework, specifically tailored to social enterprises, was born. Thanks to this ‘social purpose company’ (SPC), commercial corporations are allowed to define other goals than maximizing shareholders’ profits. This combined two aspects that seemed irreconcilable at first,

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namely 'social purpose' and 'commercial activity'. The SPC framework, however, has hardly been adopted.

In sum, the set of legal frameworks for social entrepreneurship in Belgium consists mainly of associations, (accredited) co-operatives and 'social purpose companies'<sup>16</sup>. In this section, we will discuss these three legal frameworks, providing ratio legis, main characteristics, drawbacks and refinements. We will also present some key figures that indicate the relative significance of these frameworks. Subsequently, we will apply the theoretical framework of section 2 to evaluate comparative advantages of these three legal frameworks.

### 3.1 Associations<sup>17</sup>

#### 3.1.1 Ratio Legis

Historically, associations were linked to religious congregations, who were tolerated by those in power, as their work mainly concerned charitable purposes and were therefore not immediately seen as threatening to large ownership. The feudal rulers, however, were scared of the 'mortmain' and did issue certain restrictions to reduce the influence of associations. The rulers at the time were terrified that land property would be locked away forever in these institutions, which meant they could be withdrawn from the feudal tax system and also from feudal power in general. Their activities were therefore restricted to activities outside of the economic circuit such as education, care of the poor and of the sick. These activities therefore did not generate any income which meant they were dependent on other means such as gifts. Other associations, for example for the guilds and for artisans would suffer the same fate. (Denef, 2004: 46-61).

After an enduring love-hate relation between the proclaimed notions of freedom and equality on the one hand and the political struggle for power after the French Revolution on the other hand, the Constitution of the new Belgian state, did stipulate in 1831 that the Belgians had the right to assemble and that this right could not be subjected to any preventive measure. The legislator however failed at this point to entrench this specific right in any law.<sup>18</sup> The 19th century,

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16 As we will restrict our attention to entrepreneurial activity, we will not include foundations in our analysis. Furthermore, we will not focus on the accidental adaptation by social enterprises of regular-economy corporate legal forms, such as private and public companies, either.

17 Associations are known in Belgium as 'vereniging zonder winstoogmerk', vzw (in Dutch) or 'association sans but lucratif', asbl (in French).

18 See article 27 of the Belgian Constitution.

however, was characterized by the industrial revolution and the reaction of the labour movement, spurring the conception of laws for health service<sup>19</sup>, 'trade associations'<sup>20</sup> and the co-operative company.<sup>21</sup>

By law 27 June 1921, the legislator finally created a law for non-profit associations and foundations. According to this law, an association is generally described as an organisation consisting of an agreement through which several persons combine their efforts or even certain goods, for a purpose not involving the division of profits. According to the law, the association can obtain legal personality when it fulfils certain formalities and publicity regulations. When it does not fulfil these obligations, it is called a 'non-registered' association. These organisations are not governed by law and are not legal entities.<sup>22</sup> Such a non-registered association is a mere organisation of individuals, the sum of its members, who can each be held liable separately. Trade unions, political parties, sports and religious organisations are examples of non-registered associations (Mortier, 2008: 808). As these associations hardly have any activities that can be considered as social entrepreneurship, we will limit our analysis to the (non-profit) association.<sup>23</sup>

### 3.1.2 Main characteristics

#### *. Definition*

Article 1 of the Association and foundation law<sup>24</sup>, stipulates that the (non-profit) association is an organisation that "does not conduct industry or trade and that does not distribute material benefits to its members." (translation by the authors). It must therefore function without the intention of personal gain and can not practice 'acts of trade'.

The jurisprudence is of the opinion that only direct capital benefits to members of associations are forbidden. Indirect benefits by the association are, however, possible, for example to curtail expenses, avoid losses, etc. Possibilities to perform 'acts of trade' are stipulated in articles 2 and 3 of the Commercial Code but academics agree unanimously that this list is out of date and

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19 The first law concerning the 'mutualiteitswezen' (national health service) dates back to 3 April 1851 but was replaced by the more supple law for 'mutualiteitsverenigingen' or 'maatschappijen voor onderlinge bijstand' in March 1894.

20 Known in Belgium as 'beroepsverenigingen' (in Dutch) or 'associations professionnelles' (in French). Law on trade associations 31 March 1898, BS 8 April 1898.

21 The co-operative company was inserted into what then resulted in the Company law 18 May 1873, which was then inserted as title IX of the Commercial Code.

22 Known in Belgium as the 'feitelijke vereniging' (in Dutch) or the 'association de fait' (in French).

23 We will hereafter refer to the non-profit association as "association."

24 Law 27 June 1921 concerning (non-profit) associations, international non-profit associations and foundations, BS 1 July 1921, modified by law 2 May 2002, 16 January 2003, 22 December 2003, 9 July 2004 and 23 March 2007.

confusing (De Patoul, 2003). However, in the 'Volkstoerisme' case in 1996<sup>25</sup>, the Belgian Court of Cassation accepted that an association can conduct acts of trade, as long as they are 'accessory' to the not-for-profit principal purpose. Nonetheless, the question remains what accessory activities exactly are.

#### *. Accessory activities*

The majority in the jurisprudence states that industry and trade acts are allowed as long as they are accessory. According to this proposition, an association can perform economic activities, as long as three conditions are fulfilled (Denef & Straetmans, 1997: 290; Denef & De Leenheer, 2005: 30-31).

1. there must be a quantitative subordination of the trade activity in relation to the non-trade activity.
2. there must be a direct or indirect link of a lesser or more necessity between the two activities, and
3. profits of the economic activity must be used for the realization of the non-trade activity or purpose.

A minority in the jurisprudence is of the opinion that associations may exercise trade activities unlimitedly, as long as all profits are used for the non-trade activity and neither the members nor the association gain any profit. There are however certain problems with this proposition as organisations that are not subjected to trade law or to minimum capital requirements, can accordingly compete under limited liability with commercial companies. This obviously could lead to unfair competition (De Wulf, 2006: 452).

It is clear that the 'accessory criterion' is far from transparent. The criterion first of all leads to certain far reaching and negative consequences. Firstly, it leads to a lack of legal complementarity with several codes and laws, which may be very cumbersome for social enterprises. Secondly, it is difficult to define boundaries for the accessory character of activities. All this leads to legal uncertainty. We will discuss these and other drawbacks in the subsequent section.

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<sup>25</sup> Court of Cassation 3 October 1996, Pas. 1996, I, 350.

### 3.1.3 Drawbacks

#### *. Lack of legal complementarity*

According to article 1 of the Commercial Code, a 'merchant' conducts acts of trade and makes it his principal or supplementary profession. The accessory obligation means that an association cannot be a merchant according to Belgian law and that the legislation relevant to being a merchant is not applicable: the Commercial Code is not applicable to associations, nor are the articles 573 and 584 of the Judicial Code stipulating that the Commercial Court is authorized to hear disputes between merchants and neither is article 2 of the Bankruptcy law, with the resulting negative consequences for creditors (an association cannot be declared bankrupt). Hence it was impossible for an association to be registered or recognized as a building contractor, as only a merchant can be enrolled in the trade register which of course had consequences for associations that wanted to participate in public procurement. The Royal Decree of 26 December 1998 therefore inserted a list of exceptions to the enrolment in the trade register.<sup>26</sup> In the meantime, article 2 § 3 of the Royal Decree of 27 December 2007 has replaced this enumeration by inserting the clause 'social economy organisations, (...) acknowledged by the government'.<sup>27</sup>

Lots of other legislation, however, does not use the merchant criterion as an application boundary, an example is the Law on trade practices.<sup>28</sup> The law uses 'vendor' as a starting point. In article 1.6 a vendor is described as:

1. every merchant or artisan and every natural person or legal entity, who offers for sale or sells products or services for its profession or to realize its purpose, pursuant to the Articles of Association;
2. government bodies or legal entities in which the government has a preponderant share, that exercise commercial, financial or an industrial activity and that offer for sale or sell products or services;
3. persons who, themselves or in name of a third party with or without legal personality, with or without for-profit, exercise a commercial, financial or industrial activity and who offer for sale or sell products or services.

Article 1.6c therefore does not comprise a for-profit condition and explicitly says it is irrelevant. Some doubt did however arise in the jurisprudence whether for-profit was relevant for point 1.6a. In the 'watertaxi' case of 2002, the Court decided that associations can be vendors

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<sup>26</sup> Royal Decree 26 December 1998, BS 31 December 1998.

<sup>27</sup> Royal Decree 27 December 2007, BS 31 December 2007.

<sup>28</sup> Law 14 July 1991 concerning trade practices and informing and protecting the consumer, BS 29 August 1991.

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according to article 1.6a, even if there is no profit-making purpose and the association conducts trade in an accessory manner. The nature of the activity determines whether the service in question resorts under the Law on trade practices.<sup>29</sup> Confusingly enough, the same law stipulates a different situation for services. A service is described in article 1.2 as “all performances that are trade acts,” which means, according to the Court of Cassation, that a for-profit purpose is necessary. If an association provides services without a for-profit purpose, it is not a vendor (Swennen, 2001: 556).

If the association crosses the boundary of accessory activities, it can be considered ‘unfair competition’ if the association violates or could violate the interests of one or more vendors. According to Belgian law, competitors can order cessation on grounds of article 93 Law on trade practices.

*. Boundaries on the accessory character of trade activities*

Where exactly does the boundary lie for accessory activities? Case law has tried to define the boundaries related to the ‘accessory’ concept. In the Red Cross case in 1997<sup>30</sup>, the non-urgent transport of the sick by the Red Cross was contested by the Union of Belgian ambulance services. The cessation judge of the Commercial Court<sup>31</sup> considered the Red Cross as a vendor of services and found that it had violated its Articles of Association by exercising this trade activity. The Court of Appeal, however, also considered the extent of the activity and decided that, although it considered the Red Cross a vendor, the organisation was authorized to exercise accessory trade activities providing certain conditions are fulfilled<sup>32</sup>. First of all, the trade activity has to be quantitatively less important than the non-trade activity concerning allocation of resources. Next, the trade activity has to be necessary to realize the social purpose. Last but not least, the profits of the trade activity must be allocated to realize the social, non-commercial purpose. In this specific case, the judge was of the opinion that all three conditions were fulfilled.

In Ghent<sup>33</sup>, the Court of Appeal applied an entirely different logic in a similar case. Here the case concerned Saint-Joseph’s school that gained extra profits by organizing driving lessons. The Court was of the opinion that these driving lessons remained inferior to the main purpose of the association which consisted of running, managing and doing the upkeep of the buildings and

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29 Court of Cassation 13 September 2002, TRV 2003, 290.

30 Brussels 29 October 1997, DCCR 1998, nr. 38, 57.

31 Chairman Commercial Court Brussels 19 February 1997, AJT 1996-1997.

32 These conditions are more or less the same as the conditions mentioned in section 3.1.2.

33 Ghent 13 June 2002, DAOR 2003, 58.

classrooms of the school. The inferiority was however not judged by looking at the allocation of resources, as in the Red Cross case, but by looking at the returns. The driving lessons amounted to 15 million Belgian francs, the upkeep of the buildings required a sum of 70 million Belgian francs and was mainly financed by government subsidies. It was not proven however that these subsidies had been misused to organize the driving school and had thus been withdrawn from subsidy purposes.

It goes without saying that the entire discussion around accessory activities creates legal uncertainty. The criteria created by the Court of Cassation in the “volkstoerisme” case are open to interpretation. The Red Cross case and the Driving school case prove that the interpretation by different judges plays a major role: depending on the judge, the outcome of the case can be quite different. The necessity criterion does not give much to go by as every activity that generates resources that could be allocated to finance its non-commercial activity, can be interpreted as a necessary activity (Denef & Straetmans, 1997: 290). According to certain jurisprudence, the allocation criterion must also above all be seen as a presumption of allocation towards the non-trade activity. A case from 2005 of the Court of Appeal in Antwerp, stated that a foundation could exercise unlimited economic activities, as long as it was intended for the realization of its social purpose (which had not been the case). Extrapolated to the association by the jurisprudence, this proves that the allocation does play an important role and can act as a benchmark for unlimited commercial activities (Denef & De Leenheer, 2005: 189).

