

Social Enterprise in Ethiopia: Examining Major Regulatory Issues

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Abstract

Traditionally, private entities were divided into for-profit and non-profit organizations, with the goal of maximizing profit and social impact, respectively. Recently, however, both social and financial maximization have begun to be carried out in a single institution. Investors start a firm with the primary purpose of fixing the community's social, environmental, economic, and cultural (SEEC) concerns while earning a modest profit. These types of businesses are called social enterprises. Social enterprises combine profit and social mission into a single company. Though their income is primarily derived from their business, they also get donor-funded grants and government subsidies. Though these types of businesses are flourishing in Ethiopia, there is no special regulatory framework in Ethiopia designed for social enterprise so far. They are treated and regulated as ordinary for-profit businesses under Ethiopia's existing Commercial Code. The goal of this article is to investigate the regulatory concerns of social enterprises and the viability of regulating them within Ethiopia's existing commercial laws. To achieve this goal, the author applies doctrinal research methods. Finally, the author discusses important regulatory challenges for social companies in Ethiopia. The major issues of social enterprise regulation identified by this study include business legal form, evaluation of the social mission, profit allocation, asset transfer, business sale and merger, disclosure of enterprise performance, the duty and liability of directors and managers to stakeholders, and supervision. The author concluded that the existing rules of the

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Commercial Code are not suitable to regulate these major concerns of social enterprises. Thus, the author recommends that the government promulgate a specific law that regulates these issues of social enterprises.

Key words: Social Enterprise; Regulatory Concerns; Social Mission; Ethiopia

Introduction

Traditionally, private entities were dichotomized as for-profit and nonprofit.¹ While for-profit legal entities try to maximize the interests of shareholders, nonprofit organizations (NPOs) work to tackle social, environmental, economic, and cultural problems (SEEC) of societies by collecting income mainly from grants, “legacies,” and membership payments.² Nowadays, however, the attributes of for-profit and nonprofit legal entities begin to be mingled in a single legal entity. On the one hand, nonprofit legal entities participate actively in income-generating activities like for-profit corporations to fund their mission.³ On the other hand, for-profit business entities enter a deep commitment to solving the SEEC problems of the community like that of nonprofit entities.⁴ The fuse of the features of nonprofit and for-profit entities in a single legal entity causes the creation of another category of a legal entity called social enterprise, which engages in commercial activity

¹Mark S. Blodgett *et al*, ‘Social Enterprise: Reaffirming Public Purpose Governance through Shared Value’, *Journal of Business and Securities Law*, Vol. 16:No. 2, (2016), p. 306.

²Bob Doherty *et al*, ‘Social Enterprises as Hybrid Organizations: A Review and Research Agenda’, *International Journal of Management Reviews*, Vol.16:No. 4, (2014), p. 3.

³Matthew F. Doeringer, ‘Fostering Social Enterprise: A Historical and International Analysis’, *Duke Journal of Comparative & International Law*, Vol. 20: No. 2, (2010), P. 293-294.

⁴Robert Katz and Antony Page, The Role of Social Enterprise, *Vermont Law Review*, Vol. 35, (2010), P 3.

with the prime mission of solving SEEC problems of society.⁵ Such a type of legal entity is also known as shared value, mission-driven business, social business, social entrepreneurship, or triple bottom line.⁶

In the past few decades, the concept of social enterprise has expanded in many countries in Europe, USA, Latin America, and Asia.⁷ As social enterprise is a strategic tool to solve SEEC problems in the community, it easily gets acceptance in many countries.⁸ Even some countries develop separate policies and regulatory frameworks for social enterprises with the view of facilitating them.⁹ The United Kingdom (UK),¹⁰ United States of America (USA),¹¹ Canada (British Columbia and Nova Scotia),¹² and Italy¹³ are countries that develop policies and regulatory frameworks for social enterprises.

The concept of social enterprise has also begun to be practiced in Ethiopia in recent periods.¹⁴ There are many socially conscious businesses running their commercial activities to address SEEC problems of the society in Ethiopia.

⁵ Alissa Mickels, 'Beyond Corporate Social Responsibility: Reconciling the Ideals of a For-Benefit Corporation with Director Fiduciary Duties in the U.S. and Europe', *Hastings International and Company Law Review*, Vol. 32: No. 1, (2009), P. 279.

⁶ Alicia E. Plerhoples, 'Can an Old Dog Learn New Tricks? Applying Traditional Corporate Law Principles to New Social Enterprise Legislation', *Transactions: The Tennessee Journal of Business Law*, Vol. 13: No.2, (2012)

⁷ Jacques Defourny and Marthe Nyssens, 'Conceptions of Social Enterprise in Europe: A Comparative Perspective with the United States', (2012), p. 4.

⁸ Id. p. 1 ff.

⁹ Doeringer, *Supra* note 3, p. 306 ff.

¹⁰ Id. p. 309.

¹¹ Id. p. 210 ff.

¹² Pauline O'Connor, 'The New Regulatory Regime for Social Enterprises in Canada: Potential Impacts on Nonprofit Growth and Sustainability', *Centre for Voluntary Sector Studies*, Ryerson University, Working Paper Series, Vol. 1, (2014), P. 7 ff.

¹³ Alissa Pelatan and Roberto Randazzo, 'The First European Benefit Corporation: Blurring the Lines Between 'Social' And 'Business'', ___, p.1.

¹⁴ British council, *The State of Social Enterprises in Ethiopia*, (2016), P. 7.

This type of business does not, however, get policy recognition and support on the part of the government. Rather, they are subject to the same rules of regulation as other profit-oriented businesses.¹⁵ They are licensed and registered in various business legal forms such as partnerships, companies, and sole traders.¹⁶ They acquired the status of social enterprise through self-declaration after they were licensed as an ordinary business.¹⁷ Nevertheless, there is some confusion about whether the existing business laws of Ethiopia are fit to regulate social enterprises in the country. Specifically, it is not clear whether the existing business regulations of Ethiopia are fit to regulate social enterprises' activities and to protect the interests of customers, the community, donors, and investors. The purpose of this article is, therefore, to examine the major regulatory concerns of social enterprises and the feasibility of regulating them through the existing commercial laws of Ethiopia.

1. Nature, Development and Features of Social enterprise

1.1. Nature of Social Enterprise

Though the social enterprise business type is expanded in many jurisdictions in the world, including Ethiopia, it lacks a single definition.¹⁸ In some European countries, social enterprise is understood as not-for-profit entities that engage in commercial activities without profit distribution.¹⁹ For example, in Italy, social enterprise is understood as a private legal entity,²⁰ in for-profit or nonprofit legal form, that 'perform *continuously and mainly*

¹⁵ Id.

¹⁶ Id.

¹⁷ Id., p. 23.

¹⁸ Blodgett *et al*, *Supra* note 1, p. 313.

¹⁹ Mystica M. Alexander, 'A Comparative Look at International Approaches to Social Enterprise: Public Policy, Investment Structure, and Tax Incentives', *William & Mary Business Law Review*, Vol.7: No 2, (2016), p. 9.

²⁰ Id.

economic activity of production or exchange of goods and services of social utility, aimed at achieving general interest goals²¹ and “either *reinvest* those profits in public benefit or use them to increase assets.”²² In some other countries, however, it is used to describe for-profit ventures that carry out a business to solve SEEC problems with possible distribution of limited profit to owners.²³ For example, in Belgium, it is understood as a company with ‘a purpose of serving members of the community rather than seeking profit, independent management, a democratic decision-making process, and the primacy of people and labor over the capital in the distribution of income.’²⁴ In the UK, it is defined as ‘a business 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 maximise[sic] profit for shareholders and owners’.²⁵ Furthermore, in South Korea, article 2 of the Social Enterprise Promotion Act enacted in 2006 (SEPA) defined social enterprise as;

“[T]hose companies that have been certified (...) that engage in business activities such as the production and sale of goods and services with the objective of achieving social goals, including providing vulnerable groups with social services or jobs, thus improving the local residents’ quality of life.” Additionally, for an enterprise to be legally recognized as a social enterprise, the SEPA requires that it “adopt a decision-making structure where stakeholders (including service recipients, workers, etc.) are

²¹Weisen Tang, The Research on Social Enterprise Legal Systems —To Establish the Social Enterprise Legal System in China, PhD Thesis, Doctoral School in Comparative And European Legal Studies, (2014-2015), P. 16 ff.

²²Alexander, *Supra* note 19, p. 9.

²³*Id.*, p. 2.

²⁴Doeringer, *Supra* note 3, p. 308.

²⁵Robert T. Esposito, The Social Enterprise Revolution in Corporate Law: A Primer on Emerging Corporate Entities in Europe and the United States and the Case for the Benefit Corporation, *William & Mary Business Law Review*, Vol. 4, (2013), p. 646.

