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Review of Social Enterprises in Asia: A New Legal Form

by Ernest Lim. Cambridge University Press, 2023, 196pp (£85.00 hardback)
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Amid global crises and local challenges, companies, as the cornerstone of our economy, are increasingly expected to take wider responsibilities beyond generating profits for their shareholders. While the purpose and function of traditional for-profit corporations remain subjects of significant debate,¹ social enterprises have emerged as innovative business models, lauded for their potential to generate positive social impact.² Social enterprises, while operating as for-profit entities, generate revenue by addressing social challenges through the adoption of one or more of the following approaches: allocating a portion of their profits to promote social benefits, integrating stakeholder interests into their core mission, and providing goods and services specifically designed to improve social outcomes for targeted community groups. Particularly in the Asian context, social enterprises play a crucial role in addressing pressing socioeconomic challenges by providing essential goods and services often overlooked by the public and private sectors.³ However, unlike in the UK, US or Europe, nearly all Asian jurisdictions lack a separate legal form for social enterprises. In these jurisdictions, social enterprises operate within existing legal frameworks, such as companies limited by shares, companies limited by guarantee, sole proprietorships, societies, partnerships (or limited liability partnerships), and cooperative societies, with the private company limited by shares being the most commonly used structure.⁴

Against the background of rising prevalence of social enterprises worldwide and the vital social and economic roles they play, Professor Ernest Lim's new book, *Social Enterprises in Asia: A New Legal Form*, critically examines whether the existing legal frameworks effectively enable social enterprises to thrive.⁵ Lim contends that the existing legal forms available to social enterprises in common law jurisdictions across Asia (namely, Singapore, Hong Kong, Malaysia and India) are inadequately equipped to support their unique and critical functions. In particular, these frameworks fail to resolve three principal conflicts of interest: between social entrepreneurs and investors, between pro-social and for-profit investors/members, and between social entrepreneurs and stakeholders (such as consumers, clients, and intermediaries).⁶ As a result, disagreeing with the proposition that existing legal forms do not pose a major barrier,⁷ Lim has proposed a new legal form for social enterprises in Asia, structured around five key criteria: (i) corporate purpose; (ii) directors' duties; (iii) decision-making powers; (iv) reporting,

¹ See eg E Pollman and R Thompson (eds), *Research Handbook on Corporate Purpose and Personhood* (Edward Elgar Publishing, Cheltenham 2021); M Yan, 'Shareholder Control in the Context of Corporate Social Responsibility—A Fundamental Challenge to Modern Corporations' (2020) 50 *Hong Kong Law Journal* 1057.

² See eg B Means and J Yockey (eds), *The Cambridge Handbook of Social Enterprise Law* (Cambridge University Press, Cambridge 2018) p 1.

³ See British Council, 'The State of Social Enterprise in Bangladesh, Ghana, India and Pakistan' (2016) available at <https://www.britishcouncil.org/sites/default/files/bc-report-ch6-digital_0.pdf>.

⁴ See British Council, 'The State of Social Enterprise in South East Asia' (2021) available at <https://www.britishcouncil.org/sites/default/files/the_state_of_social_enterprise_in_south_east_asia_0.pdf> at 32.

⁵ E Lim, *Social Enterprises in Asia: A New Legal Form* (Cambridge University Press, Cambridge 2023).

⁶ *Ibid*, at 22–26.

⁷ For example, the evidence gathered from the British Council's surveys does not suggest that existing legal forms constitute a major barrier or that a new bespoke form is necessary. See British Council, above n 4.

impact measurement, and certification; and (v) the distribution of dividends, assets, and tax benefits.

The book is organised into seven chapters. Chapter 1, as an introductory chapter, highlights that the growth of social enterprises is hindered by divergent understandings across jurisdictions, which limit public awareness, and by restricted access to funding,⁸ as social entrepreneurs struggle to convince pro-social investors of their genuine commitment to social objectives rather than using the label merely as a branding or public relations tool. It then examines the challenges related to three principal conflicts of interest arising from the six existing legal forms.⁹ The chapter also well explains that contractual devices, such as shareholders' agreements, are ineffective in addressing the conflicts of interest among different types of shareholders in social enterprises, given the inherent transaction costs and the structural allocation of corporate power based on shareholdings.