Over the years, the jurisprudence has developed alternatives to the ‘accessory’ criterion. One possibility would be the deletion of the legal restriction on industry and trade for associations, which of course means an adaptation of the legal framework in general. In the Netherlands for instance, the main characteristic of associations and foundations is the non distribution of profits to its members, but profit making or the aim of making a profit is not forbidden. The association may therefore have a commercial purpose and realize profits (Dijk & Van der Ploeg, 2002: 14). This does mean however that the association should have to follow all economic regulations without exception to avoid unfair competition. Another possibility would be the opposite case: economic activities for associations could be completely forbidden and the Social Purpose Company could become the alternative for those organisations that do want to undertake economic activities. Yet another possibility brought up in the jurisprudence is the technique of placing the economic activities in a separate company and giving the association the majority of shares. The jurisprudence however is not completely sure that this option is completely without risk for the association (Denef, 2004: 544-549). Other authors in the jurisprudence have opted to expand the list of trade acts in the Commercial Code; to assume that all acts are considered as

commercial except those listed in the Code or recognized by the government as being non-commercial; creating two types of associations, for example a 'trade/commercial association' with or without legal personality; creating a completely new type of company, etc. (Straetmans, 1998: 164 and Coates, 2008: 71).

*. Lack of minimum capital requirements*

Unlike most company legal forms, there are no minimum capital regulations for associations. Minimum capital requirements provide a guarantee to creditors, as it enhances the capacity of an enterprise to pay its debts. Companies can of course go bankrupt, but it is obvious that the total absence of capital would lead to difficulties with credit institutions as they might deem that there are insufficient guarantees. Consequently, credit institutions will ask board members or a third party to stand guarantor; if not, no loans will be granted at all.

According to Deneff (2004b: 293), it is understandable that there are no minimum capital requirements for associations, as an association conducting economic activities is an atypical apparition of the form laid down in article 1 of the Association and foundation law and the notion of 'capital' is linked to the concept of 'shareholder' and to 'distribution of profits.' She however also points out that associations with economic activities also have creditors and the distribution of profits notion must now be seen in a different light since the insertion of the social purpose company (SPC) into the Commercial Code. One could of course argue that all associations should transform themselves into SPC's, thus solving the whole capital problem. We will however discuss that the conversion from an association to a SPC is problematic and that the SPC also has other specific drawbacks.

Luckily, an association in Flanders can now invoke a guarantee when it contracts a bank loan<sup>34</sup>. When an association wishes to invest but is unable to obtain a loan, the Flemish government can guarantee up to 75% of the credit. The association must however undertake an economic activity, which means that it should offer its products and services conform market price and it should not predominantly (more than 50%) be subsidized by the government<sup>35</sup>. Although this should be considered positive, especially as the entire discussion concerning 'trade activities' is avoided and the 'economic activities' notion is used, it is still rather confusing in being contrary to the Association and foundation law.

<sup>34</sup> Known in Dutch as the 'waarborglening'.

<sup>35</sup> De Laeter (2007: 1) and PMV, "De waarborgregeling is nu ook toepasbaar voor vzw's," 26 January 2007, [www.pmvlaanderen.be](http://www.pmvlaanderen.be).

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There are of course other constructions that can be interesting to creditors. First of all, an association dossier must be deposited at the Court of Commerce registry in the district where the association has its seat. The dossier contains among other things a co-ordinated text of the Articles of Association after every modification, the deeds concerning modifications of the composition of the board and representation and the annual accounts<sup>36</sup>. Creditors can find all relevant information in this dossier and the disclosure is completed after publication in the addenda of the Belgian Official Gazette *Moniteur*. Secondly, when an association exceeds two of the following three criteria, it must also act conform the Bookkeeping law.<sup>37</sup>

1. have the equivalent on average during the year of 5 full time employees, registered in the personnel register (that is held conform the Royal Decree nr. 5 of 23 October 1978 concerning the keeping of social documents);
2. have an income (other than exceptional earnings) of 250,000 euro, VAT excluded;
3. have a balance total of 1,000,000 euro.

This also means that the annual accounts of large associations become public. Associations that do not exceed two out of the three criteria may apply a simplified accounting system, but are still obliged to draw up an annual account.<sup>38</sup>

There is, however, no specific sanction in the association law in case of non deposition of its annual accounts, neither for damages suffered by third parties due to not depositing, nor a criminal sanction for negligent board members.<sup>39</sup> Furthermore, the association does not have to draw up a financial plan, as is the case with companies. The founders of the public company and limited company have to compile a financial plan to justify the amount of registered capital. It forces the founders to think about the extent of their contribution in function of the activities that they would like to practise in the company. Although associations cannot be declared bankrupt and there is no specific liability for board members, a financial plan could certainly help associations with economic activities to anticipate (Claes & De Blay, 2006: 5).

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36 The annual accounts of small associations are to be found at the Court registry, the accounts of large associations at the Central Balance Sheet Office of the National Bank of Belgium.

37 Law 17 July 1975, modified by Royal Decree 19 December 2003.

38 Royal Decree 26 June 2003 concerning the simplified book-keeping of certain non-profit associations, foundations and international non-profit associations, BS 11 July 2003 and Tuytten (2007: 1).

39 X., Ozza report: Ondernemen zonder zorgen en zonder aandeelhouders? Pleidooi voor onbeperkte economische activiteiten voor vzw's en stichtingen naar Belgisch recht, 2006, 46.

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*. Conversion from an association to a company*

It is not possible to convert an association into a company.<sup>40</sup> It is therefore impossible that a false association builds up capital during a few years according to the friendly fiscal statute of the legal personality tax and then converts into a company and distributes the profits to its partners (Tas, 2005: 494). The association would then use its means contrary to its legal speciality. It is however possible to convert an association to an SPC, without winding-up the association and keeping its legal personality. We will consider this procedure when discussing the SPC.

*. No general merger regulation*

There are many reasons why enterprises decide to merge. A straightforward rationale for mergers is the existence of increasing economies of scale. Mergers may also be the consequence of external factors, such as governmental requirements for recognition and subsidies<sup>41</sup>. In other cases, mergers are necessary because the existing means of the enterprise are insufficient (Kunsch, 1999). The Company Code contains a merger procedure, which starts with a merger proposal, followed by a report of the boards of both companies and a report in every company by a certified auditor or accountant.<sup>42</sup> The merger decision is taken at each General Assembly and the decisions must be laid down in an authentic instrument or can otherwise be declared null and void.<sup>43</sup> An important issue is that all assets and liabilities are automatically transferred to the new company, without the permission of the creditors and without any other formality, although a special protection mechanism is in place for creditors. The possibility of transferring the assets but leaving all liabilities in the company is therefore not an option.<sup>44</sup> In sum, a merger in the Belgian Company Code is a smooth procedure, without any winding-up or bringing in capital separately.

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40 This is the case in the Netherlands, which is not surprising as associations there may exercise economic activities. Certain guarantees have also been put in to place to avoid problems. See for example Dijk & Van De Ploeg (2002: 252-253).

41 Which is, for example, the case in governmental regulations on subsidies for hospitals. See Royal Decree 31 May 1989 concerning the description of mergers between hospitals and concerning the special standards that need to be fulfilled, BS 5 July 1989.

42 See articles 693-695 Company Code.

43 See article 700 paragraph 1 Company Code.

44 See article 682, 3° Company Code.

For associations, the situation is completely different. There is no merger procedure, although certain associations, for example hospitals, do have a specific regulation.<sup>45</sup> However, little attention is paid to the procedure. This also means that there is no unambiguous definition of the 'merger' concept. Jurisprudence accepts that a merger is an operation by which one or more associations are dissolved and by which their means are brought into, and their activities are continued by, a new or existing association with a similar purpose, while at least certain members and board members of the disappearing associations transfer to the new or existing association (Tas, 1996: 464).

Due to the lack of a decent procedure, a number of existing legal operations have to be performed instead. The associations that disappear must be dissolved and wound-up and the remaining means must be transferred to the association that will continue or that has been created specially for the merger. All in all, such a procedure is complicated and is as follows. First, a merger proposal is drawn up presenting the new member structure and the composition of the board, which activities will be pursued, etc. The General Assembly must approve the proposal and the draft Articles of Association. If a new association needs to be formed, this needs to be done at this stage as well. Secondly, the voluntary dissolution and winding-up of the (two) association(s) must take place. The General Assembly must follow a specific procedure<sup>46</sup> and must appoint the liquidator(s). This liquidator must convert the assets into cash, settle the liabilities and transfer the net value according to the purpose stipulated by the Articles of Association. Lastly, the takeover association must accept the brought in assets, the modification of the membership and board structure and carry through a modification of the Articles of Association if necessary (Napolitano, 2001: 33). There is no automatic procedure for merging associations. This creates legal uncertainty, as creditors, members, and the board have no certainty concerning their legal position.

#### 3.1.4 Significance - incidence and rationale

As indicated by Mertens (2002), it is not straightforward to measure the size and scope of non-profit associations in Belgium. For instance, it is not possible to measure the number of associations that are currently active, as many associations never dissolve themselves when they cease to exist. Some indicators we do know, however, are employment by associations, and

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<sup>45</sup> See the procedure for hospital associations. Royal Decree 31 May 1989 concerning the description of mergers between hospitals and concerning the special standards that need to be fulfilled, BS 5 July 1989.

<sup>46</sup> See article 20 Association & foundation law.

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financial data such as turnover and value added. As the latter information is only available for associations that are obliged to deposit their annual accounts to the Central Balance Sheet Office of the National Bank of Belgium, at least a lower limit can be calculated of the size and significance of associations in Belgium. Marée et al. (2008) provide an analysis on the number of employees in associations in 2005. They find that in total, associations have an employment of 272,300 FTE. This figure excludes 154,893 FTE teachers working in independent schools that use the association as a legal form, and 666 FTE in specific government programmes for the unemployed. The majority of the former group works in associations that are active in social services and health care. Social entrepreneurship in Belgium has largely embraced the legal form of the association. Deraedt and Van Opstal (2009) showed that more than 60% of all work integration enterprises recognized by the Flemish Agency for Work and Social Economy adopt the legal form of a non-profit association. Excluding public sector initiatives from this set increases its relative size to 75%, employing more than 86% of all disadvantaged people in this sector.

As such, there are good reasons for these activity domains to embrace the association as its preferred legal form. Firstly, the non-distribution constraint provides a trustworthy signal that the social enterprise pursues a social goal. Secondly, a non-profit association is a flexible form that is easy to establish. Next, as many associations exist, it is quite easy to gather information and support with respect to this legal form. Of course, founders of an association also have to take into account the drawbacks of this legal form in their cost-benefit calculus of choosing the best legal form. However, a fourth advantage may be imperatively persuasive, as the non-profit association is often the only legal form that is eligible for recognition (and hence for subsidization) for many activities in health and social care, but also in work integration.

## 3.2 Co-operatives

### 3.2.1 Ratio Legis

Co-operatives have been established since the 19th century to address mutual problems with the means of an economic organisation. The International Co-operative Alliance (ICA) defines co-operatives as:

*“autonomous economic associations of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise. In co-operative business enterprises ownership, control, and beneficiary are vested directly in the hands of the user.”<sup>47</sup>*

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47 [www.ica.coop](http://www.ica.coop) .

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Specific principles of co-operative entrepreneurship have been developed throughout the years (ICA, 1995). They are voluntary and open membership (1), democratic member control (2), member economic participation (3), autonomy and independence (4), education, training and information (5), co-operation among co-operatives (6), and concern for community (7). While the definition, the value pattern and the principles through which these values should be put into practice are universal in nature, as laid down in the ICA Statement on Co-operative Identity (1995), co-operative legal frameworks mostly do not include sufficient conditions to guarantee adherence to these co-operative principles (Cracogna, D., 2002: 3), which is also the case in Belgium.