*represented” and that “at least two-thirds of any profits generated (...) be used for the realization of social goals”, thus making the elements of participatory decision-making and social contribution mandatory requirements. (Quotations in original)*²⁶

When we see the definition of social enterprise in the context of Ethiopia, we may not be able to get any literature or legal instrument that gives a clear definition of social enterprise, as it is a newly developed business type. In fact, an attempt is made in one literature to give some operational criteria of social enterprise. To mention it, research conducted by the British Council²⁷ tries to give some operational criteria of determining the social enterprise status of a business. According to this study, a social enterprise is a legal entity that (1) gives primacy for achievement of social goals or equal weight with the profit-making objective; (2) drives its majority fund from its business operation, but can receive donation; and (3) can distribute few profits but not as a primary mission.²⁸ Except for these criteria, there has been no any attempt thus far to define social enterprise in Ethiopia. Because of this, the author adopts the following operational definition:

Social enterprise is a privately owned business that undertakes a business freely with the primary aim of solving SEEC problems of the community in tandem with limited profit distribution and that collects funds from multiple sources, including donations. Such entities, from the outset, registered as a for-profit legal entity, not as a non-profit entity or as a subsidiary of a non-profit entity. Though their primary source of such entities is income

²⁶ Hwang Deok Soon *et al*, ‘Social Enterprise in South Korea: International Comparative Social Enterprises Models (ICSEM)’, ICSEM Working Papers No. 35, (2016), p. 4

²⁷ British council, *Supra note* 14, P. 7

²⁸ *Id.*

generated from their business, they also receive funds from donations, debt, and other sources of funding.

1.2. Development of Social Enterprises

In its modern sense, social enterprise emerged in Italy in the 1980s.²⁹ Social enterprise first originated from the nonprofit sector when “volunteers” undertake businesses to render “social services” and create job opportunities to the disadvantaged people.³⁰ It was in 1991 that social enterprise got official recognition when the Italian government recognized it in distinctive legislation, Social Cooperative Act (law 381/1991) and legal form, Social Cooperative.³¹ Unlike traditional co-operatives whose primary aim is to serve their members, the Italian social co-operatives aim at serving non-member communities by undertaking business with total inhibition of profit distribution to members.³² Inspired by the development of social cooperative social enterprises in Italy, most European countries also introduced Italian-like co-operative social enterprises at different times.³³ Italy also enacted another law on social enterprises in 2005 that allows any legal form of entity, be it non-profit or for-profit, to operate as a social enterprise, which is referred to as social enterprise *et lege*.³⁴ This law also prohibits the distribution of profit and assets to owners even during the dissolution period.³⁵

Through different times, most European countries introduced the not-for-profit social enterprise type, which includes cooperatives, associations,

²⁹Jacques Defourny & Marthe Nyssens, *Social Enterprise in Europe:Recent Trends and Developments*, EMES Research Network, 2001, P. 4.

³⁰Alexander, *Supra* note 19, p.9.

³¹*Id.*

³²*Id.*, p. 5.

³³Defourny and Nyssens, *Supra* note 7, p. 4.

³⁴Alexander, *Supra* note 19, p. 9.

³⁵*Id.*

foundations, and mutual societies³⁶. In general, the social enterprise in most European countries developed in the nonprofit sector through undertaking a business to resolve SEEC problems of non-member societies with a total prohibition of profit distribution and asset lock in the dissolution period. Such a type of social enterprise is categorized as a “not-for-profit” social enterprise.³⁷

The concept of social enterprise, however, has also begun to develop in the for-profit sector.³⁸ For-profit entities have begun to engage in commercial activities with the prime motive of solving SEEC problems, but with limited profit distribution.³⁹ Such type of social enterprise is called a for-profit or hybrid social enterprise and serves two masters: driving profit and solving SEEC problems.⁴⁰ For-profit social enterprises were recognized for the first time in Belgium in 1995, during which the Belgium parliament passed a law that creates a legal form called “Société à Finalité Sociale (SFS)” for social enterprises.⁴¹ SFS is a legal form designed for social enterprises with a total or partial (not more than 6% on the investor’s principal) restriction of profit distribution.⁴² Similarly, the UK government recognized social enterprises in a distinct legal form called ‘community interest company (CIC) in 2004.⁴³ The UK’s CIC is a hybrid social enterprise model that integrates “the mission of creating social betterment with generating a profit for investors.”⁴⁴ The parliament of the UK opted to adopt a for-profit social enterprise than a not-

³⁶Jacques Defourny & Marthe Nyssens, ‘Social enterprise in Europe: At the crossroads of market, public policies and third sector’, *Policy and Society*, Vol. 29: No. 3, (2010),P. 232.

³⁷ Defourny and Nyssens, *Supra note 7*, p. 4.

³⁸ Katz & Page, *Supra note 4*, p. 60-61.

³⁹ Alexander, *Supra note 19*, p. 2.

⁴⁰ Plerhoples, *Supra note 6*, p. 223.

⁴¹ Doeringer, *Supra note 3*, p. 308.

⁴² Id., p. 309.

⁴³ Esposito, *Supra note 25*, P. 675 ff.

⁴⁴ Alexander, *Supra note 19*, p. 12.

for-profit social enterprise model by justifying that the former is better to raise capital through attracting investors by rewarding return for owners.⁴⁵

Similarly, in the USA, many states introduced for-profit social enterprises at different periods. Vermont introduced a low-profit limited liability Company,⁴⁶ California introduced Flexible Purpose Corporations (FPCs) in 2011, and Maryland introduced benefit Corporation (BC) in 2010.⁴⁷ Moreover, British Columbia and Nova Scotia in Canada have also introduced their own hybrid social enterprise legal form namely Community Contribution Companies (C3s) in 2012, and Community Interest Companies (CICs) in 2012, respectively⁴⁸. Like the UK's CIC social enterprise model, these two forms of social enterprises designed to enable investors to do business to bring positive social and environmental externalities, and at the same time, to drive limited profit for owners.⁴⁹

The concept of social enterprise is not well developed in Africa compared with the US and Europe. But there are some movements to seek the development of social enterprise in the country. For example, Rwanda, which is the first African country to recognize social enterprise officially, has introduced the community benefit Company legal form of social enterprises at the beginning of 2021 through promulgating legislation known as Benefit Corporation.⁵⁰ However, most African countries do not enact a separate law for social enterprises, though such a type of business exists in many jurisdictions.

⁴⁵ Id., 13.

⁴⁶ Id.

⁴⁷ Id. P. 688 ff.

⁴⁸ O'Connor, *Supra note 12*, P. 7.

⁴⁹ Id. p. 28 ff.

⁵⁰ "Rwanda Becomes 5th in the world to pass law on conscious Business Practices," available at <<https://b-labafrika.net/rwanda-becomes-5th-country-in-the-world-to-pass-law-on-conscious-business-practices/>>, accessed on August 20, 2024.

In Ethiopia, investors in the for-profit sector commence undertaking businesses with the primary aim of solving SEEC problems of the society by considering themselves as social entrepreneurs.⁵¹ They start to be socially, culturally, and environmentally conscious and endeavor to fill the gaps left unmet by other sectors. Ecopia Organic Food PLC,⁵² Eternum Energy Ventures (EnVent),⁵³ World Entrepreneurs Do Good (W.E. Do Good) company,⁵⁴ [Oliberté Limited](#) company,⁵⁵ Eminence Social Entrepreneurs Company,⁵⁶ Bahir Zaf Restaurant⁵⁷, Whiz Kids Workshop PLC,⁵⁸ and Tebita Ambulance Company⁵⁹ are some of the businesses that claim the status of social enterprise, declaring that their primary aim is solving SEEC problems of the community. Generally, after recent periods, the concept of social enterprise is also being practiced in Ethiopia without, however, any policy, and legal recognition on the part of the government.

⁵¹ Id. p. 4 ff.

⁵²“Ecopia// Welcome//Company”, available at <http://www.ecopia.de/> accessed on February 23, 2024

⁵³ “Africa’s Need is Not Another Great Lamp Design– EnVent Energy Energizes Solar Lamp Distribution in Ethiopia (EcoStories)”, available at <http://www.bailiffafrica.org/africas-need-is-not-another-great-lamp-design-envent-energy-energizes-solar-lamp-distribution-in-ethiopia-ecostories/> accessed on February 23, 2024

⁵⁴ “SDUS Business Alum Builds School in Ethiopia” available at <https://business.sdsu.edu/articles/2016/02/Ethiopia> accessed on February 23, 2024

⁵⁵ “Oliberté’s factory in Addis Ababa, Ethiopia: The world’s first Fair Trade Certified™ footwear manufacturing factory” available at <https://www.oliberte.com/pages/fair-trade-certified/> accessed on February 23, 2024

⁵⁶ “Eminence Social Entrepreneurs” available at <https://www.2merkato.com/directory/19911-eminence-social-entrepreneurs> accessed on February 23, 2024

⁵⁷ British council, *Supra note* 14, p.27.

