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## THE NEW ITALIAN LAW ON SOCIAL ENTERPRISE (\*\*)

*Summary. – 1. Introduction. – 2. The definition of “social enterprise”. – 3. Private organisations ... – 4. performing an entrepreneurial activity of production of social utility goods and services ... – 5. for the common interest and not for profit. – 6. Principles of social enterprise regulation.*

### *1. Introduction.*

In this paper I will give a general overview of the new Italian law on social enterprise (Legislative Decree, 24 March 2006, n° 155), whilst also trying to outline the effects of this new law on the system of “third sector” organisations and players.

In my opinion, some knowledge of the Italian experience would be useful both for European countries that want to modify their existing legislation on non-profit organisations and social enterprises, and for those that wish to introduce such legislation. The reason for this lies in the particular approach to the subject taken by the Italian legislators. For several aspects – which will be pointed out below – their strategy is substantially different from those embraced by other countries. This might result in a new institutional structure of the so-called “third sector” and of relationships among its players.

In order to justify the last statements, this paper will focus on the definition of “social enterprise” under Italian Law and its implications.

### *2. The definition of “social enterprise”.*

With the 155/2006 Law a definition of social enterprise has been introduced to the Italian legal system<sup>1</sup>.

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Although it is the result of a long academic and political debate, and will no doubt be subject to subsequent interpretation, we finally have an official definition that anyone who wishes to analyse social enterprises has (at least) to consider.

The first general aspect that has to be highlighted is that social enterprise is neither a new legal form, nor a new type of organisation, but a *legal category* in which all eligible organisations may be included, regardless of their internal organisational structure. Therefore, the eligible organisations could in theory be co-operatives (i.e. employee-, producer-, or customer-owned firms), investor-owned firms (i.e. business corporations), or traditional non-profit firms (i.e. associations and foundations)<sup>2</sup>.

In this regard, Italian law is a general law on social enterprises and not a particular law on a specific (or unique) form of social enterprise<sup>3</sup>.

The choice not to consider the organisational structure as a condition for eligibility as a social enterprise has its roots in the aim to protect and promote pluralism in the production of social utility goods and services, especially in welfare and health<sup>4</sup>. Each legal form (either a co-operative, or an association, or a foundation), in fact, does not only imply a particular organisational structure but also a distinct history, culture, and ideology. The value of pluralism, which would have been sacrificed had a specific legal form been selected for the running of a social enterprise, is supported by the principle of “neutrality of the legal forms” adopted by the Italian Law.

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<sup>1</sup> Art. 1, para. 1, Law 24 March 2006, n° 155, states: «*All private organisations, also including those of the Fifth Book of the Civil Code, which carry out a stable and main economic and organised activity with the aim of production or exchange of goods and services of social utility for the common interest, and which meet the requirements of articles 2, 3 and 4, can be considered as social enterprises*».

<sup>2</sup> For this terminology and classification, see HANSMANN, *The ownership of enterprise*, Cambridge-London, 1996, 11 ff.

In the Italian legislation, co-operatives are regulated by art. 2511 ff., Civil Code. Investor-owned firms are “società” regulated by the fifth book of the Italian Civil Code (art. 2247 ff.). Non-profit organisations are associations and foundations regulated in the first book of the Code. Other non-profit organisations are, among others, “social co-operatives” (Law, 8 Novembre 1991, n° 381), “voluntary organisations” (Law 11 August 1991, n° 266), and “social promotion associations” (Law 7 December 2000, n° 383).

<sup>3</sup> Like, for example, the French Law on “Common Interest Co-operatives”.

<sup>4</sup> In this sense, see CAFAGGI, *L'impresa a finalità sociale*, *Pol dir.*, 2000, 595.

In conclusion, “social enterprise” is like a legal “brand” which all eligible organisations can obtain and use in the marketplace (see art. 1, para. 1, and art. 7, Law 155/2006)<sup>5</sup>.

The requirements, which will be examined below, are:

- a) being a *private organisation*;
- b) performing an *entrepreneurial activity* of production of *social utility* goods and services;
- c) acting for the common interest and *not for profit*.

In order to be defined as a social enterprise, an organisation needs to simultaneously hold all the aforementioned attributes.