Chapter 2 addresses the first of the five proposed criteria, namely the corporate purpose—to promote social benefit while being financially viable. It analyses the company laws of the four Asian jurisdictions, highlighting that they do not prevent social enterprises from deviating from their stated corporate purposes. In other words, existing laws fail to address the risk of social enterprises prioritising profit over the provision of social benefits. For example, in Singapore and Malaysia, company law neither incentivises nor obliges social enterprises to prioritise the interests of the community.¹⁰ In Hong Kong, case law has interpreted the directors' duty to act in *the interests of the company* primarily aligning with *the financial interests of shareholders*.¹¹ As a result, even when a company defines its purpose in terms of stakeholder value, social enterprises may find themselves subordinating their social mission to profit generation in order to comply with the law. When examining the Community Interest Company (CIC) in the UK, it reveals that CICs are not mandated to disclose the proportion of expenditure allocated to promoting social benefit as opposed to profit generation within their financial statements.¹² This suggests that CICs could still largely focus on profit-making activities, provided that some aspects of the business are devoted to promoting the interests of certain community members. Similarly, the laws governing Public Benefit Corporations (PBCs) and Social Purpose Corporations (SPCs) in the US also fail to include effective mechanisms to ensure that these social enterprises promote their stated social benefits over profit.¹³ Building on the shortcomings of existing legal forms, this chapter advances a new corporate purpose that mandates the prioritisation of social benefit, ensuring sufficient clarity regarding the social enterprise's objectives and aspirations. Lim proposes that: “on the whole, the pursuit and delivery of social benefit is prioritised over profit-making except where doing so will have a material and adverse effect on the financial viability of the social enterprise”.¹⁴ To determine when such subordination is appropriate, Lim recommends assessing the proportion of expenditure allocated to promoting social benefit versus generating profit in order to evaluate whether a social enterprise prioritises social benefit overall.¹⁵

The challenges faced by directors in promoting the proposed corporate purpose while simultaneously fulfilling their duty to act in the best interests of the company are examined in

⁸ Lim, above n 5, at 20.

⁹ Ibid, at 26–43.

¹⁰ Ibid, at 53.

¹¹ Ibid, at 51 (emphasis added).

¹² Ibid, at 61.

¹³ Just as pointed out by Reiser and Dean, “[t]hey advance no prioritization of social goals whatsoever”. D Reiser and S Dean, *Social Enterprise Law: Trust, Public Benefit and Capital Markets* (Oxford University Press, Oxford 2017) p 54.

¹⁴ Lim, above n 5, at 48.

¹⁵ This approach is referred to by Professor Lim as the “expenditure test”. Ibid, at 69.

Chapter 3. Unsurprisingly, corporate interest is either directly equated with shareholder value (as in Hong Kong) or regarded as the ultimate objective (as in Malaysia). Even in jurisdictions where shareholder interests are not explicitly prioritised (such as India), the significant governance rights of shareholders, including the ability to appoint and dismiss directors and enforce directors' duties, often compel directors to favour shareholder interests when they conflict with those of other stakeholders.¹⁶ Outside the Asian context, the duty of directors in a Delaware PBC also involves a mishmash of public benefit, shareholder value, and stakeholder interest, with neither statute nor case law providing clear guidance on how to balance these competing considerations.¹⁷ Similarly, while directors' duties in Californian SPC are required to align with the stated purpose in their articles, there is no guidance on interpreting *best interests* or addressing conflicts between the SPC's purpose and its shareholders' interests.¹⁸ For UK CICs, although Section 172(2) of the UK Companies Act 2006 may obligate directors to act in good faith in a manner they consider will promote the success of the company for the benefit of the community, a similar challenge arises in determining how directors should proceed if acting in *the community's interest* would adversely affect *shareholders' financial interests*. Hence, Lim suggests that "the law should state that directors' duty to act in the best interests of the social enterprise means the duty to protect and promote the corporate purpose".¹⁹ By aligning corporate interest and proper purpose with the corporate purpose, directors of social enterprises are made to understand that adhering to the corporate purpose constitutes their fundamental and overriding obligation. However, the corresponding enforcement mechanism might warrant further discussion in this chapter. For example, regarding the proposal to grant beneficiaries (or their representatives) the standing to initiate derivative actions to enforce directors' duties,²⁰ the question arises as to how the proposed governance rights of beneficiaries can be reconciled with shareholders' overarching control, especially given that shareholders retain the ultimate authority to dissolve the company and amend its constitutional rules.