⁵⁸ “Mission and Milestones”, available at <http://www.whizkidsworkshop.com/about/mission-milestones/> accessed on February 23, 2024

⁵⁹ “Team-Tebita Ambulance”, available at <http://tebitaambulance.com/team/> accessed on February 23, 2024

1.3. Basic Features of Social Enterprise

As the name indicates, social enterprise has two dimensions, namely the enterprise and social dimension. These two dimensions are the major characteristics of social enterprise. In appreciating the major features of social enterprises, one may say that social enterprises are the direct replica of public enterprises. As different literature mentioned, similar to social enterprise, the public enterprise has two basic aspects, i.e. public and private/enterprise dimensions.⁶⁰ But this doesn't mean that all features of public and social enterprises are the same. For example, unlike public enterprises, social enterprises may not be necessarily fully owned by the public or society. Especially, in the case of for-profit social enterprises, there is no public ownership at all. The details of each dimension are elaborated herein under.

1.3.1. The Enterprise Feature

Social enterprises undertake economic activities with the motive of generating profit.⁶¹ They continuously engage in the production and sale of goods and services, which is the very secret of their survival.⁶² They employ business methods, principles, and strategies like that of profit-oriented business⁶³ and interact with the market, other competitors, and business regulatory institutions.⁶⁴ The profit motive of social enterprises makes them efficient and

⁶⁰ Tewedros Meheret, 'The Concept and Characteristics of Public Enterprises in Ethiopia', *Mizan Law Review*, Vol. 8: No.2, (2014), P. 342.

⁶¹ Keren G. Raz, 'Toward an Improved Legal Form for Social Enterprise', *New York University School of Law*, Vol. 36, (2012), P. 283-310.

⁶² Robert A. Katz & Antony Page, 'Sustainable Business', *Emory Law Journal*, Vol. 62, (2012-2013), P. 851.

⁶³ Id.

⁶⁴ Nardia Haigh and Andrew J. Hoffman, 'Hybrid organizations: The Next Chapter of Sustainable Business', *Universe Science Direct*, Vol. 41, (2012), p. 129.

innovators.⁶⁵ They strive to maximize their investment return by winning the competition that may face in the market.⁶⁶ Financially, social enterprises primarily rely on incomes generated from their commercial activities.⁶⁷ Though there are some other sources of funds, such as grants, driving an economic gain through engaging in commercial activities takes the lion share of their fund source.

The other enterprise feature of social enterprise is the distribution of profit to investors. Unlike NPOs, social enterprises reward some sort of return to investors, as an incidental to their non-financial mission.⁶⁸ For example, in the UK⁶⁹, Belgium⁷⁰, USA⁷¹ and Canada⁷², social enterprise investors can receive a restricted amount of dividend. Because of the possibility of distributing a limited amount of profit to investors in social enterprises, social enterprises, unlike NPOs, can issue equity security to raise their capital through attracting new equity investors.⁷³ In addition, social enterprises may also receive a donation from donors like that of NPOs.⁷⁴

⁶⁵J. Gregory Dees and Beth Battle Anderson, 'For-Profit Social Ventures', in Marilyn L. Kourilsky and William B. Walstad, *Social Entrepreneurship*,(2003), p. 5.

⁶⁶*Id.*

⁶⁷Katz & Page, *Supra note* 62, P. 853.

⁶⁸Michael D. Gottesman, *From Cobblestones to Pavement*, P. 348.

⁶⁹In the UK, social enterprise investors allowed to receive not more than 50% of the annual net profit (O'Connor, *Supra note* 12, P. 46).

⁷⁰Social enterprise investors in Belgium permitted to receive not more than 6% of the annual profit (Doeringer, *Supra note* 3, p. 309).

⁷¹Alexander,*Supra note* 19, p.5.

⁷²In a district of British Columbia and Nova Scotia, social enterprises allowed to distribute surplus to investors which shall not be exceeded 40% of the total annual profit of the enterprise (O'Connor, *supra note* 12).

⁷³Michael Blatchford and Margaret Mason, 'Introducing the Community Contribution Company: A New Structure for Social Enterprise', *presented for the Legal Education Society of Alberta*, (2013), p. 17.

⁷⁴Raz, *Supra note* 61, p. 294-295.

1.3.2. The Social/Environmental Feature

The social and/or environmental dimension is the other feature of social enterprises. Social enterprises are created primarily to solve SEEC problems of society.⁷⁵ Their core objective is the creation of “social value,”⁷⁶ and they describe their social objectives expressly.⁷⁷ They, rather than donating some amount of money to charities, worry about how to address certain social problems that happen in society.⁷⁸ They reinvest the majority portion of their profit to solve SEEC problems in the community.⁷⁹ Unlike for-profit businesses, social enterprises make social goals a primary motive of their existence.⁸⁰ For-profit businesses practice CSR, not with a true conscious of solving SEEC problems; but as a means of building a brand for their business.⁸¹ In addition, the objective of social enterprise is to solve SEEC problems of the society, i.e. non-members of the enterprise. Unlike cooperative legal entities, which primarily focus on addressing members’ SEEC problems, social enterprises’ focus is to solve SEEC problems of non-members.⁸²

Moreover, the social dimension of social enterprises includes the social management system and stakeholders’ participatory corporate governance system. Users or customers participate in the decision-making process and

⁷⁵ Fiona Wilson and James E., ‘Business models for people, planet & profits: exploring the phenomena of social business, a market-based approach to social value creation’, *Small Business Economics*, Vol. 40: No. 3, (2013), p. 716.

⁷⁶ Id.

⁷⁷ Reiser, ‘Theorizing Forms For Social Enterprise’, *Emory Law Journal*, Vol. 62, (2013), p. 684.

⁷⁸ Raz, *Supra note* 61, p. 290.

⁷⁹ Alexander, *Supra note* 66, P. 34.

⁸⁰ Alexander, *Supra note* 19, p. 6.

⁸¹ Id.

⁸² “Demutualization of Cooperatives: Reasons and Perspectives”, available at <www.coopgator.com/doc/DemutualizationCooperatives21.5.08.pdf>, accessed on April 26, 2024.

management of the business through their representatives.⁸³ Furthermore, the social dimension of social enterprises includes the public control feature.⁸⁴ Social enterprises are supervised by public authorities representing individuals to ensure the fulfillment of requirements of law and the alignment of social enterprise deeds to their original motive.⁸⁵

2. Major Regulatory Issues of Social Enterprises in Ethiopia

Normally, one may identify a lot of areas of regulation of social enterprises that a law needs to address. The area of regulation may be entry regulation, operational regulation, and exit regulation. This article may not go through all these areas of regulation in detail. Rather, the focus of the article is to examine only the major issues of regulation for social enterprise business types. Hence, the next analysis of this paper focuses on some selected major issues of social enterprise regulation.

2.1. Legal Form

The first legal concern of social enterprise is the availability of a legal form that allows investors to blend social and profit-making objectives in a single business. Social enterprises are businesses that blend financial and non-financial missions into a single entity.⁸⁶ They are motivated by the mission of realizing “triple bottom lines” (social, environmental, and profit) in a single

⁸³ Defourny and Nyssens, *Supra note 7*, p. 7.

⁸⁴ Policy Department C: Citizens' Rights and Constitutional Affairs of European Parliament, *A European Statute for Social and Solidarity-Based Enterprise*, European Union, Brussels, (2017), p.7.

⁸⁵ Id.

⁸⁶ Leff, Benjamin M., Preventing Private Inurement in Tranched Social Enterprises, *Seton Hall Law Review*, Vol. 41, (2015), p. 10.

undertaking.⁸⁷ To license such types of investors to engage in the market, there shall be a legal form that permits investors to blend both the social and profit-making objectives into a single business entity. The form shall also be designed in a way that allows investors, customers, employees, funders, and other stakeholders to identify socially-oriented businesses from profit-oriented businesses.⁸⁸ Though it may not be conclusive evidence as to the genuineness of the social mission, the nomenclature of the form of the business can at least give the first-impression to stakeholders that whether the enterprise's primary motive is to realize social missions.⁸⁹ Mission-sympathetic parties, including donors, employees, customers, and investors who want to make a contribution to social-oriented businesses, will, at first glance, look at the name of the form using which social enterprises are licensed and registered to identify the entity's primary mission.⁹⁰ If the form of the enterprise transmits a message to society about the purpose of the business, stakeholders may easily distinguish socially conscious businesses from others. This can help them avoid confusion in determining the status of the businesses while they make interactions with such businesses.

Furthermore, the form of the social enterprise shall allow the social entrepreneur to build a brand for their products and services.⁹¹ Branding is the core advantage that social entrepreneurs can receive from investing in social enterprises.⁹² Because of the social aspect of social enterprises, customers will give special preference for products and services of such enterprises; donors may incite to support such businesses; talented employees may be attracted to

⁸⁷Murray, J. Haskell, Choose Your Own Master: Social Enterprise, Certifications and Benefit Corporation Statutes, *American University Business Law Review*, Vol. 2: No. 1, (2012), p. 4.

⁸⁸John Tyle *et al*, 'Producing Better Mileage: Advancing the Design and Usefulness of Hybrid Vehicles for Social Business Ventures', *Quinnipiac Law Review*, Vol. 33, (2015), p. 242.

⁸⁹ *Id.* p. 243.

⁹⁰ Katz & Page, *Supra note 4*, P. 93.

⁹¹ *Id.*, P. 44.