The co-operative was originally introduced in the Belgian Commercial Code by law in 1873<sup>48</sup> following the 19th century social-economic situation. The industrial revolution was characterized by the existence of an industrial proletariat and by an extreme polarization in terms of wealth and income. While entrepreneurs gained huge returns on invested capital, most people were excluded from receiving a significant part of their value added. This led to the establishment of consumer co-operatives for commodities, co-operative savings banks and insurances, and agricultural producer co-operatives. These co-operatives were owned by its users, generating economies of scale and reducing information asymmetries and potential for deceit, dilution of goods and usury at credit markets. In this system, every partner would have an equal voting right in the General Assembly to guarantee the feeling of solidarity between its members and the principal of free admission was accepted, to act as a counter-weight towards the other existing 'closed' company forms (Geinger & Heijerick, 2006). Therefore, article 350 of the present Company Code defines the co-operative as a company composed of a 'variable' amount of partners with 'variable' contributions.

However, this idealism and the freedom granted to the founders of co-operatives by the legislator, had to give way to a more defined approach as the co-operative legal form was frequently abused. This is not at all surprising, as there was no obligation to found the company with an authentic instrument, no minimum capital requirements, no legal obligation to pay up in full, no specific liability grounds for founders or board members, no obligation to draw up a financial plan, no audit control, etc. The more legal forms such as the public limited liability company and limited company became more stringent, the more the co-operative was seen as the ideal 'escape route' (Wouters, 1992: 53). In 1991<sup>49</sup>, more than a century after the original

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48 Law 18 May 1873, BS 25 May 1873.

49 Law 20 July 1991, BS 1 August 1991.

law<sup>50</sup>, the legislator therefore drastically changed the legal stipulations for co-operatives and introduced two forms: the 'co-operative with limited liability'<sup>51</sup> and the 'co-operative with severally unlimited liability'.<sup>52</sup> For the co-operative with limited liability, new measures were stipulated concerning the establishment of the company, the capital and preservation of capital and liability of board members (Wouters, 1992: 56). The co-operative with joint and several unlimited liability became (and still is) the more flexible alternative. In 1999, the name was changed to the shorter 'co-operative with unlimited liability'.<sup>53</sup>

A new legal label was also introduced that could be connected to both types of co-operatives: the participative co-operative.<sup>54</sup> The idea was to explicitly put the focus on the co-operative principles and to strengthen the co-operative ties between members of the co-operative (Geens, 1992: 145). However, the stipulation that half of the profit would be divided in equal parts and the other half divided according to the capital brought in, meant that these co-operatives could not be recognized by the National Council for Co-operatives. In fact, the resemblance between the participative co-operatives and the accredited co-operatives of the National Council was almost inexistent. In 1995, the Social Purpose Company was introduced and the legislator decided that the participative co-operative had become superfluous as it was thought the co-operative SPC would be a better alternative (Michielsens, 1996: 537). The participative co-operative was subsequently abolished.<sup>55</sup>

### 3.2.2 Main Characteristics

An important distinctive feature of a co-operative is that the provision of equity capital and ownership are with the users-members of the co-operative. While the co-operative model can be applied in a variety of economic activities, types of co-operatives can be identified according to its economic function and corresponding interests of the members. In a consumer co-operative, membership consists of clients of the co-operative. For a producer co-operative, suppliers are

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50 Modifications were introduced earlier by Law 4 December 1984 and by Law 15 July 1985 but they were not that far-reaching.

51 Known in Belgium as the 'coöperatieve vennootschap met beperkte aansprakelijkheid', CVBA (in Dutch) or the 'société coopérative à responsabilité limitée', SPRL (in French).

52 This legal form was known in Belgium as the 'coöperatieve vennootschap met onbeperkte hoofdelijke aansprakelijkheid', CVOHA (in Dutch) or the 'société coopérative à responsabilité illimitée et solidaire', SCRIS (in French).

53 Known in Belgium as the 'coöperatieve vennootschap met onbeperkte aansprakelijkheid', CVOA (in Dutch) or the 'société coopérative à responsabilité illimitée', SPRI (in French). Law 7 May 1999, BS 6 August 1999.

54 Was known in Belgium as the 'Coöperatieve vennootschap bij wijze van deelneming' (in Dutch) or 'Société coopérative de participation' (in French).

55 Law 13 April 1995, BS 17 June 1995.

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members, and in a worker co-operative membership consists of employees. A specific form is the multi-stakeholder co-operative, where multiple stakeholders jointly own the co-operative.

To capture this specific form of entrepreneurship, the co-operative legal form is characterized by (1) a flexible number of partners (called members) and (2) a flexible amount of capital. While the Belgian legal framework includes these two characteristics, there is little or no resemblance to other principles of the co-operative movement. Today, two legal forms exist, the co-operative with unlimited liability and the co-operative with limited liability<sup>56</sup>. Both must be established by at least three members.

The co-operative with unlimited liability has some advantages, as it is very easy to establish, structure, and govern. It requires no authentic instrument, there are no specific stipulations concerning the General Assembly, there are no minimum capital regulations and there is no minimum payment in full. However, joint and several liability is the price to be paid by its members for this flexibility.<sup>57</sup> Note that personal, joint and several liability applies to all members of a co-operative with unlimited liability, as it is not possible to exclude groups of shareholders from this liability, while in associations, only the Board (and in principle not the members) can be held liable.

On the other hand, the limited liability version of the co-operative provides limited liability to all of its members. Establishment is done by an authentic instrument. A fixed share of capital (which serves as a guarantee for creditors) is set at a minimum of 18,550 euro, and has to be paid up in full for at least 6,200 euro and for at least one fourth of every capital share.<sup>58</sup> As we will see later on, this amount is reduced to 6,150 euro for a social purpose co-operative of which 2,500 euro has to be paid up in full. In any case, the amount of the fixed part of the capital has to be motivated in a financial plan, which needs to be deposited at a notary office at the time of establishment.

In a co-operative, one can become a partner by bringing in capital at the time of establishment. These shares are registered. If the Articles of Association do not stipulate any conditions (they can stipulate more stringent exit conditions and can even forbid a member to leave), members have the right to leave the co-operative. However, certain conditions must be fulfilled: A

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<sup>56</sup> There is also a European option: the legal form of the 'European Co-operative Society' exists since 2006. This legal form is also known under its Latin name, 'Societas Cooperativa Europaea', SCE. We will not consider this variant, however, as at this moment (May 2009) very few enterprises in Europe have adapted this framework.

<sup>57</sup> See article 352 §2 Company Code.

<sup>58</sup> See articles 390 and 397 Company Code.

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member may only do so during the first six months of the financial year and the shares may be transferred to other members according to the conditions in the Articles, or to third parties, the latter however under strict conditions.<sup>59</sup> The exit of members to the co-operative means that the capital will decrease, the entry of new members will lead to an increase. Members may ask for a refund of their original contribution to the co-operative but no refunds can be given if this means that the value of its net assets drops below that of the fixed part of the capital.<sup>60</sup> The fact that there is a capital structure, minimum capital regulations and the possibility to retrieve capital from the co-operative at the time of exit, gives the co-operative a comparative advantage compared to the association.

The Belgian Company Code prescribes that every member can cast his vote in the General Assembly and every share gives right to one vote ('one share, one vote').<sup>61</sup> The Articles of Association, however, may deviate from this, e.g. implementing a system of 'one member, one vote', or the creation of different kinds of shares with dissimilar rights. Next, the Articles of Association are entirely free to decide about profit allocation. In other words, the law does not specify any limitation on dividend payments. If nothing is stipulated, the decision is given to the General Assembly<sup>62</sup>.

A co-operative with limited liability has to draw up an annual account which has to be controlled by an accredited auditor (for large co-operative societies) or a member-auditor, assisted by an accredited auditor if necessary (for small co-operative societies). An accredited auditor must only do the same in large associations.<sup>63</sup> This annual account comprises the balance sheet and the profit-and-loss account and has to be deposited at the Central Balance Sheet Office of the National Bank of Belgium. Small co-operatives with unlimited liability may draw up an annual account according to a reduced scheme, and do not have to deposit the annual account at the National Bank<sup>64</sup>.

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59 See article 366 Company Code.

60 See article 429 Company Code.

61 See article 382 Company Code.

62 Note that the Company Code obliges the General Assembly in article 428 Company Code to allocate yearly 1/20th of net profits to a reserve fund. This obligation ceases as soon as the value of this reserve fund exceeds 1/10th of the fixed part of the capital.

63 See article 17 Association & foundation law.

64 [www.nbb.be](http://www.nbb.be).

### 3.2.3 Accreditation by the National Council for Co-operatives

As we already stated, the Company Code does not include the ideals and principles of co-operative entrepreneurship. In 1955<sup>65</sup>, the National Council for Co-operatives<sup>66</sup> was therefore established by law. This Council is a governmental instrument, embedded in the Ministry of Economic Affairs, and has basically three tasks. First, the Council should undertake adequate measures to promote the study and advancement of the principles and values of co-operative entrepreneurship. Secondly, the National Council for Co-operatives is expected to give recommendations and proposals with respect to legal design. Next to this, the National Council for Co-operatives has the competence to accredit co-operatives if five conditions, which resemble the ICA Principles, are met:

- voluntary accession
- equal voting rights or limitation of voting rights of the General Assembly (max. 10%)
- designation of board members by the General Assembly
- a moderate dividend (maximum 6 % of brought in capital)
- a patronage dividend for the members

Accredited Co-operatives receive a specific statute compared to common law. They are exempt from some specific financial regulations concerning the public call on savings, which means they can gather equity capital rather easily from the general public. Secondly, dividend payments are exempt from taxes up to a certain amount (170 euro for the moment). Thirdly, members who devote their time predominantly to the executive committee receive the social statute of employee. Next to this, accreditation may act as a signal of being a 'true' co-operative, and may open networking possibilities.

### 3.2.4 Drawbacks

While the association is characterized by a combination of clear legal drawbacks to perform economic activities but enjoys wide support among social entrepreneurs and policy makers, the situation of the (accredited) co-operative is almost the reverse. The legal framework of the co-operative is tailored for performing economic activities, while the accreditation mechanism may foster the pursuit of social and mutual goals. However, co-operatives do not have a good reputation, and basically are a blind spot in legislative work and policy making. Moreover, the

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<sup>65</sup> Law 20 July 1955, BS 10 August 1955. The accreditation conditions were officially introduced by Royal Decree in 1962. Royal Decree 8 January 1962, BS 19 January 1962.

<sup>66</sup> [http://mineco.fgov.be/sme/cooperatives/council\\_fr.htm](http://mineco.fgov.be/sme/cooperatives/council_fr.htm).

accreditation instrument of the National Council of Co-operatives has many deficiencies, and the co-operative movement in Belgium is weak, resulting in low levels of co-operative identity formation and a lack of knowledge of the co-operative model.

### *. Reputation*

The co-operative model is characterized by reputation problems, leaving many observers confused. Some consider co-operatives an outdated instrument of social movements from the 19th century that became extinct somewhere in the 1960s (Defourny, Simon & Adam, 2002). Others see the co-operative as an excrescence of communism, reminiscent of kolkhoz farms in the former Soviet Union. Another view on co-operatives is that they are a relic of the May '68 movement, made out of some surviving open sandals and woolly socks creatures. Many of these views are persistent and not really helpful for the development of a Belgian co-operative movement.

Even those who know their history often get confused by the co-operative model. Social enterprises consider co-operatives as too commercial, as the legal framework of the co-operative allows for unlimited profit distribution. In health and social care, co-operatives are often considered as a sneaky form of privatisation (while they forget they are private sector agents themselves). On the other hand, classical entrepreneurs consider the co-operative as too 'soft', too difficult to manage or too unsafe. The latter perception comes from the fact that in the pre-1991 Company Code, the co-operative was designated as the 'Wild West' of all legal frameworks, being a very flexible legal form with hardly any obligations, but at the same time with hardly any protection for its members.