Under the current corporate governance framework, governance rights are granted solely to shareholders, not to other stakeholders or beneficiaries of the social enterprise. Consequently, directors are more susceptible to shareholder influence and, thereby, are more likely to prioritise their interests in practice. Lim argues that, in the context of social enterprises, granting beneficiaries a voice in governance can enable social enterprises to more effectively address the needs of the beneficiaries they are designed to serve. Chapter 4 explores five potential approaches: Firstly, a beneficiary advisory panel could be established to provide information to the board.²¹ Secondly, a director may be appointed from such beneficiary advisory panel to advocate and act in the interests of the beneficiaries.²² Thirdly, an independent non-executive director could be designated to ensure that the beneficiaries' interests are prioritised, though this approach is not preferred due to practical difficulty and potentially disproportionate cost.²³ Fourthly, beneficiaries could be granted the governance right to directly appoint directors by allocating special class of shares in the social enterprise to them, especially when the beneficiaries are concentrated, active and well-informed.²⁴ Fifthly, powers could be vested in an independent expert regulator to safeguard the interests of

¹⁶ Indeed, the extensive powers conferred upon shareholders, including the exclusive right to hold directors accountable by initiating legal action either in their own name or on behalf of the company, precisely reflect their prime position within the corporate governance framework of traditionally for-profit companies as well.

¹⁷ Lim, above n 5, at 88.

¹⁸ Ibid, at 90.

¹⁹ Ibid, at 94.

²⁰ Ibid, at 98.

²¹ Ibid, at 110.

²² Ibid, at 111.

²³ Ibid, at 113.

²⁴ Ibid, at 114.

beneficiaries as an alternative to grant decision-making powers directly to beneficiaries, which may strike a good balance between protecting the beneficiaries and respecting the internal affairs of the social enterprise.²⁵ However, as Lim acknowledges at the outset of the book that “the devil is in the detail”,²⁶ the key question is whether these approaches can be effectively implemented in practice. For instance, while the proposal to grant beneficiaries greater participatory rights is compelling, the chapter does not elaborate on solutions to the challenge of identifying beneficiaries, leaving key questions regarding eligibility for such rights still open for further exploration. For example, in the frequently cited case of a social enterprise employing ex-convicts to provide training and job opportunities, it remains unclear whether all ex-convicts who could potentially be employed should be granted participatory rights.

The mechanisms of reporting, impact measurement, and certification provide assurance to pro-social investors, consumers and funding organisations that social enterprises are genuinely fulfilling their social mission and delivering the social benefits they claim to achieve. Chapter 5 explores these three mechanisms in detail. To start, the law in the four Asian common law jurisdictions does not impose reporting requirements on social enterprises. Even when social enterprises voluntarily disclose information, such disclosures often lack consistency and comparability. This chapter then emphasises the importance to distinguish social impacts from social outputs to accurately assess the effectiveness of social enterprises. It clarifies that social outputs refer to the goods or services delivered to beneficiaries while impacts are the positive outcomes resulting from the use of those goods and services.²⁷ Most social enterprises disclose little to no information about their social impact, and even when disclosures are made, the causal link between their activities and the social impact achieved is often unclear. The proposed framework on impact measurement in this chapter suggests that social enterprises should first identify the relevant stakeholders and then understand their varying interests before evaluating which stakeholders’ interests should be prioritised.²⁸ A balance must be struck between promoting transparency and accountability, on the one hand, and ensuring that resources are not unduly diverted from the production and delivery of goods and services to the impact measurement process, on the other.²⁹ In addition, active stakeholder engagement fosters trust, reducing the reliance on impact measurement tools to establish transparency or legitimacy.³⁰ Lastly, Lim takes a favourable stance on certification, arguing that it can act as an endorsement by the industry or state, signifying a business as a legitimate social enterprise, with objectives that include raising public awareness, increasing public confidence, improving transparency, and enhancing the social enterprise’s access to financing.³¹

Chapter 6 addresses the final criterion: the distribution of dividends, assets, and tax benefits. It begins by analysing how restrictions on dividend and asset distribution can ensure that social enterprises remain committed to their primary purpose of serving the public good.³² Take the statutory restrictions on CICs for example, capping mid-stream profit distributions to shareholders and requiring the forfeiture of capital exceeding the initial contribution help lock in private capital to safeguard financial sustainability and prevent the subordination of social benefit to profit-making objectives.³³ By the same token, it may also be worth considering here whether the remuneration of social enterprise managers should be capped, as this would

²⁵ Ibid, at 115.