⁹²Plerhoples, *Supra note 6*, P. 235.

work in such businesses; and investors may become interested investing in such businesses.⁹³ But this can be so when there is a form that is specifically designed for social enterprises and easily identifiable. The name of the legal form of social enterprises in the UK is the best example for this discussion. UK has designed “Community Interest Company” as a legal form for social enterprises.⁹⁴ The name ‘Community Interest Company’ transmits the message to society about the purpose of the businesses that adopt this form. It, at least, tells the community that the businesses that are licensed through this form have the mission of serving the community along with profit-making motives. Generally, the name of the form shall also be easily identifiable by customers, donors, and other stakeholders.

Under the current Ethiopian Commercial Code, a person can engage in businesses either as a sole proprietorship,⁹⁵ or through a business organization.⁹⁶ A person may need to undertake a business in his individual capacity without creating any cooperation with someone else. The available legal form for such a type of businessperson is sole proprietorship. Individuals may also conduct a business in cooperation with other persons who have a common objective by bringing their capital or labor together.⁹⁷ The available legal forms for such types of businesses are joint venture, general partnership, limited partnership, Private Limited Partnership, Share Company, one person limited company, and private limited company.⁹⁸ In fact, some writers list cooperative legal form as an additional available legal form for businesses in

⁹³ Murray, *Supra note 87*, p. 52.

⁹⁴ O'Connor, *Supra note 12*, P. 37.

⁹⁵ Commercial Code of Ethiopia, 2021, Federal Negarit Gazzete, Extra Ordinary Issue, Proc. No. 1243/2021, art. 5 ff (hereinafter, Commercial Code of Ethiopia).

⁹⁶ *Id.*, art. 172 ff.

⁹⁷ Gizachew Silesh, The Commercial Dichotomy of Business organization and Its Legal Significance Under the Ethiopian Law, *Bahir Dar University Journal of Law*, Vol. 3,; No. 1, (2014), p. 40.

⁹⁸ Commercial Code of Ethiopia, *Supra Note 84*, art. 174.

Ethiopia.⁹⁹ This author, however, does not agree about the availability of cooperative business legal form in Ethiopia. The cooperative legal form is not a legal form available for investors. It is a legal form designed for individuals who want to solve their common SEEC problems.¹⁰⁰ An investor cannot choose a cooperative legal form as an option for his investment. From the outset, it is hardly possible even to say that cooperatives are businesses since their objective is not to make a profit from their business.

Given these legal forms of business, the next issue is whether social enterprises in Ethiopia can operate using either of these business forms. This issue can be analyzed from two perspectives. First, it can be explored from the perspective of social entrepreneurs. Under the current business laws of Ethiopia, though there is no clear permission, at least; there is no prohibition to operate a business with the primary motive of solving SEEC problems of the society along with the distribution of a limited amount of profit. Individuals who want to undertake a business in Ethiopia as a trader or businessperson need, among others, to engage in economic activities that are designed as such by law professionally and for gain.¹⁰¹ The law does not, however, prohibit the reinvestment of the majority portion of businesses' profit to social purposes so long as owners agree to that effect.

What if, for example, investors agree to limit their portion of return to be distributed to them only ten percent or else and to reinvest the remaining to social purposes? Can the regulatory authority refuse to license and register

⁹⁹ For example on a legal guide written by Mehrteab Leul & Associates Law Office mentioned cooperative legal forms as one form available for doing business in Ethiopia (Mehrteab Leul & Associates Law Office, *Doing Business in Ethiopia: A Brief Legal Guide*, 1st ed.,(2015), p., 4 ff).

¹⁰⁰ Cooperative societies proclamation, 2016, Federal Negarit Gazette, proc. No. no. 985, 23rd year no. 7, Article 2/1

¹⁰¹ Commercial Code of Ethiopia, *Supra note* 95, art. 5; and Commercial Registration and Licensing, 2016, Proc. No. 980, 22nd year, no. 101, art 2/2.

such investors as a trader or businessperson? The answer is probably not. The law requires only the continuous engagement of a person in commercial activities and the driving of some benefit from such activities in the form of profit, regardless of the amount to be distributed to him. Even the law may not prohibit the reinvestment of the majority portion of businesses' profit for the social mission unless such act has an intention of illegal activities. Thus, persons who want to undertake economic activities with the primary objective of resolving SEEC problems in tandem with the distribution of a limited amount of profit can be licensed as a trader/businessperson using the existing businesses legal forms. Even though the law does not prohibit the licensing and registration of such types of businesses, the name of existing legal forms do not fit to protect the interests of stakeholders and social entrepreneurs. As mentioned above, the names of the legal form of social enterprises needs to communicate the purpose of the enterprise.

The existing legal forms of business in Ethiopia are not, however, able to describe the purpose of the business to the community. For example, a social enterprise that wants to be licensed and registered as a general partnership,¹⁰² limited partnership,¹⁰³ share company¹⁰⁴ or private limited company¹⁰⁵ is required by law to include the name of the form using which they have been established next to the trade name of the business. These forms, however, do not tell the mission/purpose of the business. None of them send a message to stakeholders, including customers, donors, investors, and others, whether the mission of the business is solving SEEC problems or maximizing owners' financial interests.

¹⁰² Commercial Code of Ethiopia, *Supra Note* 95, art. 184/1.

¹⁰³ Id. art. 213/2.

¹⁰⁴ Id. art. 246.

¹⁰⁵ Id. art. 497.

For example, Ecopia (Ecological Products of Ethiopia) private limited company (PLC) is a for-profit social enterprise that operates a food processing business in Ethiopia with the objective of creating the market opportunity for farmers, improving food security and rural development in the country.¹⁰⁶ But these missions of the Ecopia PLC cannot be inferred from the name of the form through which the Ecopia operates, i.e. from the ‘Private Limited Company’. The name Private Limited Company’ does not have any indication as to the purpose of the business. Donors who want to make a donation; customers who want to buy from the socially conscious business; investors who want to buy socially oriented businesses’ equity; and other stakeholders cannot easily identify whether Ecopia is a socially committed company or not.

Similarly, this problem creates a difficulty for owners of the Ecopia PLC to build a brand for their products and services. Unless the purpose of the enterprise can be deduced from the name of the form of the business, it can’t receive the advantage of the branding of its products and services. In fact, social enterprises can communicate the purpose of their firm to the people using a trade name, as the law doesn’t forbid using such types of trade names. But, in such a case, the brand will be limited only to the specific enterprise, which uses a trade name that conveys the purpose of the business. There will not exist legal branding for the social enterprise in general. Even allowing social enterprises to operate in a scattered legal form using their own trade name will cause uncertainty of form for a social enterprise on the part of socially conscious investors and societies.

¹⁰⁶ “Ecopia (Ecological Products of Ethiopia)” available at <<http://www.ecopia.de/ecopia-organic-food/>> accessed on April 15, 2024.

2.2. Evaluation of the Social Mission of Social Enterprise

Normally, when social entrepreneurs enter the market, their intention is expected to be benefiting society at large.¹⁰⁷ They engage in the market claiming that their primary mission is to solve SEEC problems of the community. Sometimes, however, the social motive of social enterprise investors may not be as true as declared. Profit seeking investors may falsely claim the status of social enterprise.¹⁰⁸ Especially, the existence of branding advantage in social enterprises may inspire greedy investors to claim deceitfully the status of social enterprises.¹⁰⁹ The fake status of a social enterprise may, consequently, result in the problem of “green or social washing”, whereby investors use or attempt to use the “branding” and “goodwill” advantage of social enterprise, by alleging that they are social entrepreneurs.¹¹⁰ It may give rise to a problem where investors “pay only lip service to the social mission thereby depriving the potential branding and signaling benefits of being perceived as a social enterprise without actually contributing a significant social benefit.”¹¹¹

To show this problem, Robert A. Katsz & Antony Page describes it as “a wolf (the conventional business) in sheep’s clothing (the social enterprise form).”¹¹² To avoid the mock use of the status of social enterprises, social entrepreneurs shall be required by law to pass a certain criteria of social

¹⁰⁷Dana Brakman Reiser, ‘Benefit Corporations —A Sustainable Form of Organization?’, *Wake Forest Law Review*, Vol. 46, (2011), p. 597.

¹⁰⁸ Michael A. Hacker, “Profit, People, Planet” Perverted: Holding Benefit Corporations Accountable to Intended Beneficiaries, *Boston College Law Review*, Vol. 57, (2016), P. 1757.

¹⁰⁹Katz & Page, *Supra note* 62, p. 865.

¹¹⁰ Hacker, *Supra note* 108, P. 1757.

¹¹¹Katz & Page, *Supra note* 62, p. 865.

