

The Emergence of Social Enterprises in China: The Quest for Space and Legitimacy

Rebecca Lee

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The Emergence of Social Enterprises in China: The Quest for Space and Legitimacy

Rebecca Lee*

In recent years, the mainland Chinese government has encouraged the development of the nonprofit sector in China. This development has been accompanied by the emergence of the “social enterprise” as a concept in China. Despite its novelty, there has been increasing recognition of the potential for social enterprises to tackle social problems such as unemployment, discrimination and low income.

This article reviews the emergence of the social enterprise as a new social entity in China, examines its vaguely defined legal status, and explores deficiencies in the relevant legal frameworks. The author recommends the introduction of a distinct category of organizational structure for social enterprises, to rectify some of the existing inadequacies in social enterprise law. These changes in turn will modernize the legal and regulatory framework for social enterprises in China. It is hoped that such measures will facilitate regulations of social enterprises and support a stronger, more sustainable and more socially inclusive economy.

* Assistant Professor, Faculty of Law, The University of Hong Kong (+852 2859 2949 / rebecca.lee@hku.hk).

I. INTRODUCTION

In recent years, the mainland Chinese government has encouraged development of the nonprofit sector in China. A primary example of this is seen by the drafting of the Charity Law.¹ The resulting increased number of charity organizations in China has also contributed to the growth of social enterprises,² albeit the total number of social enterprises remains small. A decade ago, “social enterprise” as a concept was still novel in China. Today, it has gained widespread attention and acceptance.³ The concept was introduced to China in 2005, after the world-acclaimed texts “Banker to the Poor” and “How to Change the World” were translated into Chinese.⁴ As discussed in Part II of the article, the focus on developing regulations for social enterprises has become a prominent trend,⁵ brought about by a change in the structure of government funding for the nonprofit sector. The government recognizes the benefits of establishing social enterprises to tackle social problems such as unemployment, discrimination and low income.⁶ There is a need to employ new initiatives, such as social enterprises, to respond to some of the unmet needs of vulnerable sectors of society. This is especially true with the issue of work integration, where the elderly, disabled individuals, women, and unskilled workers are excluded from certain

¹ According to the Ministry of Civil Affairs, the drafting process of the *Charity Law* commenced in 2005. Details of the draft Charity Law have not been made available to the general public, but the Ministry of Civil Affairs has invited comments on the draft from various expert bodies, including the International Centre for Civil Society Law. See COMMENTS ON THE DRAFT CHARITY LAW FOR THE PEOPLE’S REPUBLIC OF CHINA 5(1) (Int’l Ctr. For Civil Soc’y Law 2007).

² This is partly because social enterprises provide an alternative way of delivering charitable services. As institutions that possess social purposes and business traits, social enterprises can also play an important role in functions performed by charity organizations such as poverty alleviation: “Social enterprise has already been considered an important direction for NGOs in China”: Non-profit Incubator report on “The general report of social enterprise in China”; available at http://dsi.britishcouncil.org.cn/images/BC_China_Social_Enterprise_Research_Report.pdf.

³ In particular, the concept of social enterprise spreads quickly in coastal cities; see *id.*

⁴ See Muhammad Yunus, *Banker to the Poor: Micro-Lending and the Battle Against World Poverty* (Public Affairs 1999); David Bornstein, *How to Change the World: Social Entrepreneurs and the Power of New Ideas* (OUP 2004). Both books were translated into Chinese by Juliet Wu in 2005 and 2006, respectively. See <http://big5.chinabroadcast.cn/gate/big5/gb.cri.cn/9223/2006/07/20/1266@1140844.htm>.

⁵ For details, see Part II of this article.

⁶ See, e.g., China Social Entrepreneur Foundation, “Social enterprise role in China’s poverty reduction practice” (Oct 19, 2007); available at www.ifpri.org/2020Chinaconference/day3/presentations/G2-3_WPing.ppt.

labor markets.⁷ Unemployment of these groups poses the risk of social exclusion as well as the possibility of social and political instability.

This article proceeds with a brief discussion of the emergence of social enterprises in China in Part II. It then provides an overview of the different categories of organizational structures into which social enterprises have been placed under the current legal regime and examines their deficiencies. The author concludes in Part II that social enterprises in China exist in obsolete organizational structures that rest on vague legal definitions, and operate in legally and institutionally deficient environments, and that these problems have hindered the development of social enterprises in China. Part III highlights the importance of creating a specific category of organizational structure for social enterprises to guarantee its legitimacy as a coherent type of institution, distinct from other social organizations. This would give social enterprises more space for expansion and improvement. Part IV concludes that while mere transplantation of a Western social enterprise structure may not be feasible in China, an effective variant is possible. The English model can serve as a good point of reference for the government to update and modernize its legal framework. This modernization would constitute the government's crucial first step towards recognizing its own role in enabling social enterprises to promote a financially sustainable and socially inclusive economy

II. THE EMERGENCE OF SOCIAL ENTERPRISES IN CHINA

Before the concept of a social enterprise became prevalent in China, Chinese social organizations mainly took the form of self-help community groups that provided job opportunities to women, the disabled, the under-employed, the impoverished, and the victims of disasters. Today, social enterprises exist as newly formed and constantly evolving organizations in the nonprofit sector. Social enterprises are not only better organized than previous forms of social organizations, but the scale of their operation and the range of the activities they undertake are also substantially more diverse compared to social enterprises when they first emerged. The rest of Part II provides an overview of the political, socio-economic, and cultural factors that have led to the emergence of social enterprises in China.

