

## The Applicability of the Social Enterprise in a Small State: The Case of Malta\*\*

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### ABSTRACT

The main objective of this study is to assess the social, financial and corporate governance (CG) implications of the proposed social enterprise (SE) legislation in Malta. In light of such implications, the study also assesses the applicability of the SE under such legislation. A mixed methodology was adopted. Fifteen interviews were held with experts. Such data was supplemented by 52 valid responses to a questionnaire sent both to co-operatives and voluntary organisations (VOs) in Malta. The study concludes that the proposed legislation has various positive social, financial and CG implications and that the SE, as being proposed, is applicable and filling a void within the Maltese environment. Although such legislation offers both a new legal form and a label, its reference to the Companies Act which ignores SEs' unique social dimension is questionable. Alternatively, a holistic SE regulatory framework may be developed. Furthermore, statutory thresholds, such as for dividend distribution and trade income, are to be possibly rendered more flexible. This study aspires to raise awareness about the implications of a proposed regulatory framework in Malta, hence hopefully promoting the application of the concept.

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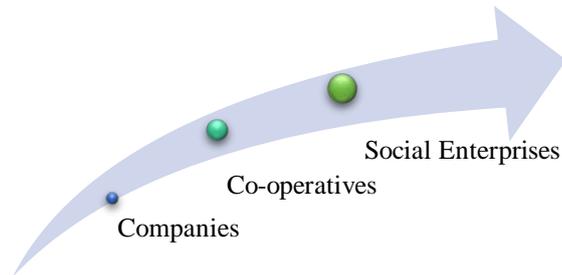
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## 1. INTRODUCTION

Increased attention is being devoted to social practices in the business landscape (Harding, 2004). Corporate social responsibility practices are being undertaken by limited liability companies (LLCs) (Popescu, 2011) which by nature, seek to maximise shareholder value (Pike and Neale, 2009). Furthermore, the co-operative fosters co-operative and ethical values whilst operating commercially (Burlò, 2013). The voluntary organisation (VO) may also nurture a social purpose. However, VOs may be established for any 'lawful purpose', such purpose not necessarily being a social one if the organisation has a public interest in terms of Art.2(1) of the Maltese Voluntary Organisations Act (Government of Malta, 2007). The social enterprise (SE) takes the notion of social responsibility a step further by nurturing a social goal as a fundamental principle (Pearce, 2003; Ridley-Duff and Southcombe, 2012). SEs are thus seen to be economic vehicles for resolving societal problems (Nicholls, 2006; Thompson, 2008; Westall and Chalkley, 2007). In this regard, as shown in Figure 1, one may see a transition from companies

to co-operatives to SEs, such that social goals become more important as one progresses, even though financial goals continue to play an important role.



**Figure 1:** From Company to SE

Presently, there is no universal definition of ‘SE’ (Blount and Nunley, 2015; Lyon and Supelveda, 2009; Young and Lecy, 2014). The European Commission has operationalised a working definition incorporating three aspects, namely, the financial, social and corporate governance (CG) dimensions (Defourny, 2001; Galera and Borzaga, 2009). ‘SE’ has become a term overarching those organisations seeking to trade for a primary social aim (Peattie and Morley, 2008a; Ridley-Duff and Bull, 2011). Although profits are desirable, the focus is on enhancing the ‘common good’ (Ridley-Duff, 2007). Furthermore, SEs may assume different legal statuses and legal forms (Kerlin, 2006; Teasdale, 2011; European Commission, 2014).

The Government of Malta, through the Ministry for the Economy, Investment and Small Business (MEIB), proposed the enactment of a Social Enterprise Act (SEA) in June 2015. This study should thus prove useful in ascertaining the potential of the SE concept in Malta. The study will seek to assess the social, financial and CG implications in Malta of the proposed regulatory framework relating to the SE, whilst also assessing the applicability of this type of enterprise under the proposed legislation within the Maltese business and social environment.

The rest of this paper is divided into five sections, the first of which provides a summary of relevant literature on the three SE dimensions and the SE concept in Malta. The second section outlines the research methodology adopted, while the ensuing sections present an analysis and discussion of the findings respectively. The last section summarises the findings, whilst presenting the limitations of the study, a number of recommendations and areas for future research.

## **2. LITERATURE REVIEW**

### **2.1 The Social Dimension**

SEs, which primarily seek to attain social and environmental objectives (Hopkins, 2012; Perez di Mendiguren Castresana, 2013), typically emerge on initiative of community members (Defourny and Nyssens, 2012; Estrin, Mickiewicz and Stephan, 2013) and lead to social cohesion through their participatory nature (European Commission, 2013; OECD, 2007). To enhance their not-for-profit principle (MEIB, 2015b), certain European legal frameworks do not permit (e.g. in Spanish social initiative co-operatives) or otherwise limit (e.g. in British Community Interest Companies) the distribution of profit to shareholders (Defourny and Nyssens, 2012). This restriction partially signifies that the real objectives of SEs are social, whilst preventing other organisations from labelling themselves SEs simply to gain unwarranted advantages (Bacchiega and Borzaga, 2001).

### **2.2 The Financial Dimension**

Trading is the means by which social objectives can be sustained (Meadows and Pike, 2010; Moizer and Tracey, 2010; Wilson and Post, 2013). A significant degree of financial risk, emerging from trading and the risk of initiative, is tantamount to SEs (Defourny and Nyssens, 2010b). The lack of funding arrangements may present SEs with a challenge (Peattie and Morley, 2008b). Thus, new finance sources have been created through social investment (Doherty, Haugh and Lyon, 2014), including those provided through social banks, crowd funders with a social platform and microfinance institutions (Périlleux, 2015). SEs may also raise finance through debt or loans, the issue of social impact bonds, public sector funds and the issue of preference shares (Searing, 2013). Preference shares offer additional flexibility since they can be offered as convertible, redeemable and cumulative (Pike and Neale, 2009). Moreover, the state can also provide grants and fiscal incentives to SEs (Fisac and Moreno-Romero, 2015).

