The Legal Framework and Support for Social Entrepreneurship Development in Latvia

Sociālās uzņēmējdarbības attīstības tiesiskais ietvars un atbalsta instrumenti Latvijā

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Latvia faces different socio-economic problems, e.g. high unemployment rate (especially among socially sensitive groups of people) and poverty risk. The state's financial resources are insufficient to tackle all socio-economic problems in the country and funding of charity organisations is limited. Social entrepreneurship has become an important mechanism for tackling socio-economic problems. Social entrepreneurship is a kind of entrepreneurship, the priority of which is the creation of social assets, ensuring the financial self-sustaining and sustainability of the enterprise. However, social entrepreneurship faces many challenges in Latvia. The key factor that influences its development is the fact that there are no legal and institutional frameworks for social entrepreneurship in Latvia. Therefore, the aim of the study is to explore social entrepreneurship legal aspects and available support mechanisms in Latvia. Within the research, there were identified appropriate legal forms for the social enterprise in Latvia and support mechanisms of social entrepreneurship. As a result, functional model of social entrepreneurship in Latvia was elaborated.

Key words: social entrepreneurship, legal framework, support instruments

Introduction

The Constitution of the Republic of Latvia stipulates that Latvia is a socially responsible state, yet, it is not able to successfully fulfil the duty of a socially responsible state, which is based on the fact that Latvia is one of the poorest European Union Member States. During the economic recession, the stratification and income polarisation of the society increased even more, which was affected by the high unemployment rate. The highest poverty risk is faced by the most socially sensitive groups of people – long-term unemployed individuals, disabled people, and large
families. Several studies of foreign scientists (Leadbeater, 1997, 8; Mulgan, Landry, 1995, 8; Wolk, 2007, 4) admit that the state’s financial resources are insufficient to tackle all socio-economic problems in the country, yet, the funding of charity organisations is limited (Yunus, 2007, 10; Perrini, 2006, 17). The experiences of European countries indicate that social entrepreneurship is one of the most efficient and innovative ways of how to mitigate socio-economic problems and facilitate balanced development of the regions (Yunus, 2003, 247; Yunus, 2010, 7).

The terms social entrepreneur and social entrepreneurship were used first in the literature on social change in the 1960s and 1970s. The terms came into widespread use in the 1980s and 1990s, promoted by Bill Drayton the founder of Ashoka: Innovators for the Public, and others such as Charles Leadbeater. A significant contribution to fostering social entrepreneurship is made by a Nobel Prize winner, the founder of social entrepreneurship, Muhammad Yunus, who regards social entrepreneurship as an important instrument for mitigating poverty and other socio-economic problems (Yunus, 2007, 15). Nowadays social entrepreneurship has gained recognition in scientific research, national policies, education, and the commercial sector. An opinion exists that social enterprises is the future of any economy, yet, there are a few social entrepreneurs in Latvia, besides, the concept of social entrepreneurship is a new one. At the end of the 2014 study “Social enterprises – Latvian non-governmental organizations” NGO “Centre for Public Policy PROVIDUS” spokeswoman Agnese Lešinska indicates that there is reason to believe that in Latvia there are no more than 100 social enterprises (Lešinska, 2014, 19).

Within the present research, social entrepreneurship is defined as a kind of entrepreneurship, the priority of which is the creation of social assets, ensuring the financial self-sustaining and sustainability of the enterprise. In addition, a social enterprise is an organisational economic entity established for the purpose of tackling social or environmental problems important to society; the enterprise employs socially sensitive groups of people or supplies services and/or goods to these groups of people (Dobele, 2014, 61).

There are several challenges social entrepreneurs face with – availability of funding, competition in a private sector, lack of knowledge and information on social entrepreneurship (Hynes, 2009, 117). However, the lack of government support is mentioned as one of the key factors that hinder the development of social entrepreneurship in Latvia. The researchers point out that the government has to create an adequate legal framework for regulating social entrepreneurship and to introduce support instruments for fostering its development (Mulgan, 2006, 82). At the moment, there are no legal and institutional frameworks for social entrepreneurship in Latvia.

**The aim of the study**

The aim of the research is to explore social entrepreneurship legal aspects and available support mechanisms in Latvia. The following specific research tasks are set to achieve the aim:

1. to characterize a potential legal framework of social entrepreneurship in Latvia;
2. to identify appropriate legal forms for the social enterprise in Latvia;
3. to explore support mechanisms of social entrepreneurship in Latvia.
Materials and methods

The following research methods were employed to achieve the aim: the descriptive method was employed to shape the theoretical discussion and interpret the research results based on the scientific findings and theories on social entrepreneurship; analysis and synthesis were employed to examine individual problem elements and identify connections among them; induction was used to make scientific assumptions and identify causal relationships from individual elements or facts; deduction was employed to logically systematise and explain empirical data; expert interviews were employed to identify social entrepreneurship development possibilities within the context of Latvia. There were performed 3 expert interviews with the representatives of social enterprises “SinaVita”, “Wooly World” and “Dizz”.