Anyhow, all this leads to the fact that co-operatives are often considered as the 'enfants terribles' of economics, being "too economical to be included in the non-profit sector and too socially oriented to be considered as an economic for-profit organization", as stated by Levi & Davis (2008). This observation characterizes both reputation problems and confusion with respect to the co-operative model.

### *. Lack of visibility*

Few entrepreneurs spontaneously think of a co-operative when considering starting up a business. This is because the co-operative model is hardly known by the general public. Curricula in schools, even in business schools and at law faculties, do not spend a lot of attention to co-

operatives if we compare this to 'traditional' legal forms, such as the public limited liability company, the private company with limited liability and the non-profit association. If any attention is paid to the co-operative, only its legal characteristics are discussed, neglecting its comparative advantages as an economic and a social instrument. It is also relatively difficult to find specific legal information on co-operatives, compared to 'traditional' legal forms. And even worse, many of this publicly available information (e.g. in starters guides or on websites) is erroneous or outdated.

Co-operatives are also a blind spot among legislators and policy makers. In certain sectors where co-operatives traditionally have a strong position such as in agriculture, this problem is less severe. But for most areas of social entrepreneurship, co-operatives are mostly forgotten as a possible legal framework. This results in a lack of legal complementarity and the fact that co-operatives are often not eligible for recognition and subsidization in the fields of health care, social care or work integration. While the accreditation system would solve many problems raised by critics of co-operatives, e.g. because an unaccredited co-operative can distribute its profits without any limits, no governmental or administrative resolutions ever include the accreditation as a possible instrument to safeguard the social purpose.

#### *. Drawbacks of the National Council of Co-operatives*

A major problem of the accreditation system is the mere fact that the National Council of Co-operatives is hardly known by the general public. Even many co-operatives have never heard of it (Van Opstal & Gijssels, 2008). This partly explains why only about 500 out of 40,000 co-operatives in Belgium are accredited by the Council. Moreover, those who know the National Council of Co-operatives often have difficulties interpreting the specific requirements to obtain an accreditation. Recently, the National Council of Co-operatives tried to resolve this by clarifying these requirements in its quarterly newsletter. Unfortunately, as the Council itself remains largely invisible, the reach of this newsletter is limited. A newsletter is also only a meagre remedy for legal uncertainty. A third problem is the fact that the benefits of becoming an accredited co-operative are simply insufficient and mainly tailored for financial co-operatives. This reduces the accreditation procedure to a deadweight loss for most social enterprises.

Except for the latter problem, all this has much to do with two major limitations of the National Council of Co-operatives. Firstly, the Council is poorly staffed, employing approximately 2 FTE, and has poor financial resources. Secondly, as the National Council of Co-operatives is part of

the administration of the Ministry of Economics, it has to work in a bureaucratic environment and subsequently has major limitations to function as an autonomous and independent umbrella organisation.

#### *. Weak co-operative movement*

The co-operative movement in Belgium is rather weak. This weakness is the result of all drawbacks mentioned until now, but is at the same time partly one of the causes of these drawbacks. Co-operatives in Belgium do not have an autonomous umbrella organisation that encompasses the entire field of co-operatives. Historically, labour movements and farmer federations stimulated the development of co-operatives in their own backyard. As these organisations were part of a strongly pillarized society, it is until this date difficult to encompass these co-operatives into a wider co-operative movement. Furthermore, as co-operatives can be found in almost every economic sector, fostering a common identity is difficult. As a result, this weak co-operative movement and a low profile identification of most Belgian co-operatives persist and reinforce problems such as a lack of visibility, the persistence of perceptual inconsistencies, and co-operatives being a blind spot in legislative work.

### **3.2.5 Significance - incidence and rationale**

Despite its drawbacks, there are almost 40,000 co-operative societies in Belgium, the majority of them have the limited liability status. However, only about 500 of them obtained an accreditation by the National Council for Co-operatives. According to Mertens (2005), this is largely due to the fact that most co-operative societies in Belgium have little or no affiliation with the co-operative model as advocated by the ICA<sup>67</sup>. While we largely concur with this hypothesis, there are not many co-operatives in Belgium that adhere to all seven principles of co-operative entrepreneurship, so a more subtle view might be justified. As mentioned earlier, the accreditation system is not known to the general public, and even management executives of some large long-established co-operatives that clearly adhere to a majority of these co-operative principles, have to admit that they did not know the National Council for Co-operatives (Van Opstal & Gijssels, 2008). However, as this accreditation provides some safeguards concerning the mutual and/or social objectives of the co-operative, we will mainly focus on this subset.

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<sup>67</sup> International Co-operative Alliance.

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Accredited co-operatives employed over 6,750 workers (5,662 FTE) in 2005 and created at least 325 million euro added value, which amounts to 0.1% of Belgian GDP (Mertens & Dujardin, 2008). Survey results on 175 accredited co-operatives show a membership that exceeds 2 million individuals (Van Opstal, Gijssels & Wyns, 2008). We should note, however, that membership in accredited co-operatives is concentrated in some large financial and pharmaceutical co-operatives. Moreover, this figure is the sum of membership in all these co-operatives, and does not exclude possible double counts of individuals that are a member of several co-operatives.

In Belgium, co-operatives can be found in virtually all economic domains. Gijssels & Van Opstal (2008) and Dujardin, Mertens & Van Opstal (2008) provide an overview of the predominant activity domains where co-operatives can be found. In the agricultural sector, machinery co-operatives, dairy co-operatives, and co-operative auctions strengthen the economic position of farmers by providing economies of scale in the procurement of capital goods and the distribution and processing of agricultural produce. In the pharmaceutical sector, co-operatives have a market share of 20%. Next, financial co-operatives hold strong positions in some major Belgian banks and provide alternative finance to social economy initiatives in the North and development projects in the South. Next to this, co-operatives can be found in retail, wholesales, alternative energy, the construction sector, housing and among professionals. In these sectors, the co-operative is used as a flexible instrument to ensure easy access for new members, generating economies of scale for the benefit of its members and the communities they operate in. However, while co-operatives have some comparative advantages to attract enterprises in health and social care and in work integration activities, they are rarely found in these sectors. The drawbacks mentioned earlier are paramount to this observation.

### 3.3 Social purpose companies

#### 3.3.1 Ratio Legis

The Social Purpose Company (SPC) was introduced in 1996 as an alternative legal structure for social economy organisations, although the first law proposal dated back as early as 1989.<sup>68</sup> It is

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<sup>68</sup> Law 13 April 1995 concerning the adjustment of the laws on trade companies coordinated on 30 November 1935, BS 17 June 1995 ; Law proposal for social purpose companies, companies in support of social purpose companies and associations of social purpose companies, introduced on 9 March 1990 by Mr. DE WASSEIGE, Parl.St., Senaat, 1989-90, nr. 904/1, 1-2 and Law proposal for social purpose companies, companies in support of social purpose companies and associations of social purpose companies, introduced on 18 November 1992 by Mr. TAMINIAUX, Parl.St., Senaat, 1992-93, nr. 535/1, 1.

not a new legal company form but a label: all types of companies can adopt the 'social purpose company' label if their statutes comply with a series of conditions (Defourny & Nyssens, 2008: 13). In contrast to the association the SPC allows unlimited trade, hence it was hoped that this legal form would facilitate the legal integration of social economy organisations (Denef & De Leenheer, 2005: 18-20). Furthermore, the SPC was considered a more credible and financially sound alternative. As the SPC can be linked to existing corporate legal forms, it ensures the SPC's assets are protected, which can be seen as a guarantee for creditors (Coipel, 1996a: 58, Ernst, 1996: 37; Denef, 2004a: 171).

According to article 664 of the Company Code, the SPC must offer third parties identical protection mechanisms found in the traditional corporate forms: the same obligations for example have to be fulfilled concerning establishment (requirements on minimum capital and a financial plan), the provision of information (annual accounts and enrolment in the trade register) and representation. Founder and administrator liability during the existence of the company and the liquidation procedure at the end of its existence, also provide protection (Denef & De Leenheer, 2005: 134). The association is characterized by a limited liability of its members, who do not have the obligation to financially back up the commitments of the association. In the SPC, distribution of profits to members is also possible, albeit in a limited way (Breesch & Coeckelbergh, 1995: 5).

At the time of its conception, the SPC was therefore considered quite revolutionary and this to the displeasure of certain legal scholars who complained that the foundation of Belgian company law was being tampered with. According to the critics, the SPC created a conceptual chaos as the profit criterion, used to clearly distinguish the company from the association, is no longer always required (Geens, 1996: 75). The Belgian definition of a company had to be rewritten<sup>69</sup> and now states that in the situations that the law lays down, the Articles of Association of a company can stipulate that it has a not-for-profit objective. For the first time conducting trade could be combined with a not-for-profit objective, a combination that is at the core of social entrepreneurship.

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<sup>69</sup> See article 1 Company Code.

### 3.3.2 Main Characteristics

Basically, every company can obtain the SPC label provided the purpose is not to enrich its members and its Articles of Association are in accordance with certain requirements. We provide a brief overview of these requirements.

#### *. Social purpose*

Article 661, 2° states that the Articles of Association must accurately describe the social purpose of the company. However, the meaning of “social purpose” is not entirely clear. It certainly concerns an altruistic, higher purpose partners are striving for and which is the main motive for the establishment of the company (Ernst, 1996: 55). The legislator restricted himself to a negative description of social purpose as it was the intention to give the founders enough freedom and not to exclude any activities beforehand (Stolle, 1997: 49; Coeckelbergh, 2001: 29). The Articles of Association must therefore stipulate that partners may or may not pursue profit (1°) the former albeit in a limited fashion. Furthermore, the main objective should not be to obtain a direct financial advantage (2°). The granting of indirect financial advantages is therefore permitted, as long as it is not the main objective of the SPC<sup>70</sup>.

#### *. Limitation of residual claims*

The SPC can distribute profits to its partners, although the dividend may not amount to more than the maximum allowed, which is set by Royal Decree for companies accredited by the National Council for Co-operatives (5°). Since its conception, this maximum has remained at 6%. The balance of liquidated assets may not be divided between the partners but must be allocated to a similar purpose (9°), as is the case with associations.

#### *. Assignment of profits*

The Articles of Association must also stipulate how profits will be allocated, according to the internal and external purpose of the company, keeping in mind the hierarchy set in the Articles (3°). If the SPC has more than one social purpose, it should fix a certain order, although the hierarchy set in the Articles may not change the legal hierarchy. The legal reserves have priority over the provisions in respect of the allocation of profits in the Articles (Ernst, 1996: 61).

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<sup>70</sup> This seems slightly strange, considering that the granting of indirect advantages is possible in an association.

### *. Employee Participation*

Article 661, 7° stipulates that the Articles of the SPC must contain rules to make it possible for every employee to become a partner in the Company within a year from the date of employment. The SPC is therefore the only company structure that anchors (financial) employee participation as a legal right (Stolle, 1997: 56). However, a slight nuance should be made; the provision does not apply to employees who are not legally competent, for example persons with mental disabilities engaged in sheltered employment (Breesch & Coeckelbergh, 1995: 12).

Employee participation in respect of capital assets is provided for in the SPC. Depending on the company legal form, there are two possibilities. First, the acquisition of existing shares; second, the creation of new shares or an increase in share capital (Navez, 2004: 9). Both techniques involve a contribution from the employee. The former possibility means that employees depend on the initiative of the existing shareholders and, for example in the private company with limited liability<sup>71</sup> and the co-operative with limited liability, of their consent.<sup>72</sup> However, this problem could be solved by creating a call-option for employees towards the founders-existing shareholders in the SPC (Denef & De Leenheer, 2005: 143). Article 661, 8° stipulates that employees who no longer have an employment contract with the company do have the right to waive their capacity as a partner, the latest one year after the end of the contract.