### **2.3 The Corporate Governance Dimension**

Being characterised by a financial dimension, SEs must give due regard to CG (Mason, Kirkbride and Bryde, 2007; Mswaka and Aluko, 2015; Spear, Cornforth and Aiken, 2009). In Malta, a model Code of Principles of Good CG (hereafter referred to as the 'Code') is applicable only to listed and licensed companies (MFSA, 2011). Democratic participation is an essential

SE characteristic (Galera and Borzaga, 2009) and can be achieved through the involvement of multiple stakeholders (Travaglini, Bandini and Mancicone, 2009). SEs having a participatory nature are usually more effective (Imperatori and Cataldo Ruta, 2015). However, involving different stakeholders at the highest level of an organisation is a bone of contention (Pearce, 2003; Travaglini et al., 2009). SEs must also exhibit a high degree of autonomy by being free to take their own decisions and to terminate their activity (Defourny and Nyssens, 2010a). Nevertheless, the state could amend public policies to increase stability within the sector (Park and Wilding, 2014; Young and Kim, 2015). SEs could also create new networks and partnerships with the intention of marshalling new resources to exploit new opportunities (Verreynne, Miles and Harris, 2013). By reporting their social impact, SEs are held accountable to achieving their stated social purposes (Bagnoli and Megali, 2009; Kay, 2015). A social audit may be a useful tool in this regard (Spreckley, 1997).

## **1.1. The Social Enterprise in Malta**

### *2.4.1 Current Scene*

The SE concept is somewhat currently employed in Malta through different organisational forms, each regulated by separate legislation (DF Advocates and APS Consult Limited (DFA&APSCL), 2012). However, some of these organisations operate with certain features opposing the ideal SE characteristics espoused by the European Parliament Decision A6-0015/2009 (ibid., 2012). Maltese law permits the formation of SEs through five different legal structures, namely, partnerships, associations and foundations (by virtue of the Civil Code), together with trusts and co-operatives established in terms of the Trusts and Trustees Act and the Co-operative Societies Act, respectively (DFA&APSCL, 2011; Vassallo and Mifsud, 2012). In Malta, band and sports clubs are mainly registered as associations in terms of the Civil Code, or as VOs. VOs are either registered as such in terms of the Voluntary Organisations Act (Government of Malta, 2007), or as associations or foundations as per the Civil Code (Government of Malta, 1868). By reference to Art.38(1) of the Voluntary Organisations Act (Government of Malta, 2007), VOs are not permitted to trade. However, Art.38(2) permits VOs to set up “an appropriate legal entity” to trade with the view of raising money to realise their goals if the trade falls outside their stated purposes [by reference to Art.38(4)] (ibid., 2007). Art.38(4) further states that if VOs engage in certain activities necessary for achieving their purposes, these shall not be considered to constitute trading activities (ibid., 2007).

### *2.4.2 Strengthening the Legal Framework in Malta*

Following on the Belgian and UK models of SE, it has been suggested to introduce a novel legal structure for SEs in Malta (DFA&APSCL, 2012). Thus, the MEIB (2015b) has issued a White Paper including a draft law entitled ‘Social Enterprise Act’ (hereafter referred to as ‘Draft Bill’). The proposal espouses the company as the most desirable form for SEs through the social enterprise company (SEC), this providing flexibility, good CG and distinct legal personality, whilst enhancing the pursuit of socio-commercial goals (DFA&APSCL, 2012; MEIB, 2015b). However, Burlò (2013 p.70) comments that the: “co-operative model beats the LLC model hands down in balancing the social and commercial aspects of business”, despite the LLC model being more beneficial from a regulatory, CG and cultural perspective (Burlò and Baldacchino, 2014). In terms of Art.7(1) (MEIB, 2015a), the Draft Bill permits social purpose organisations currently operating under a different legal form than the LLC to obtain the SE ‘label’ of ‘social enterprise organisation’ (‘SEO’), rather than alter their legal form altogether. Art.7(5) (ibid., 2015a) further specifies that in these cases, the legislative instrument pertinent to the legal form of the organisation would apply, subject to alterations necessary in the context. Art.3(1) of the proposed SEA (MEIB, 2015a) defines the SEC as being established for the carrying on of a commercial activity to fulfil a primary social objective (as defined in Art.2) in terms of Art.3(1)(a), or to integrate disadvantaged groups back into the labour force as per Art.3(1)(b) (ibid., 2015a). Hereafter, SEs set up in terms of Art.3(1)(b) (ibid., 2015a) shall be referred to as work integration SEs (WISEs). Such enterprises promote social inclusion by integrating unemployed or disadvantaged individuals back into the labour market and society through productive activity (Marthe and Nyssens, 2012; Nyssens, 2006; Vidal, 2005). Art.4(1) (ibid., 2015a) adds on that in the case of the former type, acts of trade are driven by social purposes and at least 70 percent of revenue emanates therefrom; or that at least 30 percent of those employed are disadvantaged or disabled (DD) persons when the focus is on the integration of such groups.

Art.3(2) of the Draft Bill on SEs (MEIB, 2015a), in agreement with the European Parliament (2009), determines that SECs must not be state-owned, and that VOs, pious foundations and ecclesiastical entities are not eligible for registration. Nevertheless, such organisations may hold shares in SECs.

Certain financial provisions are introduced in Art.5 of the proposed Act (ibid., 2015a). Primarily, these aim to ensure that profit distribution is limited to 10 percent. SECs will be able to raise finance in a similar manner to LLCs, namely through shares and loans. Furthermore, by reference to Art.7(5), once an organisation successfully registers as an SEO, all provisions

relating to SECs would apply to it “mutatis mutandis” (ibid., 2015a). Additionally, as per Art.25 (MEIB, 2015a), SEs must file an annual return, including a copy of the year-end accounts and annual report with the regulator (ibid., 2015a). SEs are not required to conduct social audits. Nonetheless, SECs must adhere to “all the requirements of the Companies Act in relation to annual returns, accounts and audits” by reference to Art.25(5). Furthermore, a Social Objectives Report outlining how and to what extent the social purposes have been achieved must be attached to the annual return filed with the regulator, in terms of Art.25(2)(e) (ibid., 2015a).