⁷ As a consequence of the financial tsunami in 2009, the Chinese government estimates about 20 million rural migrants, or 15.3% of all rural workers employed outside their hometowns, have returned home without jobs. See *Rising Unemployment Becomes China's Top Challenge*, *Economists*, Xinhua News, Feb. 7, 2009, available at <http://english.peopledaily.com.cn/90001/90776/90882/6587758.html>.

Given the trends in this area, it is important to evaluate the ability of the existing legal framework in China to support the further development of social enterprises.

A. Reasons for the emergence of social enterprises in China

There are several factors contributing to the recent emergence of social enterprises in China.⁸ Firstly, remarkable economic growth in urban cities has exacerbated social and economic inequalities between rural and urban China.⁹ There are new social problems which cannot be fully tackled by the government because of their large scale: rural unemployment, the problems associated with an aging rural population, and issues faced by rural-urban migrant workers, for instance. Some of these social problems have been exacerbated by natural disasters, like the snowstorm crisis and the Sichuan earthquake in 2008, which affected the poorer western part of the country. Social enterprises arose in this context to respond to the changing needs of society where new initiatives to provide relief are required.¹⁰

Secondly, changes in the government funding structure for the nonprofit sector have contributed to the emergence of social enterprises. Such changes are observed where the previous state monopoly on resources and direct provision of services shifted to government subvention or subsidy of social services.¹¹

Thirdly, as producers and manufacturers are becoming more affluent, they may seek goods or supplies from an institution that complies with their personal values and ideologies; they are not limited to sourcing goods from public or private sector enterprises. These socially conscious producers and consumers may be attracted by goods and services delivered by social enterprises because of social enterprise's philanthropic motives, their close engagement with stakeholders, as well as their flexibility in devising strategies to satis-

⁸ See, e.g., Lirong Shi, *Zhuanxing yu zhenghe: shehui qiye de xingzhi, goucheng yu fazhan* [Transition and Integration: the Nature, Structure and Development of Social Enterprises], 4 Renwen Zazhi [Humanities Bulletin] 181-197 (2007).

⁹ Xinhua News Agency reports that, according to the State Council of the People's Republic of China, the annual per-capita disposable income was 4140 yuan (approximately 608.8 U.S. dollars) in the countryside in 2007. See *Deeper Income Gap Calls for Reform to Solve Deeper Conflict in China*, XINHUA, Sep. 12, 2008, available at http://news.xinhuanet.com/english/2008-09/12/content_9949998.htm. However, the average city-dwellers received an income that was 3.33 times larger than rural residents. *Id.* The income disparity amounted to 9646 yuan (approximately 1418 U.S. dollars), marking the largest urban-rural income gap since the opening up of China in 1978. *Id.*

¹⁰ See, e.g., *Social Enterprises to Play Bigger Role*, CHINA DAILY, Feb 17, 2006; *Symposium Presents 'Social Enterprise' as Key to Sustainability*, CHINA DEVELOPMENT BRIEF, Oct. 21, 2006.

¹¹ See, e.g., Qiusha Ma, *The Governance of NGOs in China since 1978: How Much Autonomy?*, 31 NONPROFIT AND VOLUNTARY SECTOR QUARTERLY 305-328 (2002). The author notes that "small government and big society" has become a widely quoted slogan since the mid-1990s. See *id.* at 306.

fy social needs without being unduly constrained by the economic pressure of the market.¹² Consequently, the expansion of this group of socially conscious individuals has also contributed to the recent emergence of social enterprises in China.

Last but not least, international efforts also help to foster China's social entrepreneurial spirit. For example, the Skoll Centre for Social Entrepreneurship¹³ co-hosted the International Forum on Social Entrepreneurship at Zhejiang University in May 2007 to build ongoing links between Asian and Western social entrepreneurship.¹⁴ As a result, the potential for social enterprises to resolve social problems has been increasingly recognized and appreciated, in light of the tangible social and economic benefits brought forward.

However, social enterprises in China are still under-developed. Despite recent attempts at legal reform in this area, there is still no comprehensive law governing social enterprises in China; the existing laws govern the nonprofit sector generally and remain disparate and obsolete. The discussion below takes the opportunity to review the current legal framework governing social enterprises in China. It contends that in order to promote social enterprises in China, a unified legal structure must be introduced.

B. Types of social enterprises in China under the current legal regime and their deficiencies

1. Definition of social enterprises generally

According to the EMES¹⁵ definition, "social enterprises are not-for-profit private organizations providing goods or services directly related to their explicit aim to benefit the community. They rely on a collective dynamic involving various types of stakeholders in their governing bodies, they place a high value on their autonomy and they bear economic risks linked to their activity."¹⁶ Further, the

¹² Helen Haugh, *Nonprofit Social Entrepreneurship*, in *THE LIFE CYCLE OF ENTREPRENEURIAL VENTURES* 408 (Simon Parker ed., Springer 2006).

¹³ The Skoll Centre for Social Entrepreneurship was launched in November 2003 at the Saïd Business School, Oxford University, to promote the advancement of social entrepreneurship worldwide. See Oxford University Skoll Centre for Social Entrepreneurship Saïd Business School, <http://www.sbs.ox.ac.uk/skoll/>.

¹⁴ "East meets west at social entrepreneurship forum" (May 2007): see <http://www.sbs.ox.ac.uk/news/archives/Events/East+meets+west+at+social+entrepreneurship+forum.htm>.