### 3. *Private organisations ...*

First of all, social enterprises can only be “organisations”.

Therefore, the Italian Law does not consider as a social enterprise an individual enterprise (i.e. an enterprise not run by an organisation but directly by a single person).

Given this, one might ask if it is possible to define as social enterprises organisations owned by a single person<sup>6</sup>, as is generally permitted by Italian company law<sup>7</sup>.

Secondly, organisations must be “private”.

This requirement has to be interpreted both in a formal and in a substantial sense.

In the first meaning, organisations are private because their legal form is not public. Therefore, they must be companies, co-operatives, associations, foundations, and so on, that is legal forms provided for (and regulated by) the Civil Code or other private laws. A social enterprise cannot be a public law entity<sup>8</sup>.

In the second meaning, organisations are private because their membership is private, in the sense that they are made up of individuals or other private organisations, or at least that they are not controlled by the State or other public bodies (see art. 4, para. 3).

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<sup>5</sup> Unfortunately the Law does not explicitly provide for sanctions for the non-legitimate use of the social enterprise title.

<sup>6</sup> This latter situation is formally different from the aforementioned because the single person acts *through* an organisation, instead of running *directly, as an individual*, the enterprise.

<sup>7</sup> In the Italian legal system the only organisations which may be established or participated by a single person are companies, and in particular “società per azioni” and “società a responsabilità limitata”.

<sup>8</sup> See art. 1, para. 2, of the Law.

The exclusion of public organisations from the scope of the Law is the intrinsic consequence of the fact that the Law intends to promote voluntary (spontaneous) initiatives in the production of social utility goods and services, and in doing so enacts the principle of “vertical subsidiarity” laid down by art. 118, para. 4, of the Italian Constitution<sup>9</sup>. Encouraging public organisations to act for the common good would not make sense since the public sector is obliged to do so in any case.

*4. performing an entrepreneurial activity of production of social utility goods and services ...*

In order to be defined as social enterprises organisations do not merely have to deliver goods and services of social utility, but also to do so in an entrepreneurial way<sup>10</sup>.

Following the definition of enterprise under art. 2082 of the Italian Civil Code, their activity must therefore be productive, professional, economic, and organised<sup>11</sup>.

Consequently, an organisation whose purpose is to solely administrate its assets and to deliver the resulting income to beneficiaries (like the so-called grant-making foundations, of which banking foundations are an example<sup>12</sup>) or an organisation which delivers free welfare services or sets prices that do not cover costs cannot be considered as social enterprises.

The 155/2006 Law on social enterprise is noteworthy in as much as it divides the third sector into two sub-sectors, that of firms and that of organisations that are not firms.

This will in fact contribute to a better understanding of the third sector, which is not uniform but diverse.

The distinction between third sector (or social) enterprises and straightforward third sector (or social) organisations could for example be useful for a reform of tax law, which currently treats all these organisations

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<sup>9</sup> Art. 118, para. 4, Italian Constitution, states: «*State, Regions, metropolitan Cities, Provinces and Town councils favour autonomous initiatives by citizens (single citizens or groups of individuals) to carry out common interest activities, on the basis of the subsidiarity principle*».

<sup>10</sup> The Law prescribes that this activity must be the main one, namely its income has to be at least 70% of the total income of the organisation (see art. 2, para. 3).

<sup>11</sup> Art. 2082, Civil Code, states: «*The entrepreneur professionally carries out an economic and organized activity with the aim of production or exchange of goods and services*».

<sup>12</sup> See Law 17 May 1999, n° 153.

in the same way<sup>13</sup>. It would also be helpful for public administration, which at present – for example in contracting-out for welfare services – deals with third sector organisations without taking into account their entrepreneurial or non-entrepreneurial nature.

The business has to be of social utility.

The concept of “social utility” is given by article 2 of the Law, which considers two situations.

The first (para. 1) regards social utility sectors, like welfare, health, education, instruction, culture, environmental protection and so on<sup>14</sup>. All goods and services related to these sectors are considered to be of social utility. And the organisation that acts in these sectors is defined as a social enterprise.

The second (para. 2) regards the integration in the workplace of underprivileged or disabled people. In this latter case, for an enterprise to be social, the nature of the sector of activity is irrelevant. What matters is that the activity is carried out by employees, of whom at least 30% are underprivileged or disabled.