#### *2.4.3 Public Comments to the Draft Bill*

The proposal has been welcomed by the public as “it seeks to fill a legislative void” (Greenpak, 2015 p.3). A clearly emerging issue is that incentives should be established at the outset (Greenpak, 2015; Malta MicroFinance (MMF), 2015; Ministry for the Family and Social Solidarity (MFSS), 2015). The incentives recommended include: start up grants, loan guarantees, equity schemes, reduced tax rates and rebates on annual fees (ibid., 2015). Further proposals comprise the setting up of a social investment bank (MFSS, 2015) and providing incentives duly considering DD workers’ needs (Directorate General (Social Policy), 2015). Another emerging notion is that the Draft Bill grants wide discretion to the Minister, this hindering legal certainty (Greenpak, 2015; MMF, 2015; MFSS, 2015).

Moreover, the terms ‘SEC’ and ‘SEO’ are not deemed to be clearly defined (MFSS, 2015) and the Draft Bill “discriminates against all legal forms other than LLCs” (Malta Co-operative Federation (MCF), 2015 p.6). Being more democratic than the LLC form, the co-operative model is deemed to lend best as a “preferred” legal form for SE, if one had “to be considered at all” (MCF, 2015 p.9). Comments to the Draft Bill also make reference to definitions and drafting. For instance, the term ‘migrant worker’ in Art.2 may need to be more clearly defined (Pace, 2015 p.1). ‘Migrants entitled to work’ has been suggested as a more suitable term instead (MMF, 2015; MFSS, 2015). Furthermore, the term ‘disabled persons’ could be replaced by the term “persons with a disability” (Directorate General (Social Policy), 2015 p.1). Moreover, requiring 70 percent of income to be derived from trade does not generally reflect the reality of the social sector (MMF, 2015; MFSS, 2015). Contrastingly, a higher quota of DD persons has been recommended in cases where SEs are established as WISEs (Directorate General (Social Policy), 2015).

### **3. RESEARCH METHODOLOGY**

## **1.2. Research Instruments**

A mixed-methods research methodology was adopted, exploiting the advantages of both qualitative and quantitative research methods (Johnson and Onwuegbuzie, 2004; Plano Clark and Creswell, 2008). A simultaneous QUAL + QUAN triangulation approach (Tashakkori and Teddlie, 2010) was used. Certain questions in the research instruments required only comments. However, the majority constituted close-ended statements to which respondents expressed their opinion using a five-point Likert scale (where 1 corresponded to Strongly Disagree and 5 to Strongly Agree). Interviewees substantiated their views through comments. The interview schedule contained 37 questions and statements. The questionnaire contained an additional three questions, two asking for comments and one relating to demographics. An interview schedule was designed, incorporating questions categorised into five sections. An almost identical questionnaire was also designed. The first section of the research instruments set the context and established reasons for SE legislation. The second section delved into the social dimension, whilst the second and third sections focused on the SE financial and CG dimensions respectively. The final section sought to collate overall comments and demographic data on respondents, the latter in the case of the questionnaire.

## **1.3. Sample Selection, Response Rates and Data Analysis**

Initial contact was made with sociologists and lawyers (included in the University of Malta staff directory), as well as with politicians involved in the economic and social fields, encouraging their participation in an interview. Certain interviewees suggested names of other experts, including consultants, accountants and chief executive officers who were keen on the subject and thus, they were subsequently contacted. Fifteen semi-structured interviews were carried out. An online questionnaire was also sent to representatives from co-operatives, as well as Maltese-registered VOs. E-mail addresses of co-operatives were publicly available through the website of the Malta Co-operatives Board, while those of VOs in Malta were provided by the Office of the Commissioner for VOs. Representatives from both types of entities were treated as a homogenous group (namely, entity representatives), to enable a comparison of their views with those of experts.

From a total population of 1,187 organisations of whom 1,060 had valid e-mail addresses, 52 valid replies were received by the cut-off date, being five weeks after transmission of the questionnaire. This resulted in a response rate of 4.91%. Responses were received as follows: 41 responses (78 percent) from VOs, four (eight percent) from co-operatives, four (eight

percent) from sports clubs, two (four percent) from band clubs, while the last response originated from a different organisation type to the former-mentioned ones. The Mann-Whitney test and the Friedman test were the statistical tests carried out on ordinal questions using the Statistical Package for Social Scientists (SPSS).

## 4. FINDINGS

### 4.1 Setting the Context

The annotations ‘E’ and ‘R’ will be used throughout the analysis of the findings to represent experts and entity representatives, respectively. Furthermore, tables present the mean rating scores and standard deviations of the two respondent groups in relation to the respective questions in descending order. They also provide the Mann-Whitney test results for significant differences between the responses of experts and entity representatives. Results of the Friedman test for significant differences between related statements are also listed beneath each table or each question’s results.

Most respondents (E13/15; R29/33) were in favour of introducing SE-specific legislation in view of an existing legislative “*lacuna*”. Effectively, as stated by one expert, “*VOs are at one end of the pole, whilst LLCs are at the other*”, with SEs actually falling “*somewhere in between*”.

The main emerging arguments regarding the definition of ‘SEC’ as presented in the proposed SEA pertained to the SE’s legal form. Most respondents (E9/15; R5/7) were critical as the definition seemed to set the LLC as the predominant SE legal form (E4/9), with some (3/4) preferring the adoption of the co-operative form. Others (E5/9; R5/7) were critical because in a number of other EU countries, the SE was only a “*label*”. This latter argument was in line with a number of public comments to the Draft Bill. Contrastingly, a number of respondents (E6/15; R2/7) stated that making the LLC the main form of SE was beneficial, the LLC model being “*more acceptable for obtaining finance*”.

Furthermore, most experts (E9/15; R10/33) agreed with Art.3(2) and Art.7(1) of the Draft Bill; the first specifically excluding VOs, these being “*not commercially sustainable*” and therefore, different than SEs. However, those in disagreement (E6/15; R23/33) emphasised that amendments are required to render it possible to be simultaneously an SE and a VO. This would avoid VOs carrying out acts of trade considered to be outside their purposes experiencing inconvenience or even forfeiting important benefits under the new Act.

### 4.2 Reasons for SE Legislation

Table 1 presents results relating to reasons put forward for SE legislation.