¹¹²Id.

mission evaluation.¹¹³ They have to be required by law to show whether they are really inspired by and to achieve social missions. To do so, the law shall set clear social mission evaluation criteria that a social enterprise needs to pass. In fact, the standards that the social mission of the enterprise going to be evaluated may vary depending on the SEEC problem of countries. For example, in the social enterprise model law of USA, the social mission of the enterprise is evaluated by requiring it to pass the public benefit test i.e. bringing ‘a material positive impact on society and the environment ... as measured by a third-party standard.’ (Internal quotations omitted).¹¹⁴ Specifically, in the USA, social mission is said to exist when the purpose of the enterprise is;

*providing low-income or underserved individuals or communities with beneficial products or services; (2) promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business; (3) protecting or restoring the environment; (4) improving human health; (5) promoting the arts, sciences, or advancement of knowledge; (6) increasing the flow of capital to entities with a purpose to benefit society or the environment; [or] (7) conferring any other particular benefit on society or the environment.*¹¹⁵

In general, it is the concern of social enterprise regulation to set some social mission evaluation yardsticks for a legal entity to acquire the status of social enterprise and to prevent the fake use of the status of social enterprise that may ultimately result in a social or green washing problem.

¹¹³Blatchford and Mason, *Supra note* 73, p. 8, and Reiser, *Supra note* 107, p. 597.

¹¹⁴Reiser, *Supra note* 77, p. 690.

¹¹⁵ American Model Benefit Corporation Legislation with Explanatory Comments, (2016), section 102.

When social businesses are left to be regulated under Ethiopia's existing commercial rules, the regulating organ cannot order them to meet specific social mission evaluation criteria because there is no legal basis for doing so. It may expose stakeholders to being manipulated by sham social entrepreneurs. Sham social entrepreneurs may use their false status to get donations, attract customers, and get government subsidies, if any. Therefore, it can be simply concluded that the existing business laws of Ethiopia don't fit to regulate the social mission evaluation concern of social enterprises.

2.3. Allocation of Profit

The very reason for the emergence of any social enterprise is to achieve a certain social goal, rather than maximizing owners' private gain.¹¹⁶Accruing of private benefit to owners through distributing profit is their incidental mission.¹¹⁷As time goes by, however, the primary mission of social entrepreneurs may be "shadowed" by the profit-making motive.¹¹⁸Investors may be fascinated by the profitability of their enterprise and decide to drift towards receiving a lot amount of dividend from their enterprise's profit.¹¹⁹The possibility of shifting towards profit maximization to owners of social enterprises may be exacerbated after the enterprise builds a brand to its products and services in the pretext of SEEC problems. The tendency of investors to receive much profit from their social enterprise will finally lead to the problem of mission drift,¹²⁰ "a process of organizational change where an

¹¹⁶ Alexander, *Supra note* 19, p. 4.

¹¹⁷ Raz, *Supra note* 61, p. 289.

¹¹⁸ Joseph W. Yockey, 'The Compliance Case for Social Enterprise', *Michigan Business & Entrepreneurial Law Review*, Vol. 4, (2014), P. 6.

¹¹⁹ Yockey, Joseph W., Does Social Enterprise Law Matter? *Alabama Law Review*, U Iowa Legal Studies Research Paper No. 14-06, (2014), p. 780.

¹²⁰ *Id.*

organization diverges from its main purpose or mission” through time.¹²¹ The existence of mission drift, obviously, will cause the loss of non-financial missions of the enterprise.

Thus, it is the concern of social enterprise regulation to regulate the allocation of the profit and thereby to thwart the problem of drifting of the mission of the enterprise towards profit-making by forgetting its original mission. A regulation needs to be made by law as to how much of the profit of social enterprises shall be allocated.¹²² Profits need to be allocated in a way that can balance the interests of shareholders and stakeholders of social enterprises.¹²³ A legal specification needs to be made as to how much of the profit should be reinvested to the SEEC missions and to be distributed to owners. This will help to maintain or lock the SEEC missions of the enterprise by preventing owners of social enterprises from distributing the whole or the huge part of the profit to their private benefit.¹²⁴ Indeed, a difficulty may arise in determining the amount of profit to be distributed to owners and to be reinvested for social purposes. For example, if we put the cap for the profit to be distributed to owners above 50%, in effect, social enterprises may become the same with for-profit businesses that discharge their corporate social responsibility (CSR) properly. The social missions may still remain subordinate to profit-making objectives, and it may be hardly possible to say that the primary purpose of social enterprises is solving SEEC problems. Similarly, if we make the cap of profit to be distributed to owners very few, it may have the effect of discouraging investors to undertake social enterprises in the country. Thus, the restriction shall be in the middle of the

¹²¹ Chris Cornforth, ‘Understanding and Combating Mission Drift in Social enterprises’, *Social Enterprise Journal*, Vol. 10: No.1, (2014), p. 3.

¹²² The UK’S Mission Alignment Working Group, *Profit with Purpose Businesses*, (2014), p. 14.

¹²³ *Id.*

¹²⁴ *Id.*

two extremes, i.e. it shall reconcile the interests of stakeholders and investors in the social enterprise.

When we scrutinize the existing profit allocation rules of businesses in Ethiopia, the law doesn't regulate the profit allocation of businesses. The law, rather, leaves the power to determine the allocation of the profit of the business to be determined by the decision of investors.¹²⁵ Thus, when we allow social enterprises to operate under the existing business laws, the allocation of their profit will be determined by the decision of owners like that of traditional for-profit businesses. If, for example, investors in social enterprises decide to distribute the whole profit of their business to their private benefit, there is no legal means to prohibit them from doing so. The regulatory authority can't forbid them from doing that since there is no law that imposes a restriction on the allocation of profit of social enterprises. Letting investors distribute the profit of the enterprise to owners without imposing any restriction may, however, create an opportunity for owners of social enterprises to drift towards maximizing the interests of owners through distributing more profit of the business as time goes by. Even it may create a chance for owners to distribute the sum of money collected from donors to their private benefit. Some self-interested entrepreneurs may enrich themselves by distributing donor-funded capitals for their private benefit. To conclude, the existing business laws of Ethiopia do not fit to regulate the profit allocation of social enterprises. Rather, the Ethiopian government needs to enact a special law for social enterprises that sets a limitation on the amount of dividend social enterprise investors should receive.

¹²⁵ For example, the profit allocation of share companies required to be determined by the ordinary shareholders meeting (Commercial Code of Ethiopia, *Supra Note* 95, art. 394/1).

2.4. Asset Transfer, Sale of Business, and Merger

Besides the aforesaid regulatory concerns, the transfer of assets to members or to third party both at the time of dissolution and operational stage; the sale of the social enterprise to another investor; and the merger of the social enterprise with other for-profit businesses are concerns that a social enterprise regulation needs to address. Firstly, the concern of asset transfer arises when a specific asset is transferred to other third parties through sale or else during the operational life of the enterprise. Here, an asset is understood as “an item or property which is owned by a [social enterprise]...and which has a money value.”¹²⁶ It includes tangible assets such as land and equipment, intangible assets such as trade name and goodwill, and financial assets such as shares and stocks.¹²⁷ Normally, a transfer of a single asset to another person may not be problematic provided that the asset is transferred with a fair market value and in realizing social objectives.¹²⁸

Nevertheless, sometimes, directors of social enterprises may, for example, sell an asset of the social enterprise below the market value of the asset to another for-profit business in which they have a share.¹²⁹ An asset may be transferred to owners or directors below the market price in the pretext of sale to drive income for their non-financial objectives. This will ultimately weaken the attainment of the non-financial missions of the enterprise. It may also result in the problem of mission drift. To prevent the happening of such problems, some restrictions need to be imposed by law on the transfer of assets during the operational life of the enterprise.

¹²⁶ The Free Dictionary”, available at <<https://financial-dictionary.thefreedictionary.com/asset>> accessed on April 20, 2024.

¹²⁷ Id.

¹²⁸ Carol Liao, ‘The Next Stage of CSR for Canada: Transformational Corporate Governance, Hybrid Legal Structures, and the Growth of Social Enterprise’, *McGill International Journal of Sustainable Development Law and Policy*, Vol. 9: No. 1, (2013), p. 80.

¹²⁹ Esposito, *Supra note* 25, P. 677.

Secondly, the issue of asset transfer in social enterprises may arise at the time of the dissolution of the enterprise.¹³⁰ Comparable with traditional for-profit businesses, social enterprises may be dissolved due to different reasons. Then, the issue that will arise is how the assets that are left after the accomplishment of liquidation should be distributed. In traditional for-profit businesses, upon their dissolution, assets left after the liquidation process are permitted to be distributed to owners or shareholders.¹³¹ But if the assets of social enterprises are allowed to be distributed freely to owners upon the dissolution of social enterprises, it may affect the interests of donors who were donating grants to the enterprise; customers who paid beyond the market price for the products and services of the enterprise, thinking that the enterprise is a socially motivated entity; and the government, which may give to the enterprise different policy supports, including tax credit. To protect the interests of such stakeholders, there shall be some means of locking the assets of social enterprises during the dissolution of social enterprises. In the UK, for example, during the dissolution of a social enterprise, equity shareholders can receive only to the extent of their paid-up capital, and if there is a residual asset of the dissolved business, it shall be transferred to other similar community-benefit enterprises.¹³² The experience of the UK can be adopted in Ethiopia to lock the assets of social enterprises during dissolution.

