

social enterprise

A CIPFA charities panel briefing paper

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CIPFA Charities Panel

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what is a social enterprise?

There is no universally agreed definition and people take differing views as to what does and doesn't fit within the idea of 'social enterprise'. The Cabinet Office website describes social enterprises as:

'... businesses with primarily social objectives. They principally reinvest their surpluses in the business or community for these purposes. Unlike commercial businesses, they are not driven by the need to produce profit for shareholders and owners.'

Source: <http://www.cabinetoffice.gov.uk/voluntary-sector/social-enterprise.aspx>

While the above quote refers to 'businesses', social enterprise encompasses other types of organisation including charities, associations, societies and community organisations that generate earned income. NCVO's UK Civil Society Almanac 2010¹ reports that earned income now accounts for 51% of the total income of general charities in the UK. Smaller charities (annual income of less than £100,000) earn a higher proportion of income through enterprise than larger charities.

A clear understanding of social enterprise models is essential in order to assess both the benefits and the risks associated with each model. This includes assessing their abilities to deliver services efficiently and effectively as well as their ability to deliver against social policy goals.

Types of social enterprise

Social enterprise covers a wide range of organisational types including:

- Associations
- Charities
- Co-operatives
- Community groups

- Clubs
- Mutuels
- Partnerships
- Social firms
- Societies
- Trusts

The above list is illustrative of the range of types although it is a simplification. We could go on adding different types to the list. For example 'co-operatives' includes: employee led, consumer, multi-stakeholder, housing, agricultural, community, wholesale, secondary co-operatives and so on.

¹ For more information on the NCVO Almanac, see: <http://www.ncvo-vol.org.uk/almanac>

legal structures

There are a number of legal structures available for organisations that have primarily social objectives, who reinvest profits and who restrict ownership rights in order to retain assets. Incorporated legal structures include:

- Industrial and provident society
- Company limited by guarantee
- Company limited by shares
- Limited liability partnership

Key features of different incorporated legal forms

Legal form	Governing document	Able to issue shares?	Pay a return on shares?	Regulatory bodies	Suitable for Charitable status	Asset lock?
Company limited by guarantee	Articles	No	No	Companies House	Yes	No (unless CIC or charity)
Company limited by shares	Articles	Yes	Yes	Companies House	No*	No (unless CIC or charity)
Company limited by guarantee also registered as charity	Articles	No	No	Companies House & Charity Commission	Yes	Yes
CIC Company limited by guarantee	Articles	No	No	Companies House & CIC regulator	No	Yes
CIC Company limited by shares	Articles	Yes	Yes (but subject to a cap)	Companies House & CIC regulator	No	Yes
Industrial & provident society (bona fide co-op)	Rules	Yes	Yes	Financial Services Authority	No	No
Industrial & provident society (society for the benefit of the community)	Rules	Yes	Yes	Financial Services Authority	Yes	Yes (optional)
Limited Liability Partnership	Agreement or deed	No	No	Companies House	No	No

*No longer an option for charities although some did previously register as companies limited by shares.

The table above is based on the Co-operativesUK publication 'Simply Legal' (2010)², but excluding unincorporated legal structures and with an additional row for a company limited by guarantee which is also registered as a charity because of the extent of use of this legal form by charities.

While the above table provides a useful summary it is necessarily only an introduction to an assessment of key features. For example, while an asset lock is not a standard feature for all companies limited by guarantee or industrial & provident societies there are examples of enterprises who have adopted those legal forms and have included restrictions in the governing document to limit member's ownership rights in order to protect the assets of the organisation long term.

² Co-operativesUK (2009) *Simply legal: All you need to know about legal forms and organisational types for community enterprises*. Available at: <http://www.uk.coop/resources/documents/simply-legal>

size and scope of social enterprise sector

Size

How you assess the size of the sector depends on what you include under the heading 'social enterprise'.

Aggregated data from the 2005-2007 Annual Surveys of Small Businesses UK estimates there are approximately 62,000 social enterprises in the UK contributing at least £24 billion to the economy and employing 800,000 people.

The Co-operatives UK 2010 review of co-operative enterprise estimates that the UK co-operative economy accounts for £33.5 billion turnover, 4,992 businesses and 237,800 jobs.

The National Council for Voluntary Organisations (NCVO) Civil Society Almanac 2010 estimates UK voluntary sector income in 2007/08 at £35.5 billion (including £17 billion in earned income) and expenditure at £32.8 billion.