**Table 1:** Reasons for SE Legislation

State your level of agreement to the following statements giving reasons for specific SE legislation:	Respondents	Mean	Std. Dev.	p-value
Such regulation entails that their specific social purpose is clear upon their setting up	Experts n=15	4.60	0.910	0.038
	Entity Reps n=52	4.27	0.795	
SEs place priority to serving the community interest	Experts n=15	4.33	1.291	0.125
	Entity Reps n=52	4.19	0.908	
SEs may render unique opportunities of autonomy, participation and risk-taking in a democratic setting to the weaker sectors of society	Experts n=15	4.33	0.976	0.027
	Entity Reps n=52	3.77	0.962	
The profit-making objective of SEs is secondary to their social objectives	Experts n=15	4.20	1.207	0.092
	Entity Reps n=52	3.71	1.194	
SEs place due importance to the economic dimension by trading, in order to ensure sustainability, whilst providing returns to the providers of capital	Experts n=15	4.33	0.976	0.014
	Entity Reps n=52	3.75	0.905	
Unlike most other structures, SEs are required to reserve funds for social purposes	Experts n=15	3.47	1.598	0.720
	Entity Reps n=52	3.73	1.031	

$X^2(5) = 21.87, p=0.001$

Results indicated significant differences ( $p=0.001$ ) by all respondents to the six different statements. The two respondent groups were convinced that SE regulation entails clarity of the specific social purpose upon setting up, with a notable statistical difference arising in results. However, two experts cautioned that this did not imply that such purpose could not be subject to change in the future. Respondents also agreed that SEs placed priority to serving the community interest, whilst taking into account the commercial one. Furthermore, respondents believed that SEs rendered various unique opportunities to the weaker sectors of society, with a statistical difference arising in results. Yet, two experts remarked that such opportunities would probably be lower in the case of an SEC than in that of an SEO because an SEC would also be subject to the Maltese Companies Act (CA), which made no particular reference to participation.

Respondents perceived SEs to place importance to the financial dimension by trading, this therefore both ensuring sustainability and providing returns on capital, with experts again agreeing significantly more. SEs were not identical to any other specific legal structure. However, it was noted by one expert that such emphasis on the financial dimension should not necessarily be uniform for all SEs, as implied by Art.7(5)(6) of the proposed SEA. Moreover, respondents agreed that the profit-making objective should be secondary to SEs’ social objective(s). Experts were neutral verging upon agreement, while entity representatives marginally agreed that unlike most other legal structures, SEs were required to reserve funds for social purposes. Some experts (3/15) noted that while retaining funds for social purposes might

be “*noble*”, a statutorily required high level of retention could endanger financial sustainability, leading to capital attrition.

A number of respondents (E11/15; R5/52) gave additional justifications for SE legislation in Malta. Some experts (E5/11) re-emphasised that specific SE legislation could promote more initiatives in this sector, resulting in economic gain and benefits to particular sectors of the community. Moreover, such legislation could enhance societal benefits, including those resulting from sports and the environment (E3/11; R3/5). Others (E3/11; R2/5) believed that self-support among the disadvantaged sectors of society could be incentivised, rendering such groups participants in the economy.

### 4.3 The Social Dimension

Table 2 presents results regarding statements on the social dimension of SEs.

Results indicated significant differences ( $p=0.023$ ) by all respondents to two socially-related statements concerning Art.5(2), this setting the ceiling of 10 percent for distribution of profit. Respondents agreed that such ceiling ensured that most profits generated would be used for social purposes, whilst also ensuring stability of employment for employees, particularly DD workers. However, some experts (4/15) added that this also depended on other factors, particularly management competence.

Results indicated significant differences ( $p=approx.0$ ) by all respondents to four statements about SEs’ social dimension. Both experts and entity representatives were convinced that SEs contributed social cohesion, with experts agreeing significantly more. However, one expert commented that this could be “*merely idealistic*”. Surprisingly, both sets of respondents held that the financial and CG dimensions needed to be given equal importance to the social one. This response contrasted that given to an earlier statement, wherein the social purpose was stated to dominate the profit-making objective. Only two experts maintained that the social dimension was “*key*”. Furthermore, respondents agreed that SEs helped to reduce social costs, with experts being significantly more in agreement. Two experts cautioned that nevertheless, the reduction of social costs should not be an SE’s primary aim. Both respondent groups were neutral about the statement that the total exclusion of public ownership from SEs may hamper the creation of important SEs, which the private sector could be unable or unwilling to set up. Those against the statement (9/15) emphasised that if some SEs had to be publicly owned, they would lose their autonomy, this supporting the emphasis placed on autonomy in the literature (e.g. Defourny and Nyssens, 2010a).

**Table 2: The Social Dimension**

<b>The Draft Bill sets a ceiling of 10 per cent for distribution of profit. To what extent do you agree that this ensures:</b>	<b>Respondents</b>	<b>Mean</b>	<b>Std. Dev.</b>	<b>p-value</b>
That most of the profits generated are used for social purposes?	Experts n=15	4.00	1.464	0.233
	Entity Reps n=52	3.96	0.969	
Stability of employment for employees, particularly disadvantaged or disabled workers?	Experts n=15	4.00	1.254	0.110
	Entity Reps n=52	3.73	0.795	
$X^2(1) = 5.14, p=0.023$				
<b>State your level of agreement to the following statements relating to the social dimension of SEs:</b>				
SEs contribute to social cohesion, enabling members of society to come together to a well-needed aim	Experts n=15	4.47	1.060	0.036
	Entity Reps n=52	4.23	0.614	
For the social objectives to be fulfilled, the other dimensions (i.e. the financial and corporate governance dimensions) need to be given equal importance	Experts n=15	4.33	0.900	0.430
	Entity Reps n=52	4.23	0.731	
Through the attainment of their social objectives, SEs help reduce social costs	Experts n=15	4.33	1.234	0.024
	Entity Reps n=52	4.06	0.669	
The total exclusion of public ownership from SEs may hamper the creation of important SEs, which the private sector may be unable or unwilling to set up	Experts n=15	2.60	1.595	0.051
	Entity Reps n=52	3.40	0.955	

 $X^2(3) = 43.68, p<0.001$ 

#### 4.4 The Financial Dimension

Table 3 presents results regarding statements on the financial dimension of SEs.