The other concern of the social enterprise regulation is when there is the sale of the social business as a whole or merger of a social enterprise with another

¹³⁰ Id.

¹³¹ Under the Ethiopian commercial code, assets left after the settlement of the debts of the business organization allowed to be distributed to owners or shareholders of the dissolved business (Commercial Code of Ethiopia, *Supra note* 95, art.211/1 and 486).

¹³² “The Community Interest Company Regulations 2005”, <https://www.legislation.gov.uk/ukxi/2005/1788/regulation/23/made> last accessed on May 24, 2024.

for-profit business.¹³³ The owner of a social enterprise may decide to sell his enterprise/the whole business to another person for different reasons. Buyers, profit-oriented buyers, may become interested in buying the enterprise since social enterprises are better than traditional for-profit businesses in building a brand for their products and services.¹³⁴ The sale of the businesses has two prominent problems. On the one hand, the seller may enrich himself by selling the whole business, including capital collected from grants and other supporting mechanisms. On the other hand, the new owner may divert away from the original social mission of the social enterprise entity and may focus on generating much profit to his own benefit.¹³⁵ As Susan Mac Cormac wrote, the social mission of social enterprise, in most cases, 'is dependent on founders' fervor, and when founders retire or sell, their social legacy is often lost as more traditional owners and managers takeover.'¹³⁶ This problem is named a legacy problem.¹³⁷ The legacy problem is defined as the "risk of subordinating social missions to the profit" following the change of ownership of the social enterprise.¹³⁸ It is one type of mission drift that new owners of social enterprises drift away from their non-financial objectives towards driving profit for private benefit following to a change of ownership.¹³⁹ Stakeholders of social enterprises, especially donors and beneficiaries, may lose a certain interest in the social enterprise provided that there is a loss of legacy of the original founder after the enterprise has been

¹³³J.Haskell Murray, 'Social Enterprise Innovation: Delaware's Public Benefit Corporation Law', *Harvard Business Law Review*, Vol.4, (2014), P. 366.

¹³⁴ *Id.*, p. 40.

¹³⁵Susan H. Mac Cormac Et Al., 'The Emergence of New Corporate Forms: The Need for Alternative Corporate Designs Integrating Financial And Social Missions', Summit on The Future of The Corporation: Paper Series On Corporate Design, p. 88- 97 As Cited by Katz' & Page,*Supra note 4*, P. 96.

¹³⁶ *Id.*

¹³⁷ Katz & Page,*Supra note 4*, P. 95.

¹³⁸ *Id.*

¹³⁹Yockey,*Supra note 119*, p. 793.

taken over by another new purchaser. To minimize this problem, the UK social enterprise legislation, for example, allows the sale of socially conscious businesses only to similar community benefit companies.¹⁴⁰ If the social business is transferred to non-community benefit entities, it has to be sold at a market value that, in turn, shall be used by the seller for community purposes.¹⁴¹ Similarly, the Ethiopian government shall enact a law that stipulates asset lock provisions for social enterprises to maintain the mission of the enterprise during the sale of social enterprises.

Loss of legacy may also occur when there is a merger of social enterprises with another for-profit business.¹⁴² A social enterprise may merge with another traditional for-profit business due to different reasons. The merger of a socially conscious entity with a profit-conscious entity may result in the loss of the legacy of social mission, or it may at least give rise to a difficulty in detecting whether the legacy of social mission survives after the action of the merger. Therefore, to avoid such undesirable consequences of the merger, a legislative regulation must be made about the merger of socially conscious entities with profit-oriented entities. Different ways of regulation may be introduced to eliminate the problems of mergers of social enterprises with for-profit businesses. For example, the Vermont social enterprise statute requires boards of directors to provide justification why they propose mergers of a social enterprise with for-profit entities.¹⁴³ In addition, in order to reduce the possibility of merger of social enterprise with for-profit businesses, social

¹⁴⁰The Community Interest Company Regulations 2005”, <<https://www.legislation.gov.uk/uksi/2005/1788/regulation/23/made>> accessed on May 24, 2024.

¹⁴¹ Henry Peter *et al*, **The International Handbook of Social Enterprise Law Benefit Corporations and Other Purpose-Driven Companies**, Springer, 2023, P, 64.

¹⁴²Plerhoples, *Supra note* 6,P. 236.

¹⁴³ Esposito, *Supra note* 25, p. 698.

enterprise legislations of many countries, require the proposal of the merger to be approved by two-third vote of shareholders.¹⁴⁴ Generally, because of these potential problems which may arise following the transfer of asset, sale of the enterprise or merger of the enterprise with another for-profit business, regulating the transfer of assets of social enterprises both during the operational and dissolution stage; change of ownership in the sell-out or takeover of it by another person; and the merger of social enterprises with another traditional for-profit businesses become the concern of social enterprise regulation.

If we regulate social enterprises through the existing commercial laws of Ethiopia, we may not have any restrictions on the asset transfer, sale, or merger of a business. As per the Ethiopian commercial laws, during the operational life of the business, owners have full freedom to transfer a specific asset of their business to a third party through sale, donation, or otherwise. There is no legal restriction on the transfer of the assets of businesses to a third party (outsiders), so long as the owners agree. Similarly, under the existing laws, assets left after the process of liquidation during the dissolution of businesses are allowed to be distributed freely to shareholders or owners of the business.¹⁴⁵ Hence, if we regulate social enterprises under the existing business laws of Ethiopia, it means that they can freely transfer the assets of the enterprise without being locked both during the operational and dissolution period.

Moreover, under the existing business law rules of Ethiopia, there are no any restriction as to the sale of businesses.¹⁴⁶ Owners of the businesses can sell their business as a whole if they want. There is no any provision that requires

¹⁴⁴ Id.

¹⁴⁵ Commercial Code of Ethiopia, *Supra note* 95, Art. 211/1, 233, and 486.

¹⁴⁶ Id., art. 122 ff/

owners to consider the interests of stakeholders at the time of sale of a business to another person in the existing business law of Ethiopia. Owners are free to maximize their private interest through selling their business to the maximum purchase price, regardless of its impact on the stakeholders' interest in the post-sale. Furthermore, as per the commercial code of Ethiopia, business entities are free to decide the merger of their business with another business legal entity¹⁴⁷ unless it has an anti-competitive effect.¹⁴⁸ The decision to merge with another firm is left to be made by the concerned business entity. Unless the merger has an anti-competitive effect on the market, there is no ground on which the regulatory organ can interfere in the merger decision of business firms.

Thus, if we regulate social enterprises through the existing business rules of Ethiopia, they will be free to sell their business to a third party without considering the interests of other non-stockholders interests. This may, however, create a couple of problems. First, the owners may enrich themselves by selling the whole business, which comprises assets collected from donations, government support, and contributions from other socially conscious persons. Second, the sale of a business may result in the loss of legacy problem whereby the new purchaser changes the social mission of the enterprise to profit mission. This also affects the interests of stakeholders who had made different contribution thinking that the non-financial missions of the enterprise will remain intact. Similarly, if we let social enterprises to be housed under the existing business laws, they can merge with another for-profit business without being restricted. This may also have the effect of loss of a legacy of the original social enterprise. After the taking place of the merger of the enterprise with another for-profit business, the social mission of

¹⁴⁷ Commercial Code of Ethiopia, *Supra note* 95, art. 565 ff.

¹⁴⁸ Trade Competition and Consumer Protection Proclamation, (2013), Federal Negarit Gazette, 20th year, no 28, Proc. No. 813, art. 9.

the entity in the pre-merger may be darkened by the profit-making mission of the for-profit business. Generally, the existing business laws of Ethiopia don't fit to regulate the asset transfer, sale, and merger concerns of social enterprises.

2.5. Disclosure of the Performance of the Enterprise

Like the case of traditional profit-making businesses, there is a problem of information asymmetry in social enterprise.¹⁴⁹ In most cases, the information of the social enterprise is not known for outsiders.¹⁵⁰ It is only reachable for persons who control the enterprise, such as managers, directors, and owners. The problem of information asymmetry may frighten stakeholders to make interactions with social enterprises. Unless there is disclosure of the social performance of the enterprise, donors, customers, quasi-donors, and socially conscious investors may not know whether their contribution is really used to address SEEC problems. To reduce this problem, therefore, minimum disclosure legal requirements need to be set by law that any social enterprise must fulfill.¹⁵¹ It is only when the act of the social enterprise is disclosed that individuals or the government know whether the enterprise actually acts in line with its non-financial mission, and can apply for regulatory measures to be taken against any deviance, if any.¹⁵²

One means of disclosing the performance of the social enterprises is requiring them to make a report on their performance with respect to their non-financial objectives to the enforcement organ.¹⁵³ Unlike traditional for-profit businesses, social enterprises should be required to produce a report of the performance of

¹⁴⁹ Yockey, *Supra note* 119, P. 792.

¹⁵⁰ *Id.* P.793.

¹⁵¹ The UK'S Mission Alignment Working Group, *Supra note* 122, p. 13-14.