### *. Limited Voting*

According to article 661, 4° Company Code, the articles must stipulate that no one may participate in the vote with more than 1/10th of the amount of votes linked to the represented shares. This percentage is brought to 1/20th when one or more shareholders are employees of the company. This exceptional voting restraint is an extra protection for the employee participation and means that one must even take a small employee participation into consideration (Stolle, 1997: 59). It is clear that this characteristic wants to encourage employees to become shareholders and to stimulate their participation in the decision-making process. The limited vote is legally compulsory but comprises only a minimum requirement. The Articles of Association can, however, stipulate a more stringent restriction and limit the vote to e.g. one man, one vote (Navez & Demarche, 2001: 123).

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71 Known in Belgium as the 'besloten vennootschap met beperkte aansprakelijkheid', BVBA (in Dutch) or the 'société de personnes à responsabilité limitée', SPRL (in French).

72 See article 249, 364 and 366 Company Code.

### *. Special Report*

The board members or manager must publish a special annual report on how the company has supervised the purpose established in the Articles. Furthermore, this report must show that the spending pattern concerning investments, operational costs and wages were used towards the realisation of the social purpose. The main purpose of this special report is to ensure that partners or board members will not secretly share profits and to check that the company is not being abused (Demonty, 1997: 762; Stolle, 1997: 56). Not drafting or badly drafting this report can also lead to board members being jointly and severally liable for all damages as a consequence of the violation of the legal provisions and provisions pursuant to the Articles of Association.<sup>73</sup> This report must be inserted into the annual report according to article 95-96 Company Code. The legislator however forgot that article 94, 1° Company Code exempts small companies from this obligation. One expects, however, that this does not imply that small companies do not have to report in the sense of article 661, 6° Company Code.

### *. Special Sanction Mechanism*

According to article 663 Company Code, the existing reserves must, in the deed modifying the Articles of Association, have a destination that corresponds as much as possible with the social purpose of the SPC. If this is not the case, the board members or manager can be held jointly and severally liable to pay the wrongly distributed profits or to the recovery of the consequences of not fulfilling the requirements concerning the destination of the reserves. Board members or managers of an SPC therefore run an increased liability risk at the moment of transformation of the SPC into a regular company.

### *. Conversion of an association to an SPC*

It is possible to convert the association into an SPC, without winding-up the association and keeping its legal personality. The procedure is irrevocable and consists of three parts. First of all, the members of the General Assembly are informed of the conversion plans by means of a general report from the board, supplemented by a status of the assets and liabilities, not older than three months and a draft modification of the Articles of Association. The decision to convert the association and the modification of the Articles can only be valid if at least 2/3 of

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<sup>73</sup> See articles 263, 408 and 528 Company Code.

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the active members are present or represented (Van Hecke, Demeyere & Vincke, 2007: 126). Next, verification takes place. A certified auditor or an external accountant verifies the status of assets and liabilities and the General Assembly approves the conversion decision and the draft Articles of Association with 4/5 of the votes.<sup>74</sup>

Finally, certain guarantees are given. First of all, there is the appreciation and allocation of the net assets of the association. An over-appreciation of the net assets leads to joint and several liability of the board members for the compensation of damages which are the direct and immediate consequence.<sup>75</sup> The net assets must be allocated towards the financing of the registered capital of the company or be carried over to an indisposable reserve account. They may not be distributed or paid back to the partners at any time and in any form whatsoever.<sup>76</sup> If the SPC is converted to a normal company, neither the original net assets, nor the existing reserves may be distributed. The same restriction applies to the net assets that remain after payment of all creditors in case of dissolution and winding-up of the SPC.<sup>77</sup> Should there be a bankruptcy or winding-up, any surplus must be allocated to a purpose that corresponds as much as possible to that of the company (Ernst, 1996: 54-55). Finally, the conversion must be certified by an authentic instrument, failing to do so renders it null and void.<sup>78</sup>

### 3.3.3 Drawbacks

While the aims of the legislator towards the SPC statute are clearly well meant, this did not prevent its current design from having some severe shortcomings. One of the origins of these problems may be the fact that the legislator tried to achieve too many objectives within the establishment of one legal framework. At the same time, many issues concerning this legal framework are still not settled. Furthermore, little attention was paid to legal complementarity and this legal framework clearly lacks maturity. We will briefly discuss some major problems of the current SPC statute and report some results of focus group research on the SPC in 2008.<sup>79</sup>

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74 See article 26ter Association & foundation law.

75 See article 26septies Association & foundation law.

76 See article 26sexies Association & foundation law.

77 See article 668 §2 final paragraph Company Code.

78 See article 26quinquies Association & foundation law.

79 Results of this focus Group research are reported more extensively in Van Opstal, Gijssels & Develtere (2008).

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*. Lack of definition of the social purpose*

Legal stipulations concerning the SPC statute do not make any reference to a positive definition of social purpose. It is understandable that the legislator was not willing to formulate a positive definition of social purpose as he wanted to respect the freedom of the founders. On the other hand, a negative definition makes it hard to distinguish boundaries which could lead to further problems. Focus group participants indicate this 'lack of intrinsic clarity' as a major deficiency of the SPC status, as "one may formulate any social purpose, such as fostering climate change or the rights of white men".

*. Insignificance of the special report*

Another problem is the lack of control to check whether SPC's actually pursue the social purpose indicated in the Articles of Association. There is no compulsory structure or content requirement for the special report SPC's have to deposit. Moreover, this report is not followed up by any official body. A focus-group participant formulates it as follows: "the special report we have to deposit can be written within 15 minutes and has no intrinsic value. It is just an administrative obligation but does not stimulate to follow your social purpose".

The internal control is also a problem for companies that do not have a General Assembly and therefore cannot discuss or approve a report, for instance the commercial partnership<sup>80</sup> or the open limited partnership<sup>81</sup>. One may also wonder if the higher liability risk was a well thought-out plan as third parties or partners do not have a financial interest. They must also bear the costs of the procedure. The dissolution threat in article 667 Company Code in the case of a company that claims to be an SPC but the Articles of Association do not meet the required stipulations, or a company that in practice acts contrary to the Articles of Association, is for the same reasons questionable (Denef, 2004b: 157). However, other scholars argue that this sanction is absolutely necessary to pick out the false SPC's and that therefore, the sanction must be severe and clear (Coeckelbergh, 2001: 97).

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80 Known in Belgium as the 'Vennootschap onder firma' or VOF (in Dutch), 'Société en nom collectif' or SNC (in French).

81 Known in Belgium as the 'Commanditaire vennootschap' or Comm. V. (in Dutch), 'Société en commandite simple' or SCS (in French).

### *. Lack of clarity for profit assignment*

The 'assignment of profit' provision also has flaws. Firstly, what is meant by "internal" and "external" purpose? Did the legislator mean respectively, 'social purpose' and the 'actual activity' of the company? Secondly, does the stipulation of the assignment of profit not lead to a rather inflexible amendment procedure for the Articles in case of an amendment in the hierarchy? In other companies, there is no need to set the distribution of profits ex ante, as it belongs to the authority of the annual General Assembly to decide its distribution (Breesch & Coeckelbergh, 1995: 9; Demonty, 1997: 760).

### *. Employee participation*

Employee participation is also not as straightforward as it looks. First of all, not everyone agrees with the arrangement that employees who are not legally competent do not have a legal right to participate. The law provides full or semi representation or assistance for all non-competent individuals. It is therefore not totally clear why they should be excluded altogether - not only from participating in decision making at the General Assembly but also from the limited financial advantages that may result from financial participation (Coeckelbergh, 2001: 75).

And there is a further difficulty: the Company Code only allows participation in the General Assembly; in other words, only a financial participation is possible (Breesch & Coeckelbergh, 1995: 12). Moreover, the legislator leaves it entirely to the founders to stipulate the practical side of these matters in the Articles of Association. Therefore, it may be possible that the provisions in the Articles could have an adverse effect. One could for instance set the purchase price of a share extremely high or demand certain competencies that are unlikely to be met (Denef, 2004b: 142). This freedom of the founders actually means they can make this possibility as attractive as they wish. Making participation possible also means extra funding and extra time for training (Delespesse, 2001: 48; Develtere, Meireman & Raymaeckers, 2005: 68). Employees are therefore very much dependent on the goodwill of the founders. Several focus group participants raised this issue and stated that low skilled workers themselves are not always willing to participate financially in the SPC. According to these participants, many employees are even not at all interested to take up such a role, even if entry regulations are made easily accessible for low income groups. As one focus group participant formulates it: "we can't even find candidates for the election of a work council, let alone that our employees would be interested to participate financially in the enterprise".

An important fact to note is that the creation of new shares or an increase in share capital to create employee participation is far more easier in a co-operative than in most other corporate legal forms, such as the public limited liability company<sup>82</sup> or the private company with limited liability. No amendment of the Articles of Association is required, only an authentic ascertainment of the capital increase on request of the board.<sup>83</sup> Existing shareholders have in principle no right of preference and the thresholds for placement and payment in full of equity capital has been reduced for the social purpose co-operative with limited liability<sup>84</sup>. For other company forms, this procedure is expensive and difficult to say the least. For instance, a capital increase in a social purpose private company with limited liability and in a social purpose public limited liability company must be endorsed by an authentic instrument. There are also notary costs, registration rights that need to be paid and a change of enrolment in the trade register (Stolle, 1997: 118). Moreover, except for the co-operative, where equity capital is partly variable, the right to waive the capacity of partner is difficult to organize for the public and private company with limited liability. A transfer of shares to another individual or the acceptance by the company of its own shares within the legal limits seems to be the only solution to this dilemma (Ernst, 1996: 64; Deneff, 2004b: 146).

#### *. Limitation of voting rights*

The limited vote is also of concern, as it begs the question whether founders, who will invest a considerable amount in the SPC, will want to share participation with their employees. This also became quite clear during our focus groups, as there was a clear division in the enthusiasm among focus participants when it came to employee participation and the subsequent limitation of voting rights. Some fear that this would grant employees too much power, rendering work organisation basically impossible. These fears mostly occur in environments where the gap in the educational level of management and employment is rather big, which is the case in many work integration social enterprises. Other focus group participants predict a deadlock in decision-making if voting rights in the General Assembly become too fragmented.

Over the years, however, it has become clear that there are many techniques to limit employee voting rights as much as possible. For instance, one may form a 'patrimonial SPC' with a large sum of capital and a parallel 'exploitation SPC' with reduced equity capital. One could settle things in such a way that the patrimonial SPC has no employees, and therefore always stays

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82 Known in Belgium as the 'naamloze vennootschap', NV (in Dutch) or the 'société anonyme', SA (in French).

83 See articles 392 and 421 §2 Company Code.

84 There must be a fixed equity capital of at least 6,150 euro (instead of 18,550 euro for regular limited liability co-operatives) and 2,500 euro must be paid up in full (instead of 6,200 euro for regular limited liability co-operatives).

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under the control of its founders. Subsequently, this patrimonial SPC may lease real estate and other assets to the exploitation SPC (Breesch & Coeckelbergh, 1995: 11). Another example is to differentiate between different kinds of shares: shares with and without voting rights.

*. Lack of legal complementarity and know-how*

Another major problem that was referred to by focus group participants, is legal uncertainty. This legal uncertainty basically boils down to a lack of legal complementarity, as most of the initial objectives of legislators were not implemented later on. Historically, most legislation on recognition and subsidization of health, social care and work integration initiatives focused solely on non-profit associations, the introduction of the SPC left these laws largely unchanged. For instance, a sheltered workshop may only adopt the legal form of an association<sup>85</sup>. Being a federal instrument, the Company Code is a federal competence, while many recognition and subsidization schemes are regulated by the regions, provinces and even communities. “They don’t recognize us, simply because they do not know the SPC statute”, one focus group participant mentioned.