Scope

Social enterprises can be found in a wide range of sectors and activities. For example the 2010 review of co-operative enterprise points to examples in: finance, agriculture, schools, housing, community shops, sports supporters' trusts, retail and employee owned businesses. The NCVO Civil Society Almanac points out the key role played by civil society in education including: early years education, academies, universities, and independent schools. Other elements of the civil society which can be included within the 'social enterprise' definition include: housing associations, clubs and societies, leisure trusts, social and health care, community facilities, arts facilities, and so on.

how long have they been around?

Some suggest social enterprises are a relatively recent development, and point to the growth in the number of smaller social enterprises established in recent years, including those registering as community interest companies. However it is important to balance this view with an understanding that very many organisations classified as social enterprises have their roots in organisational structures that have been around longer than that. For example, many charities, co-operatives, trusts, societies, clubs and associations fall within the cabinet office description of social enterprise.

This is not to ignore recent developments in social enterprise models. There are, for example, over 4,000 community interest companies (a relatively new legal structure) registered on the Community Interest Companies regulator website (as at October 2010). However there are estimated to be over 180,000 registered charities in England and Wales, a large number of which generate fee and trading income and deliver a wide range of products and services.

Charities

One of the earliest English charities is England's oldest continuing almshouse which was founded in the 1100's. The law on charity dates back to 1601, with court decisions on legal and tax privileges linked to charity status. In 1891 a judge identified four categories of charitable purpose: relief of poverty, advancement of education, advancement of religion, and other purposes beneficial to the community. The Charities Act 2006³ set out a list of thirteen charitable purposes and also included a requirement to evidence public benefit in their activities.

Charitable purposes

- The prevention or relief of poverty
- The advancement of education
- The advancement of religion
- The advancement of health or the saving of lives
- The advancement of citizenship or community development
- The advancement of the arts, culture, heritage or science
- The advancement of amateur sport
- The advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity
- The advancement of environmental protection or improvement
- The relief of those in need, by reason of youth, age, ill-health, disability, financial hardship or other disadvantage
- The advancement of animal welfare
- The promotion of the efficiency of the armed forces of the Crown, or of the efficiency of the police, fire and rescue services or ambulance services
- Any other purposes currently recognised as charitable and any new charitable purposes which are similar to another charitable purpose

³ Charities Act 2006: <http://www.legislation.gov.uk/ukpga/2006/50/contents>

Prior to the development of a more comprehensive welfare state in the late 1940's and the increase in public sector service provision, charities were key service providers in a number of areas. Charities continued to deliver services, often in areas where public provision was limited or considered inappropriate. Examples include: social care, homelessness and consumer advice.

More recently there has been an increase in the range and scope of charity activity. This includes developments in local and community based enterprises as well as moves by some charities to adopt and adapt business models with the aim of improving service delivery and efficiency.

Co-operatives

Co-operative forms of organisation go back a very long way, although it is generally agreed that the modern form of co-operative has its roots in Rochdale in the 1800s. In 1844 twenty eight men set up the Rochdale Equitable Pioneers Society and opened a co-operative shop in Toad Lane, Rochdale.

Between 1844 and 1854 the Society published a series of "practices," which were the basis for what became known later as the Rochdale Principles:

1. Open membership
2. Democratic control (one person, one vote)
3. Distribution of surplus in proportion to trade (e.g. 'the co-op dividend')
4. Payment of limited interest on capital
5. Political and religious neutrality
6. Cash trading (e.g. no credit extended to members)
7. Promotion of education

An updated internationally agreed set of co-operative principles can be found on the International Co-operative Alliance website at: <http://www.ica.coop/coop/principles.html>

Community interest companies

A more recent arrival is the Community Interest Company (CIC)⁴ which started offering a new form of legal structure to enterprises in 2005. CICs are limited companies (limited by shares or by guarantee), with additional features, for people who want to conduct a business or other activity for community benefit, and not purely for private gain. This is achieved through a "community interest test" and "asset lock".

The asset lock seeks to ensure that assets and surpluses are retained and used primarily in support of the organisation's community benefit purposes. Registration of a company as a CIC has to be approved by the CIC Regulator who also has a continuing monitoring and enforcement role. There are now more than 4,000 CICs providing a range of goods and services.