¹⁵² Policy Department C: Citizens' Rights and Constitutional Affairs of European Parliament, *Supra note* 84, p. 28.

¹⁵³ The UK'S Mission Alignment Working Group, *Supra note* 122, p. 13-14.

both financial and social missions annually or biannually according to the manner and conditions set for by law. This reporting requirement will help to know whether the social enterprise genuinely acts in accordance with its original mission.¹⁵⁴ It will also serve as the regulatory body to take any measure provided that there is a deviation from the original mission.

In fact, the mere existence of self-reporting of the performance of the entity may not necessarily safeguard the continuity of the original mission of the enterprise. It shall be, rather, evaluated against certain standards and shall be a certified enterprise.¹⁵⁵ Specifically, there shall exist auditing of the non-financial social performance of social enterprises, social auditing, in addition to financial auditing of the enterprise.¹⁵⁶ The social performance of an enterprise shall be audited by independent and professional social auditors.¹⁵⁷ Social auditing shall be made in order to protect stakeholders of social enterprises from the problem of social or “green washing” _ claiming to be a socially conscious business, though it actually not.¹⁵⁸ In general, requiring social enterprises to fulfill minimum standards of transparency will be one concern of regulation of social enterprises since it is a strategic tool to give a notice for stakeholders of social enterprises such as customers, donors, and investors whether the enterprise really acts in accordance with its original mission.¹⁵⁹

¹⁵⁴ Id.

¹⁵⁵ Rebecca Lee, *The Emergence of Social Enterprises in China: The Quest for Space and Legitimacy*, p. 96.

¹⁵⁶ Id.

¹⁵⁷ Yockey, *Supra note* 119, P. 822.

¹⁵⁸ “Social Accounting and audit for the Community Sector” available at <<https://socialauditnetwork.wordpress.com/2015/12/12/the-need-for-social-audit/>> accessed on April 26, 2024.

¹⁵⁹ John Tyle et al, *Producing Better Mileage*, *Supra Note* 88, p. 292.

Under the existing Ethiopian business law, we can find some rules that require businesses to fulfill some standards of transparency. For example, as it is provided under the commercial code, directors of share companies are required to prepare the annual report on each financial year with respect to the balance sheet, profit and loss accounts, and the company's activities and affairs in the financial year.¹⁶⁰ They are mandatorily required to prepare the annual report on the above-mentioned areas. Similarly, though it is not a mandatory requirement, the law indicates the possibility of making a report in the case of partnership business on the management of the partnership provided that the partners require.¹⁶¹ Besides the requirement of reporting, the law requires, especially in the case of share companies and private limited companies, the auditing of such reports by professional auditors.¹⁶² The law imposes a duty on auditors to audit "the books and securities of the company; to verify the correctness and accuracy of the inventories, balance sheets, and profit and loss accounts; [and] to certify that the report of the board of directors reflects the correct state of the company's affair."¹⁶³

But when we carefully see these transparency requirements, they have two major shortfalls. On the one hand, the disclosure requirements emphasize only the financial performance of the businesses. There is no clear and mandatory requirement of reporting and auditing of the non-financial performance of the business. The existing reporting and auditing requirements focus on the disclosure of the financial performance of the business, including the balance sheets and profit and loss accounts. On the other hand, even the reports of the financial performance of businesses are not required to be made for a regulatory organ, and rather, the law requires such reports to be prepared

¹⁶⁰ Commercial Code of Ethiopia, *Supra note* 95, art. 349, 426.

¹⁶¹ *Id.* art. 191/4.

¹⁶² *Id.* art. 349 ff.

¹⁶³ *Id.* art. 349.

at the partnership or company level and to be read out to partners or shareholders in their meeting. The existing business laws of Ethiopia don't require the reports of the businesses to the regulatory authority and to be evaluated by the authority, except the reports of financial businesses.¹⁶⁴

Likewise, if we make social enterprise licensed and regulated through existing business laws, they may not prepare any social performance reports and they may not also be audited since there is no rule that requires social reporting and auditing. The social performance of social enterprises is neither disclosed to society nor audited to determine whether it is adequate and rightly made. This may, however, cause stakeholders, including the government to face the problem of information asymmetry. Stakeholders may not exactly know whether the enterprise acts in accordance with its original social mission or not. Because of the information asymmetry, they may be cheated by fake social enterprises. Donors may, for example, donate a certain amount of donation to fake social enterprises due to the problem of lack of information about the actual performance of the enterprise. To sum up, the disclosure requirements under the existing business law of Ethiopia are not sufficient to regulate the social performance of social enterprises. Rather, there shall be a disclosure requirement that requires social enterprises to report both the enterprise and social dimension performance of the business, i.e. combination of reporting standards for for-profit and NPOs.

¹⁶⁴ Financial businesses including banks, micro finances and Insurances are required to produce a report of the financial statements and other reports prescribed by National Bank of Ethiopia to the regulatory authority, National Bank of Ethiopia. (See Banking Business Proclamation, 2008, *Federal Negarit Gazzeta*, Proc. No. 592, 14th year, No. 57, art. 28, Micro Finance Business Proclamation, 2009, *Federal Negarit Gazzeta*, Proc. No. 626, 15th year, No. 33, art. 15/2 and Insurance Business Proclamation, 2012, *Federal Negarit Gazzeta*, Proc. No. 746, 18th year, No. 57, art. 33).

2.6. Duty and Liability of Directors and Managers towards Stakeholders

The other concern of social enterprise regulation is the duty and liability of directors and managers towards stakeholders.¹⁶⁵ In the corporation tradition, though they are owned by shareholders, the power to control the activities of the corporation is exercised by directors and managers.¹⁶⁶ Shareholders, in most cases, have a very limited participation in the management of the activities of their business, except that they participate in the corporate governance through shareholders' meeting.¹⁶⁷ They are simply beneficiaries of the fruits of their business. They empower directors and managers to manage and control the corporation as a proxy for them.¹⁶⁸ In such a case, directors and managers are required to act in the best interest of their appointees_ shareholders of the enterprise.¹⁶⁹ Specifically, they do have a duty to act in the best interest of the corporation and its shareholders.¹⁷⁰ Any breach of such duty will result in a derivative suit¹⁷¹ against them by shareholders and may finally make them liable.¹⁷² But they don't have a mandatory duty to

¹⁶⁵Thomas J. White IIX, 'Benefit Corporations: Increased Oversight through Creation of the Benefit Corporation Commission', *Journal of legislation*, Vol. 41: no. 2, (2014-2015), p. 342.

¹⁶⁶ Hacker, *Supra note* 108, P, 1761.

¹⁶⁷ "Role of Shareholders of the Corporation", available at <https://thebusinessprofessor.com/knowledge-base/role-of-shareholders-of-the-corporation/>, accessed on May 24, 2024.

¹⁶⁸ Id. P, 1761 &1762.

¹⁶⁹White IIX, *Supra note* 165, p. 342.

¹⁷⁰ Hacker, *Supra note* 108, P. 1762.

¹⁷¹ Derivative suit mans "[a] lawsuit brought by a shareholder of a corporation on its behalf to enforce or defend a legal right or claim, which the corporation has failed to do" ("Derivative Action," available at <https://legal-dictionary.thefreedictionary.com/Derivative+suit>)>accessed on May 15, 2024.

¹⁷² Id.

solve SEEC problems of the community, stakeholders, but not to create a negative impact on them.¹⁷³

Because of these blended objectives of social enterprises, directors and managers of such businesses need to strive to realize both missions simultaneously.¹⁷⁴ They have the duty to maximize the interests of owners and stakeholders through driving appropriate profit and through enforcing the non-financial mission of the enterprise properly, respectively.¹⁷⁵ In social enterprises, therefore, the duty of directors and managers includes their accountability to stakeholders “who [have] an interest or concern with the business but do not necessarily have an ownership interest in the business.”¹⁷⁶ Thus, like that of traditional for-profit businesses, a legislative declaration needs to be made about the existence of the duty of directors and managers of the social enterprises to protect the interests of non-shareholders.¹⁷⁷ The liability of directors and managers towards non-shareholders for the failure to discharge their duty towards stakeholders of a social enterprise shall be established by law.

In fact, the mere declaration of the existence of the duty of directors or managers to protect the interests of non-stockholders may not be a guarantee for the protection of stakeholders’ interests in the enterprise. Directors or managers may act against the interests of stakeholders by breaching their duty to act in accordance with what is required by law.¹⁷⁸ In such a case, another specific issue may arise as to how and by whom a suit should be instituted

¹⁷³ Id.

¹⁷⁴ Esposito, *Supra note 25*, P. 699.

¹⁷⁵ Id.

¹⁷⁶ White IIX, *Supra note 165*, p. 342.

¹⁷⁷ Blodgett *et al*, *Supra note 1*, P.326.