Respondents expressed their level of agreement regarding three finance-related statements relating to the profit distribution limitation. Results indicated significant differences ( $p \approx 0$ ) by all respondents to the three different statements. Both experts and entity representatives agreed that such ceiling helped towards ensuring SE economic viability, with experts agreeing significantly more. However, some experts (4/14) stated that it was significantly probable that at 10 percent, the ceiling was too low and could need to be increased in the future.

**Table 3: The Financial Dimension**

<b>To what extent do you agree that the ceiling of 10 per cent for distribution of profit:</b>	<b>Respondents</b>	<b>Mean</b>	<b>Std. Dev.</b>	<b>p-value</b>
Ensures the economic viability of SEs through the high level of ploughed back profits?	Experts n=15	4.13	1.246	0.028
	Entity Reps n=52	3.63	0.929	
Discourages providers of capital from contributing towards the setting up or expansion of SEs?	Experts n=15	2.87	1.457	0.446
	Entity Reps n=52	3.12	1.022	
Renders the economic dimension subservient to the social one, thereby rendering the entities economically risky?	Experts n=15	2.00	1.254	0.001
	Entity Reps n=52	3.00	0.886	
$X^2(2) = 21.76, p<0.001$				
<b>In relation to the Draft Bill, state your level of agreement to the following statements:</b>				
Generating at least 70 per cent of total income from trade ensures the economic viability of SEs	Experts n=15	4.27	0.961	0.016
	Entity Reps n=52	3.87	0.561	
<b>In the case of WISEs, requiring 30 per cent of employees to be disadvantaged or disabled members of society:</b>				
	Experts n=15	3.67	1.291	0.253

Is a balanced percentage, rendering disadvantaged or disabled members of society more employable	Entity Reps n=52	3.40	0.823	
Is too high as it may render SEs unproductive	Experts n=15	2.47	1.187	0.156
	Entity Reps n=52	2.98	1.146	
$X^2(1) = 7.14, p=0.008$				
<b>Current provisions need to supplemented by assistance through the inclusion of:</b>	<b>Respondents</b>	<b>Mean</b>	<b>Std. Dev.</b>	<b>p-value</b>
EU grants and loans	Experts n=15	4.73	0.458	0.238
	Entity Reps n=52	4.52	0.610	
Banking support, through specifically trained specialists and possibly, branches	Experts n=15	4.20	1.082	0.619
	Entity Reps n=52	4.25	0.682	
A lower accounting and audit-reporting regimen, varying with SE size	Experts n=15	4.13	1.356	0.051
	Entity Reps n=52	3.50	1.350	
Tax concessions to make up for the extra expenditure emanating from the integration of disadvantaged or disabled persons	Experts n=15	3.87	1.685	0.818
	Entity Reps n=52	4.33	0.648	
Amendments to other industry-related legislation	Experts n=15	3.60	1.056	0.903
	Entity Reps n=52	3.69	0.701	
A right of first refusal to SEs in Government contracts	Experts n=15	2.80	1.568	0.377
	Entity Reps n=52	3.12	1.096	

$X^2(7) = 106.60, p<0.001$

A contentious issue was that such ceiling discouraged capital providers. Most respondents (9/15) emphasised that SE shareholders’ primary motives would be social and altruistic. Furthermore, experts disagreed, while entity representatives were neutral regarding the statement that the ceiling renders the financial dimension subservient to the social one, thus rendering SEs economically risky, the responses of the two groups being significantly different. Most experts (11/15) emphasised that this derived directly from the nature of the SE. However, others (4/15) cautioned that setting a ceiling at such a low level could in effect be a cause of such subservience.

Respondents believed that requiring 70 percent of total income to be generated from trade ensures economic viability, with experts agreeing significantly more. However, some experts (3/15) hinted that viability also depended on costs, operations and competitiveness.

Respondents were asked to rate their agreement to two statements regarding the provision that in the case of WISEs, 30 percent of employees must be DD. Results indicated significant differences ( $p=0.008$ ) by all respondents to the two different statements. Experts believed such a provision to involve a balanced percentage, rendering DD persons more employable, while entity representatives were neutral verging on agreement. Whereas most of the former (10/15) remarked that such provision went even beyond increased employability, others (5/15) disagreed that such or even a higher percentage alone would be enough to make DD persons more employable. Furthermore, experts disagreed while entity representatives had a neutral view that such provision is too high, possibly rendering SEs unproductive. The majority (8/15) remarked

that this is an “*unfair assumption*” and although the percentage may be “*challenging*”, it is intended to lead to social inclusion. Others (7/15) commented that the imposition of such a percentage might in reality be detrimental to smaller SEs.

Respondents also indicated their level of agreement in relation to different types of assistance that needed to be provided to SEs. Results revealed significant differences ( $p \approx 0$ ) by all respondents to the six different statements. Out of the six incentives, both experts and entity representatives agreed to five and were neutral with respect to one.

Respondents distinctively agreed that current provisions needed to include EU grants and loans, including loan guarantees and SE-specific schemes. Banking support was also regarded highly by respondents. However, a number of experts (3/15) commented that the “*small size of the market*” could act as a limitation. Conversely, one expert longed for a specialised financial institution for SEs. A lower accounting and audit-reporting regimen, varying with SE size was also agreed to by both experts and entity representatives, the latter verging on neutral. Most experts (12/15) added that the independent audit should nonetheless be retained. Respondents further believed that current provisions needed to be supplemented by tax concessions compensating for the extra expenditure emanating from the integration of DD persons. However, some experts (4/15) hinted that care should be taken not to give the impression that employing DD persons would necessarily involve extra expenditure. Respondents marginally agreed that amendments were required to other industry-related legislation, including the: Value Added Tax Act, Income Tax Act, Malta Enterprise Act and the Malta Business Act. The statement that current provisions needed to be supplemented by a right to first refusal to SEs in Government contracts led to a controversy. Most experts (8/15) commented that this would render SEs “*dangerously*” dependent on preferential treatment, while others (7/15) saw this as feasible.