Results

Role of social entrepreneurship within the context of socially responsible state

There are no legal and institutional frameworks for social entrepreneurship in Latvia, yet, the conception of social entrepreneurship meets the basic principles of a socially responsible state, which are stipulated in the Constitution of the Republic of Latvia (RoL) and international documents. A duty of a socially responsible state is to ensure a decent standard of living and social protection in case of risks as well as to promote social justice, equality, and solidarity in society. A legal framework of a socially responsible state is presented in Figure 1.

![Figure 1. Hierarchy of the potential legal framework of social entrepreneurship in the Republic of Latvia (author's own construction)](image)

At the international level, too, the idea of a socially responsible state has gained its recognition. It is confirmed by such international documents as the Universal Declaration of Human Rights of the UN passed in 1948 (in force in Latvia since 14 April 1992), the European Social Charter (passed on 18 October 1961, but it became invalid in 1998 when the European states signed the Revised European Social Charter that was ratified by the Parliament of the RoL on 14 February 2013). Nevertheless, a socially
responsible state does not refer to only the state’s duties and the population’s rights. It requires the participation and socially responsible action of the population themselves. Any state is not able to do everything; therefore, it is important to engage the public in tackling socio-economic and environmental problems. Social entrepreneurship may be developed through establishing direct cooperation among every member of society and through finding innovative solutions to social problems.

The urgency of social entrepreneurship is stipulated in several EU legal acts, indicating that social entrepreneurship is an important instrument in shaping social integration, employment (especially for socially sensitive groups of people), territorial cohesion, and ethical economic growth. The key EU documents that facilitate the development of social entrepreneurship are the Communication from the European Commission “Social Business Initiative Creating a favourable climate for social enterprises, key stakeholders in the social economy and innovation” and the opinion of the European Economic and Social Committee “Social Entrepreneurship and Social Enterprise”. To promote the development of social entrepreneurship, it is advised to design differentiated support instruments for establishing social enterprises and incorporate the instruments in the EU legal acts, including investment priority in the eligibility criteria of the ERDF and the ESF for the programming period 2014-2020.

In Latvia, the concept of social enterprise is integrated only into strategic policy documents – in the Sustainable Development Strategy of Latvia until 2030 and in the National Development Plan of Latvia 2014-2020, in which it is defined as one of 98 options to implement the activity “decent work”. In addition, it should be stressed that on 30 October 2014 the Cabinet of Ministers has approved the Conception about implementation of social entrepreneurship opportunities in Latvia. The aim of the Conception is to “recognize and appreciate the potential of social enterprise, to launch full and effective support systems and to create a legal framework for the development of social entrepreneurship, to offer definitions and eligibility criteria, as well as the directions of support for social enterprises”. In order to determine the most appropriate way to start new policy initiatives, the Ministry of Welfare will carry out a pilot project from 1 January 2016 until 31 December 2018 under the EU Funds Operational Programme “Growth and Jobs” (9.1.1. “Support to social entrepreneurship”). Based on the pilot results, the Ministry of Welfare, together with the Financial, Economic, Environmental Protection and Regional Development Ministry until 1 July, 2018, must submit to the Cabinet of Minister a draft law on social entrepreneurship legislation.

**Legal forms of social enterprises in Latvia**

The Communication from the European Commission “Social Business Initiative Creating a favourable climate for social enterprises, key stakeholders in the social economy and innovation” (25 October 2011) states that appropriate legal forms have to be created for social entrepreneurship in Europe. Yet, no specific restrictions for the legal forms have been set; it means that the Member States themselves have to decide on the most appropriate legal form within the context of each particular Member State.

In Latvia, social enterprises emerged from various organisational and legal forms of business. In the research, the legal framework of Latvia that regulates these statuses and determines whether the mentioned legal forms meet the criteria of social enterprise was analysed. The potential legal forms of social enterprise and the legal framework of social enterprises are presented in Figure 2.
An association and a foundation partially correspond to the nature and criteria of social enterprise — they are not-for-profit organisations, their profit distribution mechanism meets the criteria of social enterprise, their decision-making is democratic, and tax reliefs may be granted if the status of public benefit organisation is obtained. Yet, the legislators allow economic activity to be performed only in the form of additional activity, while economic activity is one of the most essential criteria for identifying a social enterprise, which ensures that socio-economic problems are tackled in a long-term. Given the economic activity restrictions, associations and foundations are not appropriate for obtaining the status of social enterprise.