¹⁵ The Emergence of Social Enterprise in Europe Project [hereinafter EMES] began in 1996 to conduct research on social enterprise in EU countries with funds from the European Commission. See <http://www.emes.net/index.php?id=7>.

¹⁶ Jacques Defourny & Marthe Nyssens eds., *Social Enterprise in Europe: Recent Trends and Developments* (EMES working paper no. 08/01), available at http://www.emes.net/fileadmin/emes/PDF_files/News/2008/WP_08_01_SE_WEB.pdf.

EMES outlines criteria that define social enterprises, and asserts that an ideal social enterprise would embody the full set of conditions. These criteria include:¹⁷

- 1) a continuous activity producing goods and/or selling services;
- 2) a high degree of autonomy;
- 3) a significant level of economic risk;
- 4) a minimum amount of paid work;
- 5) an explicit aim to benefit the community;
- 6) an initiative launched by a group of citizens;
- 7) a decision-making power not based on capital ownership;
- 8) a participatory nature, which involves the persons affected by the activity; and
- 9) limited profit distribution.

Alternatively, social entrepreneurship can be described broadly as “activities associated with the perception of opportunities to create social value and the creation of social purpose organizations to pursue them.”¹⁸ A working definition can also be borrowed from the UK Office of the Third Sector which defines social enterprises as “businesses with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profit for shareholders and owners.”¹⁹

2. Social enterprises in China and their deficiencies

Under the current legal regime in China, social enterprises are spread across four organizational categories,²⁰ namely: (i) non-governmental and nonprofit organizations; (ii) social welfare enterprises (shehui fuli qiye 社会福利企业); (iii) cooperatives (hezuoshe 合作社); and (iv) community services centers (shequ fuwu zhongxin 社区服务中心). However, under closer analysis, these organizational categories are insufficient for the full and proper functioning

¹⁷ Jacques Defourny, *Introduction: From Third Sector to Social Enterprise*, in *THE EMERGENCE OF SOCIAL ENTERPRISE* 16-18 (Carlo Borzaga & Jacques Defourny eds., Routledge 2001).

¹⁸ See Helen Haugh, *A research agenda for social entrepreneurship*, *SOCIAL ENTERPRISE JOURNAL* 1 (2005).

¹⁹ “The third sector is a diverse, active and passionate sector. Organizations in the sector share common characteristics: non-governmental; value-driven; and principally reinvest any financial surpluses to further social, environmental or cultural objectives. The term encompasses voluntary and community organizations, charities, social enterprises, cooperatives and mutuals both large and small.” See Cabinet Office.gov.uk, *What is the Third Sector?*, http://www.cabinetoffice.gov.uk/third_sector/about_us.aspx.

²⁰ See Jian Kan, *Fazhan shehui qiye [Developing social enterprises]*, 1 *LEGAL SYSTEM AND SOCIETY* 183 (2008).

of social enterprises. First, they do not meet the generally-accepted definition of social enterprises, in that they do not truly embrace the essential features and characteristics of social enterprises. Second, and more significantly, these definitions are inadequate or defective in view of the evolving nature and activities of social enterprises in China. The following section discusses the characteristics of the different structures of social enterprises currently and goes on to explain why they are not ideal for facilitating the development of social enterprises in China.

(a) Lack of agreed definition

Although it may not be possible to find a social enterprise which complies with the criteria of the ideal social enterprise as defined above, these Western definitions remain useful in evaluating the current examples of social enterprises in China. In China, there is a general consensus that the simplest definition of social enterprise is that it is a business trading for a social purpose, and so pursues a 'double bottom-line' by integrating business strategies with broader social goals.²¹ Nonetheless, there is no agreement as to the essential characteristics that should be embodied by a social enterprise or a universally-agreed definition of social enterprises. For example, does the legal definition of a social enterprise in China require that it pursue business and social objectives simultaneously? What does it mean for a social enterprise to operate in a not-for-profit manner? As social enterprises are becoming more prevalent, these questions must be tackled so that social enterprises can be legally recognized, legally protected and legally accountable.

Several reasons exist to support the view that the emphasis of social entrepreneurship should be on innovation. Delivering new services to consumers, identifying new ways of delivering existing services, implementing new strategies to generate income, and delivering existing services to new individuals are a few of the social benefits that arise from an organization that focuses on innovation. So long as an organization's mission is to create and sustain social value, and it engages in innovative and adaptive methods to serve that mission, it should be regarded as a social enterprise. A broad definition will provide an inclusive environment for social enterprise to grow, particularly once legal protections become more favorable.

In fact, examples of this type of social enterprise are already emerging in China. "Venture in Development" is a nonprofit or-

²¹ Some social enterprises pursue a triple bottom-line, which include environmental goals among their objectives.

ganization that strives to catalyze the creation of more social enterprises in the Greater China region.²² The aim of its projects is to bring sustainable development to China. “Shokay” is a business that specializes in high-end knitted products. Its products are made from yak down hair sourced in Qinghai Province from the indigenous Tibetan yak herding communities. A portion of the business’s profits is reinvested to these communities to assist the herders with local development needs in areas such as health and education.²³ Similarly, “Mei Xiang Cheese Farm” is an organization intended to assist impoverished Tibetan farmers to become self-sufficient by developing their yak products for exportation to the international market. The common theme in these projects is to bring about social change in China through empowering the poorest members of society. These projects aim to enhance social inclusion, social development and the integration of the communal network. This is in direct contrast to government policies, which attempt to combat unemployment reactively, often by aiming to retrain the workforce. Social enterprises, are decidedly proactive, and take into account integral economic, social, and cultural factors, local needs, local resources, and participation by local parties.