#### 4.5 The Corporate Governance Dimension

Table 4 presents results concerning statements on the CG dimension of SEs.

**Table 4:** The Corporate Governance Dimension

<b>State your level of agreement to the following statements relating to SE regulation:</b>	<b>Respondents</b>	<b>Mean</b>	<b>Std. Dev.</b>	<b>p-value</b>
Either a regulator or an oversight committee needs to monitor the operations of Ses	Experts n=15 Entity Reps n=52	4.20 4.08	1.207 0.737	0.477
Such regulator or oversight committee must be separate from those established by existing legal structures	Experts n=15 Entity Reps n=52	3.20 3.63	1.656 1.138	0.136
$X^2(1) = 7.11, p=0.008$				
<b>State your level of agreement to the following statements relating to a code of good corporate governance for SEs:</b>				
	Experts n=15	4.13	0.915	0.080

Such Code is to specify that a specific percentage of those involved in the corporate governance of SEs, have to be knowledgeable of the needs of disadvantaged or disabled persons	Entity Reps n=52	3.71	0.871	
The regulatory framework for SEs needs to include a specific code of good corporate governance	Experts n=15	4.07	1.387	0.424
	Entity Reps n=52	4.23	0.581	
Such Code needs to be mandatory for Ses	Experts n=15	3.53	1.727	0.912
	Entity Reps n=52	3.96	0.816	
Including the participation of a disadvantaged or disabled person in the Board of Directors will not lead to a lengthier decision-making process	Experts n=15	3.27	1.163	0.295
	Entity Reps n=52	3.50	0.897	
Such Code may require the participation of at least one disadvantaged or disabled person in the direction of SEs	Experts n=15	2.40	1.682	0.027
	Entity Reps n=52	3.31	1.094	
$X^2(4) = 44.68, p < 0.001$				
<b>State your level of agreement to the following statement:</b>	<b>Respondents</b>	<b>Mean</b>	<b>Std. Dev.</b>	<b>p-value</b>
A periodic say, three-year social audit needs to be carried out on every SE	Experts n=15	4.00	1.464	0.326
	Entity Reps n=52	4.00	0.863	

Results indicated significant differences ( $p=0.008$ ) by all respondents to two statements relating to the SE regulator. Both sets of respondents agreed that either a regulator or an oversight committee needed to monitor SE operations, with most experts (13/15) commenting they were neutral about who would in fact be the monitor, subject to the regulator having the “*necessary qualifications and skills*”. Some experts (7/15) also emphasised the need for a separate monitor, while others (5/15) commented that there should not be a proliferation of regulators, but one regulator for most, if not all, types of entities.

Respondents were then presented with five statements relating to a code of good CG for SEs, three of which specifically related to WISEs. Results indicated significant differences ( $p=approx.0$ ) by all respondents to the five statements. The two respondent groups held that in the case of WISEs, a code of good CG needed to specify that a percentage of those involved in the CG of SEs had to be knowledgeable of the needs of DD persons, entity representatives being marginally so. Respondents also agreed that the regulatory framework needed to include a specific code of good CG. However, four experts asserted that imposing such requirement “*could disincentivise the setting up of SEs*”. Nevertheless, both respondent groups agreed (albeit entity representatives marginally) that such Code needed to be mandatory. For most experts (9/15), the Maltese culture is not one of self-regulation.

In relation to whether the participation of a DD person on the Board of Directors would lead to a lengthier decision-making process, experts were neutral verging upon agreement whereas entity representatives marginally agreed. Experts disagreed that the Code may require the participation of at least one DD person on the Board, while entity representatives were neutral

verging upon agreement, this resulting in a significant difference in results. Some experts (4/15) commented that if such a provision was to be introduced, participation needed to be subject to the DD person being capable for the job.

Moreover, both respondent groups agreed that a periodic, say, three-year social audit needed to be carried out in every SE. Most experts (12/15) commented however that such an audit needed to be “clearly defined” with its “specified parameters”, and with care taken for such audits to be “relevant” and “cost-beneficial”.

**4.6 Overall Comments**

The results of the final section of the research instruments are presented in Table 5.

**Table 5:** Overall Comments

State your level of agreement to the following statements:	Respondents	Mean	Std. Dev.	p-value
The Draft Bill as it stands is applicable	Experts n=15	3.60	0.910	0.027
	Entity Reps n=52	3.06	0.826	
The Draft Bill needs substantial alterations for it to be translated into law	Experts n=15	3.00	1.648	0.729
	Entity Reps n=52	3.35	0.926	

$X^2(1) = 1.33, p=0.248$

As regards the statement that the Draft Bill as it stood was applicable, experts marginally agreed while entity representatives were neutral, with experts providing a statistically higher level of agreement. Most experts (9/15) commented that the proposed SEA was a “good start”, yet calling for refinements. Some of those seeing the SEA as inapplicable (2/15) stated that this was as yet an incomplete, mostly enabling framework. For example, it was yet to include fiscal benefits and ideally, these should be laid out immediately. Conversely, both respondent groups had mixed feelings as to whether the Draft Bill needed substantial alterations for it to be translated to law. Some experts (7/15) highlighted the need for the SEA to be more “flexible” with respect to thresholds and limits.

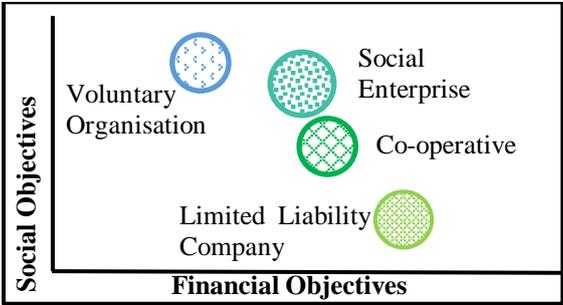
In terms of overall response, respondents welcomed SE legislation as “a long-awaited one”. Participants also envisaged that SEs would be set up in Malta in the field of community care, humanitarian aid, education, health, the environment and restoration, as well as public service delivery functions. Furthermore, reference was made to wording and drafting of the legislation. For instance, some participants claimed that the terms ‘disabled’ and ‘migrant worker’ should be “replaced by more socially acceptable terms”, such as “persons with disability” and “migrants entitled to work”. Similar observations were noted in public comments.