⁴ CIC regulator website: <http://www.cicregulator.gov.uk>

financial aspects of different types of social enterprise

Retention of profits and assets

Social enterprises can and do generate profits (also described as surpluses) however there are normally controls set on how those profits are used.

In the case of charities, profits from trading and assets must be used in furtherance of their objects and purpose. CICs have an asset lock written in to their articles and also have a cap placed on profit distribution.

In the case of co-operatives, the rules on profit distribution and ownership rights vary according to the legal structure adopted and the wording of the governing document. The amount available for distribution to members will typically be restricted and, where allowed, is often linked to the level of day to day transacting with the co-operative rather than the amount of capital invested by the co-operative member.

Trading activities and charities

Social enterprises undertake trading activities linked to furthering their social and/or environmental goals. While charities can trade in pursuit of their charitable objectives, there are restrictions on engaging in trades the objective of which is to generate funds for the charity. In particular, charities may not engage in non-charitable commercially oriented trading where a significant risk to their assets would be involved. Charities can more or less freely trade where it involves:

a. Primary purpose trading. Trade carried out directly in furtherance of the charity's objectives. Examples include: course fees charged by a charitable college, museum exhibition admission fee, residential care home fees, sale of goods made by beneficiaries of the charity.

b. Ancillary trading. Non primary purpose trading carried out in support of the main purpose.

An example would be a theatre café solely for the use of those attending a performance at the theatre.

Outside of the above, a limited amount of 'small-scale' trading is allowed if the profits are used to further the objects of the charity. The current thresholds are:

Total of all incoming resources in a Particular chargeable period of the charity	Maximum permitted annual turnover of the relevant trading in that chargeable period
Under £20,000	£5,000
£20,000 to £200,000	25% of charity's total incoming resources
Over £200,000	£50,000

Source: *Trustees trading and tax Charity Commission (2007)*⁵

Tax

Charities have a number of advantages regarding tax treatment in relation to trading and trading profits. Certain sales and purchases are exempt from VAT or zero-rated. In addition, a charity's trading profits are, in certain circumstances, exempt from income tax. This includes profits from:

- primary purpose trading
- ancillary trading
- trading falling within the 'small scale' definition
- a lottery
- trading connected with certain fund-raising events

Exemption is subject to conditions regarding the application of the profits received.

⁵ Charity Commission website: <http://www.charity-commission.gov.uk>

Some social enterprises working in the areas of health, care, education, youth work, housing and welfare may find some of their activities are exempt from VAT. VAT is a complex area and expert advice on this and other tax issues should be sought, but exemptions relevant to some social enterprises may include:

- Certain welfare services
- Certain sport, education and cultural services
- Some supplies made to members by certain non-profit making public interest bodies
- Some fundraising events organised by charities or certain other qualifying bodies

Special VAT rules apply in respect of property and where use of property is for a 'relevant charitable purpose' or 'relevant residential purpose'.

More information on charities, not for profit organisations and tax issues is available at the HMRC website: <http://www.hmrc.gov.uk/charities>

Financing

Different social enterprise models face different challenges in respect of securing adequate financing. Typically, social enterprises have limited or no access to capital markets via share issues. Some may be in a better position to access grants or donations to support their work and others may have access to social lending designed to offer a source of 'patient lending'. Finance accessed by social enterprises includes:

- Loans
- Equity
- Grants and donations
- Retained surpluses

Loans

Loan finance is a common form of finance used by social enterprises. Social enterprises typically source their loans through mainstream

commercial banks and social banks, such as Charity Bank and Triodos Bank. Social lending (also known as patient lending) refers to the practice of offering long term loans and other forms of finance below market rates to enterprises pursuing social goals.

Equity

Some social enterprises may be in a position to issue transferable shares which give ownership rights to investors and which can be transferred at market price. Their ability to do this will depend on their legal structure and governing document. This could, though, impact on the enterprise's ability to ensure the retention of profits and assets in furtherance of social goals.

Some co-operatives are able to raise equity through the issuing of member shares. Co-operative member shares will often have limited or no rights over the assets of the co-operative and limited or no transferability. This usually means that co-operative member shares are issued and redeemed at par (nominal) value. A co-operative registered as an Industrial & Provident Society can offer member shares up to a maximum of £20,000 per member.

Charities cannot raise finance through the issuance of shares.