¹⁷⁸ Hacker, *Supra note 108*, P, 1765.

before a court of law against a director or manager that violates his duty.¹⁷⁹ In traditional for-profit businesses, any breach of directors or managers' duty gives shareholders the right to institute a derivative suit before a court of law.¹⁸⁰ Shareholders can seek remedy before a court for the damage they have suffered due to the failure of directors or managers to discharge their corporate duty properly. Similarly, there shall be a means for stakeholders of social enterprises to claim the damage they will have suffered because of the failure of directors or managers to act in accordance with their duty that they have towards non-stockholder. Non-stockholders need to have the opportunity to claim their violated interest before a court either through being represented by shareholders of the enterprise¹⁸¹ or by themselves.

When we examine Ethiopia's existing business laws, we may not locate a section that specifically states the presence of duties and liabilities of directors and/or managers to stakeholders. In fact, the law does impose a general duty on them to carry out the duties outlined in the memorandum, or partnership agreement.¹⁸² This demonstrates that, in addition to the law, the duties of managers and directors can be derived from a company's memorandum or partnership agreement. Thus, for example, if a social enterprise imposes a duty on its manager and directors to consider the interests of stakeholders under its memorandum or partnership agreement then the law will make directors and managers liable for any breach of that duty. However, the issue arises when managers and directors of social enterprises are not required to consider the interests of stakeholders under their memorandum, articles of association, or partnership agreement. In such a circumstance, there is no legal

¹⁷⁹ *Id.*

¹⁸⁰ *Id.* P, 1764.

¹⁸¹ For example, in USA, in almost all states, right to bring a legal action before a court of for the violation of stakeholders' right is required to be exercised by shareholders representing non-shareholders. (Esposito, *Supra note 25*, P. 700).

¹⁸² Commercial Code of Ethiopia, *Supra note 95*, art. 315.

basis for holding directors and management accountable for their failure to heed the interests of stakeholders.

Should we regulate the duties of managers and directors of social enterprises under the present business legal environment, shareholders will be the only ones who can file a court action to enforce directors' liability. However, shareholders/owners of social enterprises may collude with directors to ignore their enterprises' social goals in favor of focusing on profit. In such instances, no one can hold directors or management accountable to stakeholders. In general, Ethiopia's existing business rules are not adequate to control the duties and liabilities of directors and managers of social enterprises toward stakeholders.

2.7. Regulatory Supervision

Thus far, attempts have been made to enlist the unique substantive regulatory concerns of social enterprises. Indications have also been made as to the need for the determination of such substantive concerns by legislation. The mere existence of a well-designed regulation may not be, however, a guarantee for the proper enforcement of such regulatory rules.¹⁸³ Though they are voluntarily established social-oriented businesses, in some cases, they may fail to act in accordance with their blended objective. Thus, a regulatory oversight needs to be made by a government enforcement organ, whether these businesses are actually performing as required by law. Specifically, there shall exist an enforcement authority that can supervise the activities of social enterprises, receive complaints and take administrative measures, protect investors and customers from being misled by false social enterprises,

¹⁸³Dana Brakman Reiser, 'Regulating Social Enterprise', *UC Davis Business Law Journal*, Vol.14, (2013), P. 240

maintain the community interest in such businesses, and follow up on the general state of the social enterprise sector in the country.¹⁸⁴

Currently, no formal regulatory authority exists to oversee social enterprises. They are, instead, governed and overseen by the Ministry of Trade and Regional Integration and similar regional trade bureaus. They are overseen as conventional profit-making firms by the profit-oriented business supervisory body. The current monitoring of social enterprises, however, is restricted to the business element of such enterprises, as there is no explicit regulatory legislation requiring the regulatory body to monitor the social performance of social enterprises. Consequently, they are left to run freely without any regulatory follow-up about their social mission. However, allowing social enterprises to operate in the market without being monitored by any regulatory organization for their social performance may encourage fraudulent social entrepreneurs to claim the status of a social enterprise. To attract consumers and acquire donor-funded financing, a business that spends a little amount of money on a social purpose can claim the status of a social enterprise. This could lead to misleading stakeholders such as investors, donors, consumers, and even the government. A fake social enterprise may influence stakeholders in social enterprises due to information asymmetry. To address this issue, a regulatory authority shall be established to oversee social enterprises from the time they enter until they exit. There must be an authority that can license social businesses by ensuring that all requirements are met during formation, supervise their operations during the operational stage and exit period, and take appropriate action against them if they violate the law.

Another related problem is which government authority should be tasked with regulating social enterprises in Ethiopia. Should they be governed by the Ministry of Trade and Regional Integration (MOTRI) and the Regional Trade

¹⁸⁴Id.

Bureaus, Charities, and Civil Societies Agency (CSA), or both, or do we need a new regulating body? If we give trade bureaus the authority to regulate social enterprises, they will fail to supervise the social performance of social enterprises because they are unfamiliar with how businesses' social performance may be monitored. These authorities are not experts in overseeing charitable activities of legal entities. Rather, they are intimately conversant with business supervision issues. Similarly, allowing them to be governed by the CSA will not be helpful in overseeing the commercial component of social enterprises, as the CSA's specialty is solely supervising the social works of organizations. The other option is to delegate the responsibility for supervising social companies to both authorities, namely MOTRI and the CSA. Giving the CSA the responsibility to supervise the social component of social enterprises and the MOTRI the commercial aspect will be an effective approach to regulating social enterprises because both are professionals in their respective fields. However, delegating the responsibility for regulating social enterprises to two separate regulatory authorities may cause inconvenience for social enterprises. For example, they will be expected to report their business performance to MOTRI and their social performance to the CSA. This will not be convenient for social enterprise founders, managers, or directors.

The author, however, believes that Ethiopia should establish a distinct regulatory entity that is solely responsible for overseeing social enterprises from their entry to their exit. A single regulatory authority shall oversee the social and business performance of social enterprises. Establishing a single, separate regulatory authority for social enterprises will help to ensure strict regulatory oversight of their social and financial performance, while also making it easier for social entrepreneurs to meet supervision requirements. In fact, one may argue that having a single regulatory authority for a specific type of business will be costly to the government. However, the cost that a

government may pay in supervising such enterprises through a separate authority will not outweigh the advantage that the country, including the society, will derive from improved supervision. Thus, the cost that the government may expend for the supervisory organ of social enterprises shall not be used as a reason not to establish a separate regulatory authority for such organizations.

Conclusion

The primary purpose of this study was to investigate the major regulatory concerns of social enterprises and the possibility of regulating them under Ethiopia's existing commercial laws. To accomplish this goal, the author cites a few regulatory concerns of social enterprises. The first two primary regulatory concerns identified in this article are developing an appropriate legal form and establishing the standards for obtaining social enterprise status. Furthermore, the article highlights certain significant regulatory issues that arise throughout the operational stage of social enterprises. The areas of regulation identified by this study include profit allocation, asset transfer and sale, social enterprise mergers, disclosure of social performance, the duty and obligation of directors and managers, and oversight of social enterprises. Lastly, regulating the fate of the assets of the social enterprise during dissolution is also another area of regulation that the article identifies.

Furthermore, the author finds that the regulations of Ethiopia's commercial code are insufficient to address the regulatory issues of social enterprises. It is stated that existing legal forms of business are unsuitable for social enterprise business types since none of them can communicate the aim of the enterprise to the community. Existing legal forms cannot protect the interests of social enterprise owners, i.e., brand building interests, and stakeholders' interests, i.e., distinguishing social enterprises from others, because they are not structured to convey the message of the business's purpose. It is also stated

that the existing business legal structures are insufficient to evaluate the social mission of the enterprise during formation, limit the enterprise's profit distribution, regulate the transfer of an asset, the sale of the social enterprise, the merger of the social enterprise with other profit-oriented businesses, and regulate the disclosure of information about the enterprise's performance. It is also noted that Ethiopia's current business regulatory regime is unsuitable for placing obligations and liabilities on directors in order to maximize the community's interests. The existing rules limit the duty and liability of directors and management to the firm owners, not stakeholders. Stakeholders cannot file a lawsuit in court when directors and management fail to maximize the community's societal interest. It was also discovered that there is currently no supervisory authority in place to monitor the social performance of social enterprises.

Hence, since the existing legal regime of businesses doesn't address the potential concerns of social enterprises, problems such as information asymmetry, mission drift, social washing, and loss of legacy or existence of fake social enterprises might have arisen if we left them to be regulated in the existing business regulatory regimes of Ethiopia. It is open for owners of social enterprises to manipulate capital collected from donations for their personal benefit.

To address these concerns of social enterprise regulation, the government shall enact a separate regulatory legal regime for social enterprise. It shall frame a regulatory framework that can prevent the happening of information asymmetry, mission drift, loss of legacy, entrance of fake social entrepreneurs, and social/green washing problems in the social enterprise sector. It shall, in particular, specify the legal forms for social enterprises, criteria for licensing and registration of social enterprises, and evaluate the social mission of the business. The intended regulation shall also determine

the allocation of profits, asset transfer, sale and merger of social enterprises, and disclosure of social and financial performance. It shall also impose duties and liabilities on managers and directors of social enterprises towards stakeholders and empower the latter to claim against directors or managers for the breach of their duty before a court of law, either through the regulatory organ or by themselves. Finally, there shall be a law that shall establish a specific and separate regulatory authority empowered to regulate social enterprises.