This brings us to the problem of the lack of know-how on the SPC as a legal form. This only strengthens problems of legal complementarity and vice versa. One focus group participant mentioned this as follows: “Local tax authorities indicated some years ago that they did not know the SPC framework and qualified us as a non-profit association. Later on, federal tax authorities recalled this qualification and considered us a regular company. Both administrations, however, had to admit that they were not familiar with the SPC statute and they had difficulties to qualify it correctly.” Coates (2008: 84) provides another example. According to the Flemish decree<sup>86</sup>, private sector enterprises need to choose the legal form of an association or an SPC in order to gain recognition as a social workshop in Flanders. However, all (private sector) social workshops in Flanders have adopted the association status (Deraedt & Van Opstal, 2009). Most entrepreneurs of social enterprises, however, do not even know that the SPC is eligible for recognition by the Flemish government, which should not be surprising as the information provided by the Flemish Subsidy Agency for Work and Social Economy only mentions the association as an eligible legal form for social workshops (Coates, 2008 and Dujardin, Mertens & Van Opstal, 2008).

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85 At least in the private sector, as other specific public sector legal forms apply for sheltered workshops that are run by local governments.

86 Decree of the Flemish parliament 14 July 1998, BS 2 September 1998. This omission is supposedly linked to the state aid problem. For more information see Coates (2009).

*. Difficulties regarding the conversion of an association to an SPC*

The conversion of an association to an SPC also implies certain difficulties. First of all, during the conversion the association does not have any capital (at least not in the company sense) but only a net worth (assets and liabilities). The question here is how the capital should be formed. Article 26sexies §1 of the Association and foundation law stipulates that there is a choice: the net assets can be incorporated in the capital or they can be carried to an indisposable reserve account. Some academics are in favour of the latter option. The capital must therefore be brought in entirely by the partners (ex-members), which solves the division of shares problem (Ernst, 1996: 55; Coeckelbergh, 2001: 68). If the net assets are incorporated in the capital, the next question therefore is who should receive SPC shares and how many? Some academics opt for the equal division of all shares amongst the members of the association. The most obvious option is that all members of the association receive a share without nominal value (Tas, 2005: 504; Geens, 1996: 61). This however is not as straightforward as it looks as it is possible that not all members want to become partners and perhaps not all to the same extent (Coeckelbergh, 2001: 206). Nevertheless, it is possible, as is the case in an association, to have different categories of members, with different voting rights.

The next question to be raised is the automatic transformation of ex-members of the association to partners of the company, as they did not bring in any assets and there is therefore actually no ground to assign shares (Ernst, 1996: 55). Article 26sexies §1 however does state that this is possible. It is in any case possible to state in the conversion act that all members of the association automatically become partners of the SPC. A solution could be to allow members who do not wish to become partners to retire in writing, before a certain date under the resolutive condition that the association will be converted afterwards. This way, the conversion is not blocked by members who do not wish to become partner and members keep their membership in case the decision would be taken not to convert the association (Tas, 2005: 502).

The last question is whether the shares that represent the net worth of the association can be distributed among its members. Article 26 sexies §2 states that the amount of the net assets may not, directly or indirectly, be distributed or paid back to the partners at any time under any form (see article 668 §2 Company Code). In practice, the choice in the past went to a clause pursuant to the Articles of Association that stated that the shares did not qualify for a dividend distribution. This could be seen as an important plea for the placing of the net worth to an account (Denef, 2004b: 154).

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*. Attempts to refine this legal framework*

In February 2007, a proposal to modify the SPC framework was accepted by the federal government. First of all, during the first seven years after establishment, a distribution of profits of more than 6 % during a certain financial year would become possible, on the condition that the average over the first seven 'years', would be lower or equivalent to 6 % (article 2). Secondly, a Royal Decree would stipulate the obligatory structure and contents of the special report, including control by a body (article 3). Thirdly, employee participation would be modified: SPC's would be able to expand participation. The Articles would be allowed to stipulate how employees could participate, including direct or indirect participation in the board. In other words the choice set for SPC's on employee participation would expand from a mere financial participation to a participation in management (without becoming a partner) or a combination of both forms of participation (article 4). Moreover, minimum capital requirements would also undergo certain changes. The fixed capital of the social purpose co-operative would be raised to 12,500 euro and paid up in full for 5,000 euro. This should have reduced the risk founders run in the case of bankruptcy: they are personally liable for the low amount of capital if it turns out to be insufficient (article 7). Finally, apart from the dissolution sanction, the company would also be punished by losing the title 'social purpose company' (article 9).

The Council of State<sup>87</sup>, however, rejected this proposal, as the text apparently had not been thought through enough. Basically, almost every article in the proposal would have had to be rewritten as the text used wrong terminology, referred to old legislation, quoted wrong articles, etc. For example, the Court judged that 'financial year' should have been stated instead of 'year' in article 2. The Court also stated that the legislator should have specified what exactly was meant by 'control' of the special report and what exactly the extent of the delegation to the King (by Royal Decree) was. The Court further stated that the employee participation was not clear enough: what was meant by participation in the 'policy/management' of the Company, why was the participation limited to the legal organs and was not extended to all organs including those pursuant to the Articles and the Articles should also state how the participation should end when waiving the capacity as partner. The Court was of the opinion that the text should be completed to specify the consequences of this sanction. A new attempt was undertaken in 2008 by the Cabinet of the Minister of social integration, pensions and large cities, Marie Arena. Due to the Belgian political crisis, however, modifications have yet to be made.

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<sup>87</sup> Belgian Council of State, Law section, Advice 42.408/2, 28 March 2007.

### 3.3.4 Significance - incidence and rationale

Despite its recent growth, only 457 enterprises did adopt the social purpose company by 2008. Dujardin, Mertens & Van Opstal (2008) calculated that SPC's in Belgium had a total added value of at least 200 million euro, which amounts to 0.07% of Belgian GDP. Mertens & Dujardin (2008) estimate total employment in SPC's at 5,406 employees, which comes down to 4,625 FTE. Most of these enterprises that use the SPC label have the legal form of a co-operative. As stated before, the co-operative has some clear advantages over other legal forms to implement the SPC label, because of its flexibility to include new partners and lower minimum capital requirements. Table 2 gives an overview of the share of legal forms that applied the SPC framework in 2008.

**Table 2** Utilization of the SPC framework by legal forms, in 2008.

Legal form	Number of Enterprises	Relative share
co-operative with limited liability	306	67%
co-operative with unlimited liability	21	5%
private company with limited liability	81	18%
public limited liability company	33	7%
other legal forms	16	4%
<b>Total</b>	<b>457</b>	<b>100%</b>

Source: adapted from Dujardin, Mertens & Van Opstal (2008)

The growth of the number of SPC's is mainly due to the service voucher system that was introduced in 2001. In this system, households can use subsidized service vouchers to purchase household chores, like cleaning activities, shopping and gardening. According to Dujardin, Mertens & Van Opstal (2008), half of social enterprises that have been established since 2001 applies to be recognized as a provider of such services<sup>88</sup>. Next to this, SPC's are active in health care and social services. All in all, SPC's seem to be active in different domains as accredited co-operatives. Only about 15 co-operatives seem to combine an accreditation by the National Council for Co-operatives with the SPC-label. Dujardin, Mertens & Van Opstal (2008) also note that, while accredited co-operatives often focus on 'internal', thus mutual goals, most SPC's clearly focus on 'external', thus social goals.

Noteworthy is the fact that the majority of SPC's can be found in the Walloon region of Belgium. This can be linked to the obligation in the Walloon region for work integration enterprises to

<sup>88</sup> For an extensive analysis of the service voucher system, see Henry et al. (2008).

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obtain the SPC statute before being eligible for subsidization.<sup>89</sup> In Flanders, this is not compulsory, so only 17 % of all work integration enterprises has the SPC statute (Deraedt & Van Opstal, 2009). However, the Flemish Decree for work integration enterprises<sup>90</sup> has provided certain guarantees. Social inspectors are responsible for the supervision of the criteria and the obligations laid down in the decree. The company must also incorporate corporate social responsibility notions in its company strategy, according to a self drawn up process which has been valorised at the stage of accreditation. The company must also be prepared to let employees have their say in the company by respecting the existing consultative bodies or, in the absence of such bodies, to take the necessary initiatives to enhance the say of employees. The SPC statute is of course more far-reaching, but there are certain resemblances none the less (Coates, 2008:40).

Next to this compulsory rationale to opt for an SPC label, focus group participants indicated some other benefits of the SPC label as well. Firstly, the SPC label is considered by some as a marketing tool. "It attracts the attention of our stakeholders" and "It strengthens the credibility of our vision and our mission" are two quotes of focus group participants that illustrate this finding. Another advantage that was pointed out is the fact that limitations on dividend payments free social entrepreneurs partly from certain typical equity capital market concerns. One participant formulated it as follows: "it is far more easy to bring into practice your social purpose if you do not have to pay a large dividend. Being social requires financial resources". Another participant: "this limitation on dividend payments allows us to reinvest profits, which allows us to deepen the quality of labour we offer to disadvantaged groups". Furthermore, while limitations concerning voting rights were considered by some as a drawback, others see it as an advantage, as it "provides guarantees not to be taken over by any third party".

Focus group participants clearly considered the SPC as a bridge between an association and a classical company, combining advantages of being able to run commercial activities without having to harm social goals. In sum, the SPC statute allows social enterprises to strengthen their economic position in comparison to the association. Nevertheless, many practical drawbacks have to be solved before the SPC becomes an attractive alternative to the majority of social enterprises in Belgium.

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<sup>89</sup> Decree of the Council of the Walloon region 18 December 2003, BS 10 March 2004.

<sup>90</sup> Decree of the Flemish government 15 July 2005, BS 29 July 2005.

### 3.4 Comparative advantages of these legal frameworks for social entrepreneurship

Now that we have discussed the three major legal frameworks for social entrepreneurship in Belgium extensively, we will apply the theoretical framework we developed in section 2 to assess comparative advantages of these legal frameworks. We will structure our findings accordingly.

#### 3.4.1 Intrinsic design

##### . *Social goals*

	Association	(Accredited) Co-operative	SPC
Objective	Social goal	Mutual goal	Social goal
Reporting obligations concerning purpose	Specified in the Articles of Association	Not necessary to specify	Specified in the Articles of Association
Distribution constraint	None	None	Special Report
Liquidated assets	Non-distribution constraint	Limitation of dividend payments (6%) Patronage dividend	Limitation of dividend payments (6%)  Profit allocation has to be specified in the Articles of Association
	Allocation to a purpose in line with the social objective	Allocation to members	Allocation to a purpose in line with the social objective

When safeguards ensuring the pursuit of social goals are concerned, the association seems to dominate other legal frameworks. Conversely, the pursuit of social goals is protected the least in accredited co-operatives. However, the social purpose company approaches the non-profit association and even has to stipulate in its Articles of Association a hierarchy of social objectives and the way profits will be allocated. Next to this, the SPC has to justify its operations in the light of its pursuit of the objective in a special report. For the time being, however, the meaning of this special report is insignificant.

. *Economic activity*

	Association	(Accredited) Co-operative	SPC
Registration requirements	Limited	Either very limited (unlimited liability) Either extensive (limited liability)	Depends on the underlying legal form
Minimum capital provisions	None	Yes (limited liability) No (unlimited liability)	Depends on the underlying legal form Favourable in case of SPC-co-op
Financial plan	No	Necessary (limited liability) No (unlimited liability)	Depends on the underlying legal form
Ownership of assets	No	Yes	Yes
Access to equity capital	Depends on philanthropy, subsidies, etc.	Easier, but possibly troubled by  - limited voting rights - limited dividend payments	Easier, but possibly troubled by  - limited voting rights - limited dividend payments - no access to liquidated assets
Access to debt capital	Troubled by  - no minimum capital requirements - not possible to be declared bankrupt	Normal	Normal
Liability of members	Limited liability	Either limited liability for all Either unlimited liability for all	Depends on the underlying legal form

When it comes to performing an economic activity, the co-operative with limited liability dominates the alternative legal frameworks discussed. Legal regulations concerning minimum capital, a financial plan, but also registration costs deter adventurers from starting a co-operative with limited liability and stimulate founders to think twice at the time of establishment. Next to this, its intrinsic design makes funding easier for a co-operative than for an association, both in terms of equity capital as in terms of debt capital. The social purpose company approaches the advantages of the accredited co-operative, especially when it combines the legal form of a co-operative with the social purpose label.