**5. DISCUSSION ON FINDINGS**

**5.1 The Regulatory Framework**

*5.1.1 Is SE-specific Legislation Required?*

A legislative “lacuna” is existent within the Maltese business landscape as evidenced by the findings, in support of public comments. As illustrated in Figure 2, SEs probably fill a gap in the legislation, since no other legal structure, save for the social co-operative, has a dominating social purpose whilst still devoting attention to financial objectives. LLCs often devote minimum attention to benefiting society through corporate social responsibility practices, as cited in Popescu (2011). Contrastingly, VOs generally have little concern for financial objectives while co-operatives may not be guided primarily by social objectives.



**Figure 2:** The Social and Financial Objectives in Different Legal Structures

As advocated in Defourny and Nyssens (2012) and Estrin *et al.* (2013), SEs emerge on the initiative of community members aiming to contribute to the common good (Ridley-Duff, 2007). However, SEs must necessarily trade to sustain their objectives (e.g. Meadows and Pike, 2010). Therefore, in line with respondents’ belief, SEs uniquely take into account the community interest and the commercial one, with priority being given to the former.

*5.1.2 Label, Legal Form or Either?*

The LLC model has been tried and tested in Malta and as stated by DF&APSCL (2012) and Burlò (2013), proved in its own right to be “the most appropriate trading vehicle” (MEIB, 2015b p.10), in contrast with the co-operative model, as cited in Burlò and Baldacchino (2014). Given in particular the deemed predisposition of LLCs in raising finance, one may argue whether it is better to require limited liability for all SEs. However, such legal requirement may be too restrictive. The issue revolves around the nature of SEs. In this context, the Draft Bill seems to offer the best possible solution. It requires limited liability in the case of newly-formed SEs (except for VOs) and places these under the specific legal structure of SECs. However, existing legal structures may retain their legal structure (again except for VOs) and these are

allocated a mere label. Such legal versatility is probably a practicable way of attracting all kinds of SEs.

Accepting the principle of limited liability for SECs does not mean that such entities are adopting the LLC legal structure. Therefore, one may question whether Art.3(3) by which all provisions of the CA are made applicable to SEs, are appropriate to SECs, and perhaps, by virtue of Art.7(5), even more relevantly to SEOs. It could be that the CA provisions are insufficient to cover the exigencies of the SE. For example, neither the Draft Bill nor the CA refer specifically to any guiding social principles, such as democratic control by members. These are referred to only in the White Paper. It could also be that some provisions in the CA, such as the reporting requirements, need to be modified in the context of SECs and also SEOs. It is difficult to accept that the same legislation as the CA is generally applicable. After all, SEs are deemed to be economic vehicles for solving social problems (e.g. Nicholls, 2006). The legal framework must therefore not discount such SE predicament.

## **5.2 The Social Dimension**

### *5.2.1 The Reduction of Social Costs*

There has been general agreement that SEs bring about a reduction in social costs, thereby also saving on public expenditure. For instance, the integration of DD persons into the labour market should present a win-win situation to DD workers and to the economy, leading to both social inclusion and economic growth, as hinted in the literature (e.g. Nyssens, 2006). Moreover, the provision of certain services through SEs, including education and healthcare, will result in a more affluent society. However, given that attaining the SE's specific social aims continues to be the pivotal aim, to what extent should the public authorities incentivise SEs to give priority in their operations to the reduction of social costs? Such public policy will be reflected in the kind of incentives to be eventually offered subsequent to SE legislation.

### *5.2.2 The Participation of DD Persons*

There is general positivity in relation to WISEs, these being welcomed on the belief that having a workforce composed of at least 30 percent DD persons would translate into new opportunities and empowerment of such individuals. This even goes beyond the literature (e.g. Marthe and Nyssens, 2012; Vidal, 2005), where it is advocated that WISEs promote social inclusion. However, the percentage may be challenging, especially to smaller SEs. Therefore, different percentages varying with the size and number of years of establishment of an SE may be considered. Rather than legally requiring the participation of DD persons on the Board of Directors, perhaps, incentives may in due course follow towards promoting such participation. After all, as discussed by Galera and Borzaga (2009), Imperatori and Cataldo Ruta (2015), Pearce (2003) and Travaglini *et al.* (2009), while being a bone of contention, participation has its benefits. Yet, such a provision could be counterproductive unless the DD persons have the skills and qualifications necessary to reside on the Board. Therefore, such criteria cannot be ignored.

## **5.3 Restrictions, Incentives and Boundaries**

### *5.3.1 The Restriction on Profit Distribution*

It is believed that retaining a high proportion of profits will ensure that profits generated will be used for social purposes and will also help towards ensuring stability of employment for employees, particularly DD persons. This sheds light on the fact that SEs work primarily to fulfil social objectives, in support of Bacchiega and Borzaga (2001). Such a ceiling is also believed to ensure the economic viability of SEs, as advocated in Defourny and Nyssens (2012).

However, although it has been claimed that SEs mainly attract altruistic investors, certain investors might not be inclined to invest in SEs given that returns are “*minimal*”. Furthermore, although subservience of the financial dimension to the social one is in the very nature of SEs, at times, such a limitation could render such entities to be perceived as economically risky. In light of these arguments, set at 10 percent, the ceiling may be deemed to be rather low. Contrasting positions have been taken in this respect in various EU countries, as stated in the literature (e.g. Defourny and Nyssens, 2012). The more one regulates in this area, the more difficult it is for financial management to act according to the prevalent circumstances. Perhaps a way out of this, if one is to maintain the present distribution limitation, is to encourage other sources of capital beyond the minimum capital, such as through the use of preference shares issued at a commercial yield. Such a hybrid source of finance may provide the flexibility needed by the circumstances.

### *5.3.2 A Minimum Level of Trade-Related Income*

In support of Moizier and Tracey (2010) and Wilson and Post (2013), among others, a minimum level of trade-related income is believed to further promote economic viability, sustaining the SE in its social objectives. Yet, the floor of 70 percent set by the Draft Bill seems to lead to controversy. Again, perhaps allowing for some flexibility depending on the number of years of establishment of the SE, as well as on its size, might be helpful in encouraging the formation of new SEs.