(b) Deficiencies under the current legal regime

The existing classifications of organizational structures are unable to capture the many features and characteristics of social enterprises. Under the current legal regime in China, none of the existing categories of organization sufficiently reflects the definition and functional needs of social enterprises. Further, the existing categories do not recognize social enterprises as a distinct legal entity. The law merely sees them as organizations that pursue social goals.

(i) Non-governmental organizations and nonprofit organizations

The first type of social enterprises can be collectively called non-governmental organizations or nonprofit organizations.²⁴ These include “social organizations” (shehui tuanti 社会团体) or “civil non-enterprise institutions”²⁵ (minban feiqiye danwei 民办非企业单位

²² See Ventures in Development, <http://www.venturesindev.org/>.

²³ See Shokay, <http://www.shokay.com/>.

²⁴ These institutions operate in the nonprofit sector in China. See generally Qiusa Ma, *Defining Chinese Nongovernmental Organizations*, 13(2) VOLUNTAS: INTERNATIONAL JOURNAL OF VOLUNTARY AND NONPROFIT ORGANIZATIONS 113-130 (2002).

²⁵ Also known as “non-governmental, non-commercial enterprises,” “public institutions,” or “private nonprofit institutions.”

or minfei 民非), and “foundations” (jijinhui 基金会). Social organizations and civil non-enterprise institutions are voluntary organizations engaged in nonprofit making activities,²⁶ whereas foundations are civil nonprofit organizations that use donated assets to undertake public welfare activities.²⁷ The relevant laws governing these entities are the “Regulations for the Registration and Management of Social Organizations” (Shehui tuanti dengji guanli tiaoli 社会团体登记管理条例),²⁸ the Temporary Regulations for the Registration and Management of Civil Non-enterprise Institutions (Minban fei qiye danwei dengji guanli zanxing tiaoli 民办非企业单位登记管理暂行条例)²⁹ and the “Regulations for the Management of Foundations” (Jijinhui guanli tiaoli 基金会管理条例) respectively.³⁰ Article 29 of the Social Organizations Regulations and Article 21 of the Minfei Regulations stipulate that the income made can only be used for activities set out in the relevant constitutions, and that there cannot be any distribution of profits to its members. With the introduction of the Trust Law (Xintuofa 信托法)³¹ in 2001 which contains a chapter on charitable or public welfare trusts (gongyi xintuo 公益信托), it is now possible to establish an NPO in the form of a charitable trust in China.

(ii) Social welfare enterprises

Social welfare enterprises are the most prevalent legal form of social enterprises. They are in essence profit-making enterprises with an aim to social enhancement by providing job opportunities to the disabled. Social welfare enterprises are regulated by the Temporary Regulations on the Management of Social Welfare Enterprises (Shehui fuliqiye guanli zanxing banfa 社会福利企业管理暂行办法

²⁶ See Regulations for the Registration and Management of Social Organizations (promulgated by the State Council, Sep. 25, 1998, effective Sep. 25, 1998) art. 2, translated at <http://www.chinadevelopmentbrief.com/node/298> (last visited Jan. 6, 2010) (P.R.C.) [hereinafter Social Organization Regulations]; Temporary Regulations for the Registration and Management of Civil Non-enterprise Institutions (promulgated by the State Council Oct. 25, 1998, effective Oct. 25, 1998) art. 2 (P.R.C.) [hereafter *Minfei* Regulations].

²⁷ See Regulations for the Management of Foundations (promulgated by the State Council Sep. 27, 1988, effective Sep. 27, 1988) art. 2, translated at http://www.novexc.com/management_of_foundations.html (last visited Jan. 6, 2010) (P.R.C.) [hereinafter Foundation Regulations].

²⁸ See Social Organization Regulations, *supra* note 26.

²⁹ See *Minfei* Regulations, *supra* note 26.

³⁰ See Foundation Regulations, *supra* note 27.

³¹ See the Trust Law, (promulgated by the Standing Committee of the National People's Congress, Apr. 28, 2001, effective Oct. 1, 2001), translated at http://www.gov.cn/english/laws/2005-09/12/content_31194.htm (last visited Jan. 31, 2010) (P.R.C.).

).³² Article 8 of the Regulations provides that, in order to qualify as a social welfare enterprise, at least 35% of its operational staff must be disabled workers. Article 16 then provides that a social welfare enterprise would enjoy tax benefits.³³ Pursuant to the Notice regarding certain beneficial corporate income tax policies (*Guanyu Qiyesuodeshui ruogan youhui zhengce de tongzhi*, 关于企业所得税若干优惠政策的通知) issued by the Ministry of Finance and State Administration of Taxation in 1994, if more than 35% of the operational staff of a social welfare enterprise are disabled workers, it will be exempted from income tax. Where the percentage of disabled staff is between 10% and 35%, the enterprises' income tax will be halved accordingly.³⁴ In 2001, there were 38,000 social welfare enterprises employing 699,000 handicapped people.³⁵ This shows that social welfare enterprises are performing an important social function of providing job opportunities to the disabled.