#### *5. for the common interest and not for profit.*

In accordance with the Law, the other element in the definition of social enterprise is the non-profit goal of the organisation.

This requirement needs to be carefully explained.

In general, the non-profit aim of an organisation doesn't imply that the organisation cannot make a profit from its activity, in other words that its strategy has to be profits equal costs. It means instead that the organisation cannot distribute earnings to its members or owners. The non-profit requirement is therefore a non-distribution constraint.

The Law carefully defines the non-distribution constraint, with the goal of enlarging its scope.

In fact, social enterprises have to invest their income in the core business or in increasing their assets (art. 3, para. 1).

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<sup>13</sup> The Law 155/2006 does not contain a tax treatment of social enterprises, that therefore, with regard to this aspect, continue to be regulated by the previous legislation, in particular by the Law n° 460/97 on “Non-commercial legal bodies and non-profit organisations of social utility”.

<sup>14</sup> More precisely the sectors are: *a*) welfare; *b*) health; *c*) welfare-health; *d*) education, instruction and professional training; *e*) environmental and eco-system protection; *f*) development of cultural heritage; *g*) social tourism; *h*) academic and post-academic education; *i*) research and delivery of cultural services; *l*) extra-curricula training; *m*) support to social enterprises.

They cannot distribute (not even indirectly) neither profits (however they may be named) nor parts of the assets to directors, shareholders, members, employees or collaborators (art. 3, para. 2)<sup>15</sup>.

The Law moreover meticulously defines the notion of “indirect profits distribution” (art. 3, para. 3), which, as has already been said, is forbidden to social enterprises. For example, it is considered indirect profits distribution to reward directors more than 20% of the remuneration awarded by firms that operate in identical or analogous sectors and conditions.

The intention to defend the non-profit orientation of social enterprises is evident in the rule that forbids for-profit organisations to control a social enterprise (art. 4, para. 3).

But why do we need a non-profit model of social enterprise? Why should not the social utility requirement be sufficient for the definition of social enterprises? And how should we identify the objective of a social enterprise, its “mission”, if it is not the distribution of profits?

The first question finds a traditional and established answer: non-profit firms solve the “market failure” issue in the production of social utility goods and services.

In fact, in this area, relationships between producers (or sellers) and users (or customers) are characterised by asymmetric information, since users cannot ascertain in advance what quality services and goods are, and sometimes neither afterwards. Furthermore, even if the lack of quality becomes known to users *ex post*, the breach of contract is almost impossible to prove in court, since the information is not observable by third parties.

If this is the case, the non-profit orientation of producers increases trust in the social utilities, since non-profit organisations do not have any reason to cheat users, thus increasing profits that cannot be distributed.

This is the most widespread theory on the existence of non-profit firms in the market-place and on their competitive advantage in relation to for-profit firms.

The second question can be answered through similar arguments.

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<sup>15</sup> The only exception to this rule regards “social co-operatives”, which can distribute limited profits to their members. This exception stems from the combined rules of art. 17, para. 3, Law 155/2006, of art. 3, Law 381/1991 and of art. 2514, Civil Code.

Some authors do not agree with the total distribution constraint requirement, since they sustain that a limited profit could simultaneously pursue the same objectives as the total constraint and stimulate better administration and finance of the social enterprise (see BORZAGA & MITTONE, *The Multi-Stakeholder Versus the Nonprofit Organisation*, University of Trento, Department of Economics, Discussion Paper, n° 7, 1997, 29 s.).

The Italian Law does not consider meritorious in absolute organisations that carry out a social utility activity, but only those that do so for a non-profit aim. What makes such organisations worthy of a special legal framework is, as previously stated, their non-profit orientation, which is the real indicator of their reliability.

The third question at first sight does not appear to be very complicated, although it raises a few considerations.

The non-profit aim is a negative requirement that does not necessarily indicate the purpose of the organisation, but only that its purpose is not to distribute profits to the owners.

Therefore we can ascribe to the non-profit area two kinds of organisation.

The first regards organisations which act on behalf of their members, though not in their economic interest. Say, for example, a chess (or a golf) club.

The second regards organisations that act for the common interest and do not limit their activity to members but deliver goods and services also to non-members.