### *5.3.3 The Case for Incentives*

Incentives supplementing the legislation are generally expected, similarly to the situation abroad, as discussed in Fisac and Moreno-Romero (2015). The immediate introduction of incentives would create an aura of legal certainty, hence further solidly encouraging the setting up of more SEs, as hinted in public comments received. Conversely, introducing incentives at a later stage would ensure that SEs are not set up merely to gain such benefits. Moreover, the introduction of such incentives may also need to take its time because amendments to other industry-related legislation may be required. EU grants and loans, loan guarantees, SE-specific schemes, start-up schemes, tax concessions and banking support (perhaps also through a specific bank for SEs) could be part of the incentive schemes offered. One may also think on the possibility of new specialised institutions helping SEs, such as whether or not a social investment bank should be set up. Such a bank could provide financial services for a social purpose, as cited in Périlleux (2015).

Rather than simply adopting the requirements of the CA, SEs may have a more specific accounting and audit-reporting regimen, varying with SE size, also involving the statutory independent audit. More details with respect to the contents and other requirements relating to the Social Objectives Report could prove helpful. Furthermore, the outcome and output indicators referred to could involve a mixture of social and financial key performance indicators. However, there is probably the need for more research in this area. Moreover, as advocated in Bagnoli and Megali (2009) and Kay (2015), a periodic exercise in social auditing, say, every three years, could help SEs to progress in the achievement of their social objectives.

#### *5.3.4 The Case against Public Ownership*

As cited in the European Parliament Decision A6-0015/2009 and Defourny and Nyssens (2010a), SEs must be autonomous organisations. SEs cannot be autonomous if owned by the state. Yet, at times, the private sector may be unable or unwilling to set up SEs. The Government may thus help the promotion of SEs by means of Public Private Partnerships or similar incentivising legislation, as advocated in Young and Kim (2015). Such partnerships could enable SEs to exploit new entrepreneurial opportunities, as described in Verreyne *et al.* (2013). It remains essential that SEs do not become over-dependent on any type of preferential treatment that may be meted out by the public authorities. In this context, preferential treatment, such as that allowed by the EU Public Procurement Directive (2014/24/EU) may perhaps best be conceded in the initial years of operation.

### **5.4 The Governance Dilemmas**

#### *5.4.1 Who is to Regulate?*

One may argue that a separate regulating body could wholly devote its attention to SEs. However, it may perhaps be time to have a large body integrating the regulation of most types of legal structures, such as co-operatives, companies and SEs. Such a body would probably turn out to be stronger and more effective, leaving no room for inter-regulator miscommunications and gaps. Furthermore, the need for the Minister to intervene in the registration of an SE as stipulated in Art.6(3) and Art.7(1) of the proposed SEA is probably not called for, and may lead to unnecessary controversy.

#### *5.4.2 Regulations*

A specific code of good CG for SEs is warranted to prove useful, such Code being recommended to be mandatory in view of the Maltese culture working against self-regulation. In response to the argument that certain provisions might be somewhat burdensome for SEs, a Code with a ‘comply or explain’ requirement could be introduced for SEs. Such Code could become applicable only for SEs of a reasonable size.

#### *5.4.3 Lack of Awareness and Misconceptions*

Maltese co-operatives and VOs seem to be insufficiently aware of the peculiarities of the SE concept and seem to have common misconceptions about it, as evidenced by certain responses in the study. Thus, for the SE concept to succeed, the enactment of the law must be accompanied by more communication by the public authorities with these entities; the availability of training and educational material with further help in this regard.

## **6. SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

In summary, the SE has various positive social, financial and CG implications and is applicable within the Maltese environment. It is envisaged that once converted into legislation, it will fill a missing void relating to such entities having a dominant social objective and a secondary financial one. Regarding the argument, ‘SE Label vs. Legal Form’, the Draft Bill seems to present the best of both worlds, offering both a new legal form – that of SEC, as well as a mere ‘label’ – that of SEO. However, current CA provisions may be insufficiently applicable to SECs and probably, even less applicable to SEOs, which by Art.7(5) of the Draft Bill are also required to follow some of its provisions. Reference to social objectives may need to be made within the CA itself and modifications to reporting requirements may be required. An alternative could be a more developed SE regulatory framework.

The imposition of a number of floors, such as the percentage of trade-related income may be too challenging for smaller SEs. A progressive minimum level over the initial years may thus be called for. The SE could be rendered more effective through member participation on the Board of Directors. Such participation could be encouraged through incentives on condition of possessing the necessary qualifications and skills. There is also a clear need for guidelines relating to the proposed Social Objectives Report. The need or otherwise for a tailor-made accounting and audit-reporting regimen possibly varying with SE size will have to be determined. A periodic social audit would prove beneficial here. Over time, various new

incentives will probably be introduced, priority perhaps best being conceded to incentivise SE formation.

Moreover, integrating SE regulation within an established regulatory body would probably be advantageous as past expertise could be availed of. The specific SE characteristics would in time lead to more specialised regulation. This study has also shown the need to focus legally on the relevant code of good CG for SEs. The extent to which such Code will be required to be obligatory, to include recommendations, and/or be subject to the 'comply or explain' provision requires further research.

In interpreting the findings and results, one needs to keep in mind that owing to the relatively low response rate, the resulting margin of error indicates a notable limitation in the extent to which the responses are representative of the whole population.

This study recommends that the link between the CA and the SEA be re-assessed. Furthermore, the varying sizes of SEs should be taken into account in the setting of thresholds. Incentives and benefits should also complement SE legislation within a reasonable time period. It is also recommended that SEs seek other sources of finance beyond equity capital, including preference shares and loan capital. Reporting requirements in the law should also be rendered more detailed and communication about the SE concept should be carried out with the stakeholders of existing legal structures.

This study has also shed light on a number of areas that would merit further research, including the introduction of a social audit for the Maltese SE. The CG of Maltese SEs, together with their regulator also beckon further study, as do the links and distinctions between SEs and co-operatives.

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