However, with social welfare as a predominant consideration, social welfare enterprises suffer from inefficient management, lower productivity of the workforce and poorer product quality. Thus it is more difficult for social welfare enterprises to compete with commercial enterprises in the face of the recent economic reforms.³⁶

(iii) *Cooperatives*

Cooperatives are simply nonprofit entities formed by the poorer sectors of society, such as farmer cooperatives. They are generally very small in scale and the enterprise operations are relatively primitive.

(iv) *Community services centers*

Community service centers are part of the state social welfare system. They provide social services to society, such as the provi-

³² See, e.g., Lihua Yu, *Jiedu Shehui Qiye [Interpretation of Social Enterprises]*, 7(3) JOURNAL OF WUHAN INSTITUTE OF TECHNOLOGY 22-24 (2008); Fenglu Yang & Qinqin Sun, *On the Commercialization of Nonprofit Organizations*, 5 SHANDONG UNIVERSITY BULLETIN 16 (2007).

³³ Where the proportion of disabled persons is between 10% to 35%, article 16 of the Social Welfare Enterprises Regulations provides that they may also enjoy tax benefits after verification by the Ministry of Civil Affairs. See Temporary Regulations on the Management of Social Welfare Enterprises (promulgated by effective Sept. 15, 1990) art. 16 (P.R.C.) [hereafter Social Welfare Enterprises Regulations].

³⁴ See Notice Regarding Certain Beneficial Corporate Income Tax Policies (promulgated by the Ministry of Finance and State Administration of Taxation, 1994) Article 1(9). The Notice also provides for exemptions from product tax and value-added tax where applicable.

³⁵ See International Labor Office, Disability Compensation System – People's Republic of China, http://wallis.kezenfogva.iif.hu/eu_konyvtar/Projektek/Vocational_Rehabilitation/china/chi_rap/comp.htm.

³⁶ See Linda Wong, *MARGINALIZATION AND SOCIAL WELFARE IN CHINA* 120-21 (Routledge 1998).

sion of basic sanitary facilities and nursery services to the rural villages.³⁷ These centers provide a diverse range of services, but the lack of resources means that many of these projects are ineffective.³⁸

There are two main problems with this current legal regime for social enterprises. First, the current organizational structure of social enterprises does not clarify the concept of social enterprises. Social enterprises differ from nonprofit charitable organizations (*feiyingli / gongyi zuzhi* 非营利/公益组织) which are charitable in nature or commercial enterprises (*shangye qiye* 商业企业) which are profit-making in nature. Social enterprises are entities which exist in the middle of the spectrum and manifest both charitable and profit-making features.³⁹ Because of the differences between NGOs and social enterprises, the latter should be treated as distinct from NGOs or charities. The current law does not manage to distinguish the two entities, and this leads to the unclear identity of social enterprises. By distinguishing these two entities, social enterprises can uphold and develop their own values.

Second, and more importantly, there are institutional obstacles in adopting nonprofit organizations as the organizational structure for social enterprises in China. For example, nonprofit organizations in China are not truly self-governing or autonomous; rather the government tends to retain control over them. This can be exemplified by the dual registration and management system in China. For a proposed nonprofit organization to become registered, it must obtain the support of a sponsor organization or a professional leading unit (*yewu zhuguan danwei* 业务主管单位), which is usually a government agency in charge of the area of the proposed nonprofit organization as well as the approval of the relevant Ministry of Civil Affairs or registration management agency (*dengji guanli jiguan* 登记机关).

The governing laws and regulations may also impose strict eligibility requirements which in turn restrict the use of a particular organizational structure as a social enterprise. For example, the Foundations Regulations impose stringent eligibility requirements for the establishment of both public foundations, which engage in public fundraising, and private foundations, which do not engage in public fundraising. Public foundations are sub-divided further into

³⁷ See, e.g., Opinion of the State Council on Strengthening and Improving Community Services (Apr. 9, 2006) (P.R.C.).

³⁸ See Wong, *supra* note 36, at 130.

³⁹ See, e.g., Lihua Yu, *Jiedu Shehui Qiye [Interpretation of social enterprises]*, 7(3) JOURNAL OF WUHAN INSTITUTE OF TECHNOLOGY 22-24 (2008); Fenglu Yang & Qinqin Sun, *Feiyingli zuzhi de shangyehua tantao [On the Commercialization of Nonprofit Organizations]*, 5 SHANDONG DAXUE XUEBAO [SHANDONG UNIVERSITY BULLETIN] 16 (2007).

national and provincial foundations. The former must have an initial endowment of RMB 8 million and the latter RMB 4 million.⁴⁰ For private foundations, they must have an initial start-up of RMB 2 million.⁴¹ These high start-up costs make it very difficult, if not impossible, for smaller organizations to pursue social missions. If the legal framework were inclusive of the concept of social enterprises, such institutional barriers could be addressed with specific provisions for their special needs. It may be useful to draw on practices from other jurisdictions to create a new legal structure for social enterprises.

III. THE QUEST FOR SPACE AND LEGITIMACY

Even though there are many benefits with developing social enterprises, such development is still at an embryonic stage. Given the relatively recent emergence of social enterprises and the lack of public understanding in this area, social enterprises in China face a number of challenges, such as structuring successful organizations; acquiring resources for the enterprise; and affecting social impact.