The latter are “social” (or “third sector”) enterprises, while the former are merely non-profit but not social organisations. Ultimately, the third sector and the non-profit areas do not overlap.

This separation is clear in the Law, given that on one hand it states that organisations that restrict (even indirectly) the deliver of goods and services to their members cannot be considered as social enterprises (art. 1, para. 2); on the other hand, it obliges social enterprises to invest their income in the core business or in increasing their assets (art. 3, para. 1), and thereby acting in the interest of customers of the social enterprise.

## *6. Principles of social enterprise regulation.*

After providing the definition of social enterprise, the Italian decree sets out rules on its internal structure, with the aim of directing the action of social enterprises towards their institutional purpose, that is pursuing the common interest<sup>16</sup>.

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<sup>16</sup> In reality, from a theoretical point of view (but practically relevant as well), it is not clear whether the rules on the governance of social enterprises have to be considered as legal obligations which bind social enterprises, or as additional requirements organisations must possess in order to be defined as social enterprises.

The structure of social enterprises is subject to these general principles: correct and efficient management, transparency, “open door”, participation, worker protection.

The correctness and efficiency of management should be guaranteed by art. 8, para. 3, stating that *«the by-law [of a social enterprise] must lay down specific requirements of reputation, professionalism and impartiality of the members of the organs»*, and by art. 11 that, in certain cases, obliges social enterprises to appoint one or more persons for the control of management conduct and the audit of accounts.

Transparency is addressed firstly in art. 5 that requires by-laws drawn up in writing and in public (notary’s) form, sets a minimum content for them, and prescribes their deposit in the public registry of firms; secondly in art. 7, para. 1, that imposes the use of the expression “social enterprise” in the name of the organisation; furthermore in art. 10 that obliges social enterprises to draw up and deposit in the public registry of firms annual accounts (financial balance sheets) and the so-called social report (social balance sheet), that is a document which should represent and testify to the pursuit of the goals of common interest by the social enterprise.

The principle of the “open door” arises from art. 9 that provides for the non-discrimination rule in the admission and exclusion of members and entitles rejected candidates (and excluded members) with the right to appeal to the general meeting (the assembly) of members. Unfortunately, however, the Law does not oblige directors to motivate the denial of admittance. Art. 9 does not of course imply the right to be admitted, but recognises the interest of candidates, and protects them through the power of appeal to the assembly of members.

The principle of members’ participation is laid down in art. 8, para. 1, stating that the election of the majority of organ members cannot be reserved to external subjects (i.e. non members), and above all (in this second case with regard to external stakeholders) in art. 12 that prescribes the involvement of workers and customers in the daily proceedings of social enterprises.

Art. 12, para. 1, obliges social enterprises’ by-laws to provide for *«forms of workers’ and customers’ involvement in the activity»*, clarifying in para. 2 what involvement exactly means. Indeed, the definition of “involvement” is so wide (any process, including information, consultation or participation, through which workers and customers can influence decisions of the enterprise, at least those directly regarding working conditions and the quality of goods and services) that one might foresee that the rule will not be in effect implemented by social enterprises in the interest of workers and

customers unless extra-legal incentives force them to adopt practices of real involvement<sup>17</sup>.

The principle of worker protection is laid down especially in art. 14, para. 1, stating that the economic and legal treatment of workers of social enterprises cannot be inferior to that provided for by the applicable contracts and collective agreements.

As one could easily note, among the principles of social enterprise regulation I have not included democracy. It is a principle which – following the experience of the co-operative world – finds its widest expression in the rule “one head, one vote”, i.e. in the fact that each member of the organisation has a vote and no more than one in the assembly regardless of the quantity of shares subscribed. The absence of this rule in the Italian law on social enterprises should not however surprise us, since this is consistent with the choice of the Law not to limit eligible organisations on the basis of their legal form: eligible organisations – as pointed out above – could in theory be co-operatives (i.e. employee-, producer-, or customer-owned firms), investor-owned firms (i.e. business corporations), or traditional non-profit firms (i.e. associations and foundations).

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<sup>17</sup> On workers’ participation in enterprises, see FICI, *Financial Participation by Employees in Co-operatives in Italy*, 37 *Journal of Co-operative Studies* 16 ff. (2004).