²⁶ Ibid, at 6.

²⁷ Ibid, at 130.

²⁸ Ibid, at 139.

²⁹ Ibid, at 137–138.

³⁰ Ibid, at 140.

³¹ Ibid, at 141.

³² Ibid, at 148.

³³ J Liptrap, ‘British Social Enterprise Law’ (2021) 21 *Journal of Corporate Law Studies* 595, 619.

reinforce the altruistic nature of social enterprises.³⁴ The chapter then examines how tax incentives, such as tax benefits for investors or tax credits for social enterprises, can encourage investment and support the development of social enterprises. Through a detailed examination of the UK Social Investment Tax Relief scheme and the Philadelphia Sustainable Business Tax Credit scheme, the chapter highlights the importance of designing flexible frameworks.³⁵ Such flexibility allows social enterprises and their investors to tailor arrangements that suit their diverse objectives while maintaining a focus on delivering social benefits. Certainty, the question whether these measures could help attract more investment from the private sector, as beyond the impact-first investment, can perhaps only be empirically tested in the due course.

Chapter 7 concludes the book by highlighting the potential role of the proposed new legal form for social enterprises in reducing transaction costs for social entrepreneurs, investors and consumers, while also enhancing trustworthiness and public trust, which are key factors for the success of social enterprise. Meanwhile, regarding concerns that the introduction of a new legal form would potentially undermine the sustainability practices of profit-driven companies, the chapter reassures that social enterprises and socially responsible profit-driven companies are distinct, both in their underlying rationale and their practical implementation.³⁶

While the proposed new legal form presents a strong case for the future of social enterprises in Asia, some questions remain only partially addressed upon closer examination. For instance, since social benefit is central to the new legal form, one fundamental issue is how to define *social benefit*. While the creation of economic value in the traditional sense may not constitute social value within the context of social enterprises, the question becomes more nuanced when considering entities formed by a segment of the community solely for their own benefit (eg those providing services that are otherwise costly to obtain individually or operating a bulk purchasing discount scheme). Alongside the previously discussed concerns about enforcement mechanisms for the proposed corporate purpose (eg the potential clash with shareholders' ultimate authority over the company) and the explicit roadmap for empowering beneficiaries with participatory rights (eg determining eligibility for such rights), these issues underscore the need for further investigation to overcome the potential obstacles in the practical implementation of the proposed legal form and to ensure it can lead to meaningful change. Or perhaps greater emphasis could be placed on public enforcement mechanisms and independent regulators if private enforcement mechanisms prove to be unviable. Furthermore, given the diverse social and political contexts of the jurisdictions explored in this book, examining the political determinants and existing social welfare systems that shape the forms and functions of social enterprises may provide some valuable insights for future developments in this field.

To conclude, Professor Lim's *Social Enterprises in Asia: A New Legal Form* is a timely and valuable contribution to the growing body of literature on social enterprise law, offering a new analytic framework. While the book focuses on the four Asian jurisdictions, impact extends beyond these regions. Policymakers and regulators in other jurisdictions may also find the proposed new legal form a useful guide in navigating the evolving landscape of social enterprises. For researchers, practitioners, and students with an interest in social enterprise or corporate governance in general, this book will undoubtedly serve as essential reading.

³⁴ For example, in a French social enterprise company, the highest-paid director's salary, including bonuses, must not exceed ten times the annual salary of a full-time employee based on legal working hours and the minimum wage. See *Law No. 2014-856 of 31 July 2014 on Social and Solidarity Economy* (à l'économie sociale et solidaire), Article 11(3), available at <<https://www.legifrance.gouv.fr/loda/id/JORFTEXT000029313296>>.

³⁵ Lim, above n 5, at 162.

³⁶ *Ibid.*, at 167.