All of these challenges are interrelated, and the root problem is that in China the legal categories that exist to classify social organizations are inadequate for the specific needs of social enterprises. In order to establish a successful social enterprise sector, it is important to assign a proper legal status to the entire class of social enterprises. The lack of a legitimate status for social enterprises in China has given rise to problems at two different levels. From the perspective of the individual organization, lack of adequate legal definition is an obstacle in developing sources to fund start-up and operational costs. This affects the ability of social enterprises to acquire resources. Moreover, the business sectors and the wider community may be reluctant to consider the potential of using social enterprises to pursue economic and social objectives. This limits the positive impact that can be brought about by social enterprises.

Increasing our awareness and understanding of social enterprises may strengthen social enterprises' ability to acquire resources. This would allow social enterprises to deploy these resources strategically and make a greater impact. The enterprises can go on establishing networks and partnerships, improving operational efficiency and effectiveness. A proper understanding of social enterprises helps to kick-start a cyclical chain of benefits: social enterprises demonstrate better work performance which leads to an inflow of more funding

⁴⁰ See Foundations Regulations, *supra* note 27 at art. 8.

⁴¹ See *id.*

and, ultimately, to the expansion of the sector. The recent introduction of a newly created enterprise legal structure in England suggests that there are benefits to such an approach and that similar attempts might be made in China.

A. Experiences from the U.K. provide analogy

Similar to the current situation in China, before 2004, social enterprises in the U.K. could take on any legal form, and thus did not have a distinct legal identity. There was no requirement for social enterprises to ensure that their assets would be used to pursue social objectives instead of personal financial gains. However, the Companies (Audit, Investigations and Community Enterprise) Act 2004 recognized a new and specific legal form of company known as a “community interest company” (“CIC”).⁴² A company limited by shares or by guarantee may be formed as a CIC.⁴³

The corporate form of a CIC is used to avoid the regulatory prohibitions which forbid charities to do commercial activities irrelevant to their objective. Provided that an organization satisfies the standards of a community interest test and contains an asset lock, the CIC legal form can be used. The “community interest test” assesses from the perspective of a common reasonable individual whether the objective of a company is to promote a public interest.⁴⁴ Where the standard of this test is met, the presence of an “asset lock” ensures that capital invested in the company is used for community interest. Therefore, capital can only be transferred to companies which are also subject to such asset-locking regulations. Furthermore, distribution of dividends may not be made unless there is a cap and the shareholder is also an asset-locked entity.⁴⁵ In the event of dissolution, the assets are passed to another social enterprise.⁴⁶

Accountability of social enterprises is further ensured through requiring CICs to produce a “community interest company report” to

⁴² Companies (Audit, Investigations and Community Enterprise) Act, 2004, c. 154, (Eng.). By April 2007, there were 1040 Community Interest Companies on the register. *See id.*

⁴³ *See id.* at §26(2). Note that a community interest company is not a charity. *See id.* at §26(3)(a).

⁴⁴ “A company satisfies the community interest test if a reasonable person might consider that its activities are being carried on for the benefit of the community.” *See id.* at §35(2).

⁴⁵ “Community interest companies must not distribute assets to their members unless regulations make provisions authorizing them to do so.” *See id.* at §30(1). *See also* Community Interest Company Regulations, 2005, §17 (Eng.) [hereinafter Community Interest Company Regulations] (setting forth detailed rules on declaration of dividends).

⁴⁶ *See* Community Interest Company Regulations, *supra* note 45, at §23 (requiring the residual assets either to be distributed to members who are entitled to share in the distribution on the winding up of the social enterprise, or to other social enterprises which are subject to asset-locked requirements).

stakeholders annually,⁴⁷ in addition to normal accounting reporting. The Law also creates a Regulator of Community Interest Companies⁴⁸ which (i) considers and approves formation of CICs; (ii) ensures compliance; and (iii) investigates complaints and initiates enforcement actions.⁴⁹ The British government further set up the Of-Office of the Third Sector in 2006 to promote social enterprises and the third sector generally.

B. The case for a specific organizational structure for social enterprises in China

It is submitted that it is worth considering the creation of a distinct organizational category to buttress the growth of social enterprises in China. It is not necessary for this new entity to replace the existing organizational structures. If the specific legal structure satisfies the features of a social enterprise, promotion of public interest and asset locking, and is accountable through a reporting system and regulated by an independent regulator, the legitimacy of social enterprises in China can be boosted. Since social enterprises are organizations which integrate business with social objectives, it may be helpful to adopt a structural company form to raise financing for business purposes through issuing preferred shares which entitle shareholders to a fixed nominal return. The public value of a social enterprise can further be promoted by requiring the residual assets to be preserved for the community rather than distributed to its members on its dissolution. Thus, such an organizational structure is suitable for community-based social enterprises which wish to improve their access to financing while also providing public confidence through the locking-in of assets profits for public interest purposes. In addition, it is submitted that the creation of a specifically-designed organizational structure for social enterprises in China can enhance their legal status, promote governance and accountability, and ultimately, create more space for the expansion of the sector.

1. Enhancing legitimacy through granting legal identity

Suchman defines legitimacy as “a generalized perception or assumption that the actions of an entity are socially desirable, proper or

⁴⁷ See *id.* at §34(1) (“The directors of a community interest company must prepare in respect of each financial year a report about the company’s activities during the financial year (a ‘community interest company report’).”).

⁴⁸ See *id.* at §27(1) (“There is to be an officer known as the Regulator of Community Interest Companies...”).