Grants and donations

Some social enterprises are in a position to access grants and donations. Charities may be in a better position to access such funds from a variety of sources including charitable trusts. The Association of Charitable Foundations (2007)⁶ estimated that there are more than 8,000 charitable trusts and foundations in the UK, providing approximately £2.7 billion per year to fund charitable activities.

⁶ Association of Charitable Foundations (2007) *Grantmaking by UK trust and charities*. Available at: <http://www.acf.org.uk>

Retained surpluses

This is the relatively simple process of retaining and reinvesting surpluses. Many social enterprises, if sufficiently profitable, will be in a position to retain and reinvest accumulated surpluses. In many situations they may not need to distribute any profits to members or share holders and so have greater freedom over applying all profits in furtherance of the organisation's goals.

Other options

There are other options open to certain social enterprises and depending on their legal structure and eligibility. Other options include, for example, issuing preference shares, loan stock, social loans and bonds. All of these represent various forms of debt instrument.

delivering social impact: three models of social enterprises

In their paper: 'the three models of social enterprises' (2008) Venturesome (an initiative of the Charities Aid Foundation) identify three fundamental ways or models through which social impact can be created through trading activities. It is not designed to be a prescriptive approach to thinking about social enterprise, but it can assist in analysing the benefits of various social enterprise models and identifying key performance factors for assessing their social impact.

Three models of social enterprise

1. Profit generator model

Engage in a trading activity that has no direct social impact, make a profit, and then transfer some or all of that profit to another activity that does have direct social impact.

2. Trade off model

Engage in a trading activity that does have direct social impact, but manage a trade-off between producing financial return and social impact.

3. Lock-step model

Engage in a trading activity that not only has direct social impact, but also generates a financial return in direct correlation to the social impact created

Model 1 is primarily concerned with achieving a financial return. Other benefits, such as job creation, may arise but are secondary to the main purpose. The social return occurs after a profit has been generated and then invested in activities aimed at having a social impact. Examples include:

- for-profit businesses which provide grants and donations to organisations
- charitable foundations investing in mainstream financial markets

- trading subsidiaries of charities (e.g. charity shops)

Model 2 does engage in trading activity designed to have a direct social impact but balances this against generating a financial return. Because social purpose is integral to operational activities a social return is achieved prior to the generation of profit and regardless of the level of surplus achieved because it occurs through day to day trading activity. Examples include:

- fair trade businesses
- microfinance institutions
- firms that employ disadvantaged people

Model 3 trading activity is designed to have social impact but also the impact increases or decreases in parallel with the level of financial returns. The difference to model 2 is that the financial return is sacrificed to balance social return whereas in model 3 financial and social return move in the same direction. Examples include:

- co-operatives
- wind farms

For more information on the models go to: <http://www.cafonline.org/default.aspx?page=18956> and <http://www.cafonline.org/default.aspx?page=18950>

social enterprise examples

There are a wide range of services being delivered by social enterprises. Here are four examples of social enterprise in leisure, social care, child care and health.

Leisure services - Greenwich Leisure Limited (GLL)

GLL Manages 70 leisure centres within the M25 area in partnership with thirteen London Boroughs.

Legal structure: Industrial & Provident Society – Society for benefit of community.

Charitable status with HMRC

Website: <http://gll.org/default.asp>

Social care services - Sandwell Community Caring Trust

Providing a range of social care services including: supported living, residential care, day care, respite care and home care.

Legal structure: Company limited by guarantee and registered charity

Website: <http://home.btconnect.com/sandwellcct/trust/index.htm>

Child care - The Co-operative Childcare

Part of Midcounties Co-operative operates six nurseries in Oxford, Swindon, Stroud and Dursley.

Legal structure: Industrial & Provident Society – Co-operative

Website: <http://www.thecooperativechildcare.coop/live/welcome.asp?id=204>

Health - Central Surrey Health (CSH)

Central Surrey Health is a social enterprise co-owned by employees who previously delivered community nursing and therapy services from within the PCT. They are:

- district nurses
- community hospital nurses
- school nurses
- specialist nurses
- health visitors
- nursery nurses
- physiotherapists
- podiatrists
- dieticians
- speech and language therapists
- occupational therapists
- support and administrative assistants

On transferring to Central Surrey Health all staff were presented with a single share in the company. As co-owners, they are responsible for delivering patient services and shaping the company's future.

Legal structure: Company limited by shares

Website: <http://www.centralsurreyhealth.nhs.uk/index.html>



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