*. Stakeholder management*

	Association	(Accredited) Co-operative	SPC
Limited plural voting	One member, one vote	Limited to 10% of voting rights	Limited to 10% of voting rights (5% if employees are shareholders as well)
Strong stakeholder notion	Governing rights for members	Governing rights for owner-users, either consumers, producers, workers or multiple types of users	Governing rights for shareholders  Workers should be made eligible to become shareholders within a year of employment.
Member economic participation	Not stimulated	Stimulated by patronage dividend	Not stimulated, unless in a co-op SPC

Stakeholder management seems to be most encompassing in the non-profit association. Legislators focused on 'workers' as an important stakeholder, but did not manage to design an optimal framework for employee participation. The co-operative has a comparative advantage in the implementation of a strong stakeholder notion towards its users, but cannot be expected to pay attention to other stakeholders as well. Furthermore, co-operatives have a strong leverage to involve stakeholders in their economic activities.

*. Autonomy*

	Association	(Accredited) Co-operative	SPC
Effect of side payments (subsidies, donations, ...)	Affects quality positively	Lower effect on quality	Lower effect on quality
Effect of tax advantages	Affects quality positively	Lower effect on quality	Lower effect on quality
Growth potential of reserves	No dividend payments	Limited dividend payments	Limited dividend payments
Use of debt capital	Weak incentive	Normal incentive	Normal incentive

When it comes to autonomy, associations have an advantage over other legal forms. Because they are not allowed to distribute any profits among their members they can, *ceteris paribus*, be expected to have a higher inclination to accrue their reserves. Furthermore, associations have a weak incentive to apply for debt capital, so they are not able to enjoy its financial leverage effect. Next to this, side payments and tax advantages affect quality provision by associations the most when compared to accredited co-operatives and social purpose companies. This is because of their greater autonomy towards the capital market. The fact that quality provision may be spurred by mere side payments, not having to apply many administrative regulations and

inspection procedures to control quality provision, is also an indicator for the autonomy of the association in the pursuit of its goals.

In sum, concerning its intrinsic design, the association has some clear advantages over the accredited co-operative and the social purpose company when it comes to incentives for a credible pursuit of social goals, stakeholder management and safeguarding its autonomy. However, serious drawbacks render the association an uninteresting legal framework for running economic activities. Especially when it comes to attracting capital, the association has its boundaries. In these cases, intrinsic design of an accredited social purpose co-operative should be an interesting second-best alternative to the association. Even if the Articles of Association would stipulate that dividend payments are allowed, access to capital should still be easier than for an association, at least when looking at its intrinsic design.

### 3.4.2 Attractive capacity

#### *. Distance to existing frameworks*

As indicated by Defourny & Nyssens (2008: 7), social enterprises are often established as associations in countries where the legal form of an association allows a significant degree of freedom for selling goods and services. This is also the case in Belgium as the merits of the intrinsic design of an association are hardly copied by other legal forms, while its drawbacks have been modified by changes in legislation, legal doctrine and jurisprudence. Therefore, quite some associations resemble companies in their economic activities. The requirements to become a social purpose company mimic in part the accreditation requirements of the National Council for Co-operatives. The limited prevalence of these latter two legal frameworks, however, is mainly due to the fact that their relative advantages do not outweigh the costs of using a framework with limited concrete advantages.

#### *. Switch costs*

A first observation here is the fact that a conversion of an association to a company is impossible. This should of course not prevent an association to create a new legal entity, without transferring the assets and liabilities of the association to that of the company. Conversion from an association to a social purpose company, however, is possible, but its procedure is complex and creates legal uncertainty. Furthermore, registration costs are the highest for the co-

operative with limited liability, and as the accreditation procedure is quite intransparent, it does not attract many co-operatives.

*. Dynamic economies of scale*

	Association	(Accredited) Co-operative	SPC
Availability of public information	Sufficient	Very limited	Limited
Quality of public information	Normal	Mixed	Normal
Availability of support by umbrella organisations	Abundant	Limited	Very limited
Availability of legal expertise	Sufficient	Very limited	Very limited
Availability of expertise in the labour market	Sufficient	Very limited	Very limited

More important than switch costs to explain path dependency and hysteresis are the dynamic economies of scale involved. While information on establishing and governing an association is abundantly available and quite qualitative, it is very hard to find relevant information to establish an accredited co-operative or a social purpose company. The situation is the most cumbersome for the social purpose company, as there is no umbrella organisation that supports and spreads know-how on this legal form.

### 3.4.3 Maturity of design

*. Legal complementarity*

	Association	(Accredited) Co-operative	SPC
Attention in legal design	Great visibility	Blind spot in legislation	Blind spot in legislation
Commercial Code	No recognition as a merchant Legal uncertainty	Complementary	Complementary
Coherence between different legislative levels	Moderate	Very low	Very low
Coherence of fiscal treatment	Mixed	Yes	Mixed

When it comes to legal complementarity, all three legal frameworks are fraught with problems. While associations receive great visibility in legal design there are still many problems concerning its legal complementarity to the Commercial Code and other laws on performing

commercial activities. The situation of the accredited co-operative and that of the social purpose company is more or less the opposite, and has definitely its drawbacks as well.

*. Coherence of public support*

	Association	(Accredited) Co-operative	SPC
Attention in design of public support	Great visibility	Blind spot in legislation	Blind spot in legislation
Eligibility for recognition and subsidization	High	Very low	Low
- in health and social care	Yes	No	Mixed
- in work integration	Yes	Limited	Limited
Access to public tenders	Improved	Yes	Yes

When it comes to public support, the association clearly dominates the other two legal frameworks for social entrepreneurship. Its visibility to policy makers make the association almost the only legal form eligible for recognition in most social entrepreneurial activities. The accredited co-operative and the social purpose company have a long way to go when it comes to recognition and visibility.

*. Adaptive capacity of legal design*

	Association	(Accredited) Co-operative	SPC
Ability to attract political attention	High	Very low	Very low
Support by umbrella organisations	High	Limited, dispersed	No
	High impact	Low impact	No umbrella organisation
Support by social movements and organisations	High, as social movements and organisations traditionally prefer the association for their own social enterprises.	Limited	Limited

Similar to previous observations concerning the maturity of legal frameworks, the association receives a considerable amount of political attention compared to its counterparts. This political attention, but also its support by strong umbrella organisations, social movements and organisations, should enhance the adaptive capacity of legal design. However, political economy considerations may create the opposite effect. Modifying the legal framework of an association

affects many organisations and quite some employment, and may become the subject of other political considerations as it may affect the popularity of a politician and its back-up by civil society organisations, which is still important in a pillarized society such as Belgium. Accredited co-operatives and social purpose companies receive hardly any support, nor by politicians, nor by civil society or third sector umbrella organisations, quite probably for the same reasons. In any case, this does not enhance the adaptive capacity of its legal design.

## 4. The joys and burdens of coexisting legal frameworks

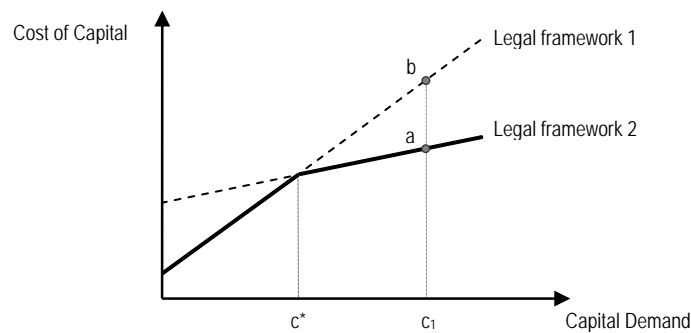
In this section, we look into another aspect of having a multiplicity of legal frameworks for social entrepreneurship. While previous sections dealt with this multiplicity as the availability of several legal frameworks, each having its comparative advantages, we now want to focus specifically on the consequences of the coexistence of these legal frameworks. We do this by looking at the benefits and the costs, or stated otherwise the joys and the burdens, of this coexistence.

### 4.1 Joys

As could be learned from section 2, and as illustrated in section 3.4, each legal framework has its comparative advantages and mostly, no single framework strictly dominates another one for all types of enterprises<sup>91</sup>. For a given enterprise, however, it should be possible to choose a legal framework that maximizes its legal needs. Given the multidimensionality of comparative advantages of legal frameworks, and given the heterogeneity of enterprises in every economy, a larger choice set of legal frameworks, *ceteris paribus*, dominates a smaller choice set in terms of efficiency, at least if intrinsic design, attractive capacity and maturity are sufficient. This is because the probability of finding a legal framework that suits your enterprise best (weakly) increases with the introduction of a new legal framework.

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<sup>91</sup> Whenever strict dominance applies, i.e. when one legal framework is more interesting for all types of firms than another legal framework, we should not expect to see this inferior framework to be applied by any firm. In that case, the only cost society has to bear is the cost of developing this framework in terms of paper, ink, time consumed on the political agenda, costs by the administration including subcontracting to lawyers and specialists in legal design, etc. At first sight, recent legal innovations for social entrepreneurship in Italy and Finland, but also the European Co-operative Society (SCE), seem to be examples of this, as hardly anyone adopts these frameworks. However, as explained in section 2.2, switch costs and dynamic economies of scale may apply. In that case, inferior legal frameworks may persist. We will address this issue when discussing the burdens of coexistent legal frameworks.



**Figure 3** Benefits of coexisting legal frameworks

In figure 3, we provide an example of the benefits that may rise from having an expanded choice set of legal frameworks. For didactical purposes, we take the cost of capital as a function of capital demand as an example, but the same logic may apply to other variables as well. The y-axis represents the cost of capital, which can be reasonably expected to increase as capital demand, represented by the x-axis, increases. Suppose now the choice set of legal frameworks expands from having one framework (legal framework 1) to having two frameworks (legal frameworks 1 and 2). Furthermore, we suppose that legal framework 2 is not as efficient in attracting capital when capital demand is low, but starts to dominate legal framework 1 if capital demand exceeds a given amount  $c^*$  of capital demand. If all enterprises have a capital demand lower than  $c^*$ , the introduction of legal framework 2 harms nobody, but does not offer any advantage to any enterprise either. This is because legal framework 1 seems to be the cheapest framework to apply in case of low capital demand. However, as soon as some enterprises exist with a capital demand that exceeds  $c^*$ , legal framework 2 starts to dominate legal framework 1 for these enterprises. In that case, there are clear efficiency gains from the introduction of this second legal framework. We may illustrate the latter case by looking at a capital demand  $c_1 > c^*$ . The gain for this enterprise of the availability of legal framework 2 subsequently amounts to  $(b - a) > 0$ . In sum, the potential gains from introducing legal framework 2 amount to the surface between the dotted cost curves and the bold cost curves.

Enterprises do not even have to switch their current legal form to another, as it might be possible to establish a new legal entity that adapts this new legal framework. By combining several legal frameworks, entrepreneurs may combine comparative advantages of coexistent legal frameworks as well. This way, social entrepreneurs may further internalize potential

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efficiency gains. Tax treatment and eligibility for subsidies offer in many cases strong incentives to opt for such a coexistence of legal forms within one enterprise structure<sup>92</sup>.

## 4.2 Burdens

In the analysis of section 4.1, we assumed that there were no problems concerning intrinsic design, attractive capacity or maturity. However, if one of these conditions is not fulfilled, burdens of coexistence of legal frameworks arise as well. We discuss the consequences of dynamic economies of scale, switch costs and immaturity of legal design and explain it as a burden in case of coexistence of multiple legal frameworks<sup>93</sup>. We also assess the burdens of combining multiple legal frameworks within one enterprise structure.