⁴⁹ See *id.* at §42(1) (“The Regulator may ... (a) investigate the affairs of a community interest company...”).

appropriate within some socially constructed system of norms, value, belief and definitions.⁵⁰ One form of legitimacy is moral legitimacy, which refers to the normative domain of propriety rather than self-interest, and it is accorded when activities are undertaken as they should be, in reference to broader norms in socio-political environment.⁵¹ In the context of social enterprises, it refers to whether the social enterprise is understood as a proper and appropriate organizational model in comparison to the more conventional nonprofit organizations. In other words, it relates to whether social enterprises can be viewed as a preferred model of organization. If social enterprises can be regarded as morally legitimate, this can also explain its increased incidence. Consequently, the lack of a distinct legal identity for social enterprises in China has contributed to the public's poor understanding of this form of institutions.

As mentioned above, social enterprises differ from charitable/nonprofit organizations which are wholly charitable in nature, or from commercial enterprises which are wholly profit-making in nature.⁵² Social enterprises emerge where there is increasing pressure on nonprofit organizations to adopt more enterprising strategies.⁵³ But social enterprises are not necessarily entirely nonprofit; they are social enterprises because they have a social mission in their structure. They bridge gaps where government welfare provisions are deficient. They improve access to social opportunities, help combat poverty and injustice, and strengthen local economies. Accordingly, the legal framework should enable social enterprises to become more entrepreneurial, so that they can become less dependent on philanthropy and donations, be more engaged in generating revenue to accomplish their social mission, and create greater social value. The variety of examples of social enterprises in China suggests that existing legal definitions for organizations are insufficient and do not adequately take into account the distinct features of social enterprises in China. The legal framework should therefore be developed to support an organizational form which specifically suits the characteristics and demands of social enterprises, so as to ultimately facilitate the development of social enterprises.

⁵⁰ See Mark Suchman, *Managing Legitimacy: Strategic and Institutional Approaches*, 20 (3) ACADEMY OF MANAGEMENT REVIEW 571, 574 (1995).

⁵¹ See Raymond Dart, *The Legitimacy of Social Enterprise*, 14(4) NONPROFIT MANAGEMENT & LEADERSHIP 411, 418 (2004).

⁵² See Yu, *supra* note 39; Yang & Sun, *supra* note 39.

⁵³ See Haugh, *supra* note 12, at ch. 14.

2. Promoting governance and accountability through modernizing the legal and regulatory framework

A specific, modernized legal and regulatory structure can also assist with the successful development of social enterprises by emphasizing best practices. For instance, a nonprofit-distribution constraint should be mandatory for parties setting up a social enterprise in order to ensure accountability in the use of profits generated by social enterprises. As well, different evaluative measures and standards can be explored to assess the performance of social enterprises. A legal framework that embodies themes such as the above will both enable and sustain the concept of social enterprises.

The existing legal framework tends to focus on nonprofit organizations providing charitable activities to the society, rather than undertaking business initiatives. For example, the Public Welfare Donations Law stipulates rules on management and protection of donated assets; the Trust Law allows the establishment of a charitable trust in China; and the Regulations for the Management of Foundations allow civil nonprofit organization that utilize donated assets to undertake public welfare activities. While these new laws and regulations are important to developing the nonprofit sector in China, they do not cater to the needs of an emerging social enterprise field, where businesses undertake activities with social objectives and nonprofit organizations adopt more market-oriented strategies.⁵⁴ Moreover, these laws and regulations fail to take account of the shifting role of the government from being responsible for the distribution of resources in the past to regulation of social organizations in the present. Besides, there are also institutional obstacles in setting up truly self-governing or autonomous nonprofit organizations in China as explained above.⁵⁵ As a result of the government patronage involved in setting up nonprofit organizations, the laws only play an aspirational role in ensuring their accountability. For example, there is a lack of accessible information for donors to assess performance and register their views.

Existing social enterprises may also have difficulties acquiring resources because of their unclear status. The public does not often know what proportions of assets and surpluses are used to pursue economic rather than social objectives. Because of the lack of governance and accountability requirements with social enterprises, lenders may find it difficult to assess the risk profile of social enterprises. Consequently, social enterprises may find that there are only

⁵⁴ *See id.*

⁵⁵ For details, *see* Part II(B) in this article.

limited sources of funding and options. On the contrary, if social enterprises were subject to nonprofit-distribution constraints, there would be an added protection device for consumers, donors, and employees. This type of constraint provides “assurances and builds organizational legitimacy and consumer confidence. Its nonprofit status ensures that the incentive to generate a surplus is weakened . . . It helps to address fear of exploitation by providing assurances that contributions, and any excess revenue, will be used to further the mission of the organization – they will not be converted into profit.”⁵⁶ Nonprofit status may also enable social enterprises to acquire resources at a preferential rate, secure favorable tax incentives, engage volunteer labor and receive donated resources.

Social enterprises do not only differ from for-profit enterprises in terms of their aims to enhance social value. The former also relies on a mixture of employees and volunteers, and multiple sources of income (private donation, government grants, trading revenue), and various measures to evaluate performance. Evaluation of performance is usually determined by social value, and concepts like social accounting have been used to measure subjective values. Social enterprises can also be evaluated in terms of developments in social capital, social justice, social inclusion, participation, regeneration, civil society, employability and social well-being. Social impacts and intangible returns (e.g. changes in demand for drug services; increased community well-being) are often difficult to quantify or impossible to measure. Thus, a distinct organizational definition can establish standardized performance measures that may be used to assess the creation of social value by social enterprises. Developments in accounting for social value will enable social enterprises to accurately measure their performance and prove their worth to stakeholders and policy makers, justifying the tax benefits received.⁵⁷

3. Creating space through promoting the value of social enterprises

At the moment, the value of social enterprises in China is underappreciated. A specific organizational structure for social enterprises in China can help promote their value and create more space for the development of the sector. In this regard, a specific organizational category may assist in (i) boosting public confidence in social enterprises; (ii) diversifying the range of social enterprise undertakings; and (iii) promoting government support.

⁵⁶ See Haugh, *supra* note 12, at 410.

⁵⁷ See *id.* at 419.

A specific organizational category for social enterprises in China can boost public confidence in these entities. From the Chinese government's point of view, philanthropy may be seen as attempting to be a substitute for government action. This may be particularly sensitive in China where socialist values still hold official importance. However, social enterprises emphasize a tripartite partnership among the government, the private sector and the nonprofit sector, and indeed the success of social enterprises depends on this tripartite partnership. Social enterprises do not aim to undercut the role of the government, but merely act as a platform for collaboration among the government, the private sector and the nonprofit sector. Further, because the development of social enterprises is still a relatively new phenomenon, there remains traditional cynicism about business engagement in social undertakings. Therefore, a specific organizational form recognized by law can help boost public understanding and support for social enterprises.

Currently, the most prevalent form of social enterprise in China is an organization that provides job opportunities to disabled persons. However, the field of social enterprises should grow beyond the narrow range of services such as work integration and personal service provision (e.g., childcare services). The social enterprise is a viable strategy for supporting other nonprofit sector activities. A specific organizational form of social enterprises can enable the range of social enterprise activities to be diversified so as to undertake activities relating to environmental protection or cultural heritage. Indeed, the China Social Entrepreneur Foundation has expressed that in selecting projects for funding, they will opt for "sustainable" options such as education and environmental protection to complement traditional poverty alleviation projects. This decision may bring about fundamental changes in the rural areas.⁵⁸ Accordingly, the Foundation selected three funding directions, namely education, community construction, and incubation of social enterprises. Diversification of activities undertaken by social enterprises can in turn promote the value and utility of social enterprises.

A specific organizational category makes it easier to advocate support in terms of favorable government policies. With a clear legal status, the government can enhance its policy support to social enterprises. For example, the government can offer preferential treatment to social enterprises in the public procurement process to social enterprises. It can contract out its services more actively by

⁵⁸ See CHINA SOCIAL ENTREPRENEUR FOUNDATION, "THE 12345 DEVELOPMENT STRATEGY OF CHINA SOCIAL ENTREPRENEUR FOUNDATION", (China Social Entrepreneur Foundation August 23, 2007), available at [http://www.youcheng.org/doc/The%2012345%20Development%20Strategy%20of%20China%20Social%20Entrepreneur%20Foundation%20\(Youcheng\).pdf](http://www.youcheng.org/doc/The%2012345%20Development%20Strategy%20of%20China%20Social%20Entrepreneur%20Foundation%20(Youcheng).pdf).

including social dimensions in the procedures for awarding public contracts. At the same time, it must be noted that partnerships with government in such contract-based relationships may create dependency on the government in the long run. The private sector may also claim that there is unfair competition by social enterprises. Therefore, the government should focus on technical policies for assisting social enterprises. These include policies that facilitate regulation of social enterprises; make them become better businesses by providing business support, training, funding and finance; and establish the value of social enterprises by building public confidence through performance and standards.

IV. CONCLUSION

The emergence of social enterprises in China represents the rise of a new generation of philanthropists who are redefining business and donation. These philanthropists – or social entrepreneurs – are characterized by their dynamism and responsiveness. They create and sustain social value, pursue new opportunities, are innovative and adaptive but also possess a heightened sense of accountability. What they need from the government is the creation of an enabling environment to support the growth of social entrepreneurship. In this regard, it is suggested that in order to modernize the legal framework to facilitate the emergence of social enterprises in China, a new and modern organizational category for social enterprises is essential to offer organizations space and legitimacy for their sustained growth.

It must be acknowledged that the lack of a specific organizational category for social enterprises is not the sole inadequacy of the legal enterprise framework. Hence the creation of a new organizational form for social enterprises is not a panacea for the multitude of challenges faced by social enterprises. Government bureaucracy and the lack of autonomy in the nonprofit sector, for instance, are also major obstacles to the successful operation of social enterprises. As well, apart from legal obstacles, the success of social enterprises in China also depends on other non-legal factors. These factors include the ability of social enterprises to recruit skilled managers, particularly those with business experience, social work skills, access to financing, experiences in network-building, and expertise, among others. Last but not least, there are also risks associated with the wholesale adoption of a Western enterprise legal structure in China. These include the different legal and cultural environments between China and the West. The difficulties of transplanting an English

model to a different jurisdiction, and the pitfalls that may be encountered, should not be under-estimated.

Nonetheless, government support is essential to the new generation of philanthropists and social entrepreneurs who are keen to navigate through the unexplored terrain of social entrepreneurship. Currently, the English model that displays the essential features of social enterprises is compatible with the Chinese legal tradition. As observed, the English model can serve as a good reference point for the government to modernize the legal framework for social enterprises. So long as careful refinements are made to the English enterprise structure before its translation into the domestic Chinese system, an effective variant can be implemented in China. By creating a specific vehicle for the development of social enterprises, the government is also taking its first crucial step towards promoting a strong, sustainable and socially inclusive economy.