Therefore, the efficiency of such a coexistence depends on the balance of its costs and benefits. Notice that this balance may be positive for individual enterprises, while it may be suboptimal from a society point of view. In game theory, this kind of strategic interaction could be identified as a coordination game, where agents are trapped in a suboptimal Nash equilibrium in mixed strategies. This equilibrium is dominated by a Nash equilibrium in pure strategies, but it requires public intervention to achieve this.

### *. Dynamic economies of scale*

While we explained dynamic economies of scale earlier in the setting of creating attractive capacity for new legal frameworks, we now consider dynamic economies of scale in a setting of coexisting legal frameworks. Existence of such dynamic economies of scale is linked to the same reality, as the availability and the quality of information, consultants, accountants, lawyers, etc. on a given legal framework increase (and the cost of it decreases) with the cumulative number of enterprises that applied this framework. The underlying analysis, however, is slightly different from what we've seen before.

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92 This is also one of the conclusions of focus group research on this issue, as documented in Dujardin, Mertens & Van Opstal (2008) and Van Opstal & Gijssels (2008).

93 Notice the difference of our approach here with the analysis of these issues in section 2. In section 2, we focused on challenges when introducing a new legal framework and conditions to have a switch made to this new framework. Here, we consider problems that arise with the coexistence of multiple legal frameworks and depart from a reality in which enterprises already adopted a variety of legal frameworks.

Figure 4 depicts these dynamic economies of scale, where the average cost of utilization of a legal framework, depicted on the y-axis, decreases less than proportionally with the cumulative number of enterprises that applied it, as depicted on the x-axis. Again, we assume that there are two legal frameworks. Unlike figure 2 from section 2, however, we assume that the average cost function of both legal frameworks is identical. This allows us to focus on the issue we want to consider. We start with an equilibrium at point 1, where  $n_1$  social enterprises apply equilibrium 1 and  $n_2$  social enterprises apply equilibrium 2. Again, we suppose that  $n_1 = n_2$  to isolate the issue we would like to analyse. In this case, both types of enterprises are confronted with an average cost of utilization of  $c_1$ .

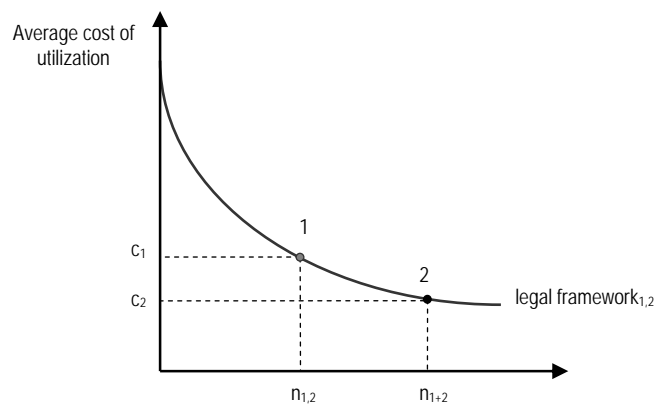


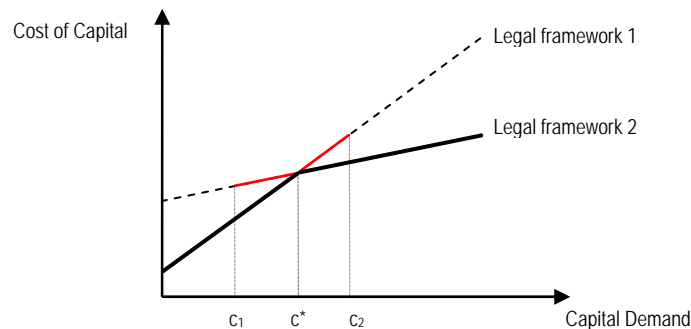
Figure 4 Dynamic economies of scale as a burden for coexisting legal frameworks

Suppose now that both types of enterprises would have applied the same legal framework. In that case, the average cost of utilization of that framework would have been lower. This situation is depicted in equilibrium 2, where the average cost of having  $n_1 + n_2$  enterprises adopting the same legal framework amounts to  $c_2 < c_1$ . An example that illustrates this lower cost is the fact that all parties involved only have to spend time and money to learn one legal framework instead of having to learn two legal frameworks. Notice that, even in the case not a single firm ever used the legal frameworks available, welfare losses apply in terms of sunk costs that have been made by legislators, policy makers, administrations, etc. to create these frameworks.

#### . *Switch costs*

Remark that in figure 4, not a single enterprise has an incentive to stay in equilibrium 1, so as it would be efficient, both for each individual firm as for society as a whole, to leave this position

and move toward equilibrium 2. In reality, however, switch costs apply, causing hysteresis and consequently the persistence of this suboptimal Nash equilibrium in mixed strategies<sup>94</sup>. Switch costs are therefore a second issue to be included in a cost-benefit analysis of coexisting legal frameworks. In figure 5, we reconsider the joys of coexisting legal frameworks when switch costs apply.



**Figure 5** Benefits of coexistent legal frameworks in case of switch costs

Without switch costs,  $c^*$  would be the critical value of capital demand that lets firms switch from one legal framework to another. In the case switch costs exist, nothing changes for new initiatives, because they do not have to bear any switch costs. For existing enterprises, however, path dependence applies. Suppose an enterprise works within legal framework 1. In that case, switch costs will augment the critical value of capital demand from  $c^*$  to, say,  $c_2$ . Alternatively, switch costs lower this critical value for enterprises applying legal framework 2 to, for instance,  $c_1$ . Switch costs thus create a range  $(c_1, c_2)$  where potential welfare gains of coexisting legal frameworks cannot be internalized, because within this range firms may end up in a suboptimal legal framework<sup>95</sup>. The larger switch costs are, the wider this range  $(c_1, c_2)$  and the larger the size of foregone welfare gains.

### *. Immaturity of legal design*

Another potential problem comes from the fact that a larger choice set of legal frameworks diverts the attention of policy makers, legislators and administrations. As it is hardly impossible for all parties involved to know all relevant details of every legal framework, a larger choice set

<sup>94</sup> Strictly speaking, we can only speak of an equilibrium situation here when switch costs apply. Otherwise, point 1 cannot be considered as an equilibrium.

<sup>95</sup> In figure 4, the existence of switch costs would create an interval around point  $n_{1,2}$  within which no single enterprise has an incentive to switch its legal form, rendering equilibrium one persistent. The larger these switch costs are, the larger this interval.

will, *ceteris paribus*, increase the incidence of legal uncomplementarities and inconsistent administrative regulations. Especially legal frameworks that represent a relatively low number of enterprises will run the risk of becoming blind spots in logistic work.

Moreover, the pursuit of legal complementarity by legislators, policy makers and administrations is time consuming and diverts attention from other policy issues that may be more worthwhile to look at. This also has to be taken into account in a cost-benefit analysis of coexisting legal frameworks.

#### *. Suboptimal combinations*

Finally, we want to address the use of multiple frameworks within enterprise structures, where social entrepreneurs try to combine the best parts of both worlds. While this seems an interesting approach to deal with coexisting legal frameworks, and from the perspective of an individual enterprise it is often optimal to act this way, it is essentially a suboptimal situation. Firstly, such combinations are only a second-best alternative for enterprises, as they have to bear the costs of managing multiple legal frameworks. Secondly, such combinations may be suboptimal from a policy point of view as well, as it might have been a policy purpose to explicitly exclude some legal forms for being eligible for state-support. The creation of multiple entities that circumvent these policy purposes may lead to an improper use of legal frameworks, which would be questionable both in terms of efficiency as in terms of ethical considerations.

## 5. Conclusions

Throughout the last decades, many European countries developed new legal frameworks to support and promote social entrepreneurship. There are, however, considerable differences between European countries to the degree upon which social enterprises have embraced these new frameworks.

In this paper, we considered the multiplicity of legal frameworks for social entrepreneurship that resulted from these legal innovations. We developed a theoretical framework to analyse the differential success in the application of these frameworks. Next, we applied this framework to the Belgian case, where three legal frameworks for social entrepreneurship, namely the association, the (accredited) co-operative and the social purpose company, coexist. Clearly, the association is still the first choice amongst social entrepreneurs, while both the co-operative and

the social purpose company are largely left aside. We applied our theoretical framework to qualify comparative advantages of each of these legal frameworks, which gave us the opportunity to refine and deepen popular insights on this issue. We also looked at this multiplicity in terms of the mere coexistence of different legal frameworks. As this coexistence brings us some joys as well as burdens, we also contributed some theoretical insights on this issue that may be helpful to explain both the Belgian case as well as cases in other countries or other contexts.

Legal frameworks have to take into account characteristic features linked to the type of enterprises they are developed for. For social enterprises, this boils down to an intrinsic design that takes into account incentives for the pursuit of social goals, tools to develop an economic activity, provisions on stakeholder management that make sense and safeguards for the autonomy of these enterprises. The association clearly has comparative advantages on three out of these four criteria, but does contain various sources of legal uncertainty when it comes to developing economic activities. There are no minimum capital requirements and it is not possible for an association to be declared bankrupt. The accredited co-operative, on the other hand, lacks sufficient conditions that safeguard the pursuit of its social goals. The social purpose company shows a lot of potential but its design on employee participation is quite cumbersome.

Besides optimizing its intrinsic design, legislators need to think about the attractive capacity of legal forms they create. Therefore, they should take into consideration the stance of an enterprise, that wants the benefits of implementing a legal innovation to outweigh the costs of doing so. The advantages of the accreditation system for co-operatives and the social purpose label are clearly too limited. Next to this, switch costs apply, both in terms of time and money. Moreover, the supply of know-how concerning these legal frameworks is very limited, as is the quality of publicly available information. Therefore, the introduction of new legal frameworks should be accompanied with measures to inform and educate lawyers, consultants, young entrepreneurs and legal officers. The importance of education in general, but more specifically in economics, law and business studies, is of the up most importance. Finally, switch costs could be reduced and dynamic economies of scale could be generated by supporting pioneering users of new frameworks both financially as in terms of legal support.

Last but not least, legislators and policy makers have to take care of the maturity of legal frameworks they develop. While some problems of legal complementarity and possible incoherencies in public support only become clear after some years, it is important that sufficient measures are built in to strengthen the adaptive capacity of legal frameworks in order

to be able to improve them. A brilliant example of legal uncomplementarity is the fact that associations cannot be considered as a merchant, preventing them to work according to the Commercial Code. An example of the incoherence of public support, on the other hand, is the fact that both the accreditation system for co-operatives and the social purpose companies are 'blind spots' among administrations and politicians. For both legal forms, the support of a strong autonomous umbrella organisation could lessen these problems, as such organisations would try to put their concerns on the political agenda. At this moment, however, current key players in the sector are not in favour of other forms than the association, as they fear that supporting these legal forms would open the door to commercialisation and privatisation. Therefore, as indicated by Münkner (2006), it is important that legal design is done in dialogue with the sector, to create a broad foundation and support for new legal frameworks.

In sum, it is clear that the situation in Belgium is suboptimal. Legal design of each legal framework discussed has its shortcomings in terms of intrinsic design, attractive capacity and maturity. Secondly the burdens of coexisting legal frameworks quite clearly dominate its joys. Therefore, possible solutions, such as the creation of a new but unique legal form, the modification of existing frameworks or a further restriction of the set of legal frameworks that are eligible to perform certain activities, have been discussed.

A 'law and economics' analysis of legal frameworks for social enterprises does not seem the most straightforward topic to deal with. Therefore, many questions are still left unanswered. First of all, it would be interesting to apply our theoretical framework to legal frameworks in other countries and other contexts and to evaluate the generic applicability of this theoretical framework. Another interesting approach would be to adapt our framework to evaluate different legal frameworks of different countries in a comparative setting. While the theoretical contributions made in this paper need further formal refinement, the greater merit will lie in the translation of these insights into specific policy recommendations. The greatest challenge, however, will be to convince politicians and legislators of the importance of an optimal and comprehensive legal design if they want social enterprises to prosper.

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