In Latvia, social enterprises may operate in the legal form of cooperatives if their profit distribution is made in accordance with the principles of operation of social enterprise (an exception — if the members of a cooperative are the disabled from socially sensitive groups, profits may be distributed among the members of the cooperative).

The operation of social enterprises is allowed within the legal forms of business on the condition that their operation meets the criteria of social enterprise. An opportunity to use support instruments, which are offered to new entrepreneurs by the central and local governments — engagement in business projects receiving EU financial support and participation in business incubators —, is a motivating reason to choose the legal form of business.

The following legal forms are as the most appropriate ones for social enterprises in Latvia: an individual merchant, a limited liability company, a cooperative, and a farm or fish farm.

Support instruments for social entrepreneurship in Latvia

According to the fact that in Latvia has not yet developed the legal framework for social entrepreneurship, the social enterprises are not able to receive special support, with the exception of funds, as well as associations that provide advisory services related to social entrepreneurship. Consequently, social enterprises are able to use...
the same support mechanisms that are available for traditional businesses in Latvia. However, it is important to stipulate financial support instruments for social enterprises and their sizes. The interviews with social entrepreneurs show that the most acute problem that limits the development of social entrepreneurship in Latvia is the insufficient financial aid for the foundation and development of social enterprises, which hinders the tackling of social problems in a long-term. The introduction of support instruments for social enterprises is important, given their need to adopt infrastructures for individuals from socially sensitive groups of people, the lower labour productivity, as well as greater time consumption for training such employees. Within the research several support instruments are described that are available in Latvia for social businesses.

**Tax credits**

Social enterprise can pay the micro-enterprise tax if it meets the criteria of the micro-enterprise. Social enterprise “Wooly World” is micro taxpayer, however, the representative of the company admit the tax burden still is very high (especially labour tax burden). In addition, the municipality can grant a property tax relief.

**Support programs for business start-ups**

Public Joint Stock Company “Latvian Development Financial Institution ALTUM” offers support programs for both new and experienced entrepreneurs. Within the grant program “Kick Off” (“Atspēriens”) the small and medium-sized businesses in Riga may receive financial support up to 15000 EUR for their business idea development. Also in a competition “Cup of Ideas” can take a part young entrepreneurs who want to develop their business ideas. The cash prize is up to EUR 7000, as well as participants can get valuable experience and contacts.

**Cooperation pattern of a traditional and a social enterprise**

It may involve the delegation of certain functions of a traditional enterprise to a social enterprise. A social enterprise operates as an autonomous and independent entity, but its products are sold to a traditional enterprise, thus reducing the risk of sales. This cooperation pattern of enterprises does not exclude a possibility for the social enterprise to perform also other activities; the diversification of goods and services is allowed to avoid the risk of selling uniform products. This model partly works in “Dizz” case.

**Funds**

There are some funds in Latvia that support social entrepreneurship development in Latvia, e.g. foundation “Social Entrepreneurship Development Fund” and the Foundation for an Open Society DOTS (before – Soros Foundation Latvia).

One of the directions of Foundation for an Open Society DOTS is the promotion of social entrepreneurship. The foundation no longer grant funds, but provide other forms of support to social entrepreneurs, for example, organizing Riga Social Entrepreneurship Forum. However, before Soros – Foundation Latvia financially supported different social entrepreneurship initiatives, e.g. “Dizz” received support from the Centre for Contemporary Art design contest “Brigade” in 2014 and also company acquired additional funds from the grant program “Kick Off” in 2011.
Also European Social Fund aims to promote employment and education quality levels, as well as business support, including funding for social enterprises. Although EU provides financial support for social enterprises, Latvia cannot acquire the funding as social entrepreneurship isn’t defined in the legal acts. It means that social entrepreneurs cannot verify their status legally.

**Business incubators**

Business incubators provide support for young entrepreneurs providing them with a suitable working environment, secretarial and advisory services. In Latvia, there are 8 business incubators, which are located in cities of Cēsis, Jelgava, Liepāja, Līvāni, Rēzekne, Ogre, Valmiera and Ventspils. Social business “Woolly World” has started their operation within Liepāja business incubator, which provided great consultative and financial support.

**Consultative services in relation to social entrepreneurship**

Consultative services are provided by associations and educational institutions. Social Innovation Centre aims at strengthening and disseminating the knowledge, promoting the international and national experience exchange and establishing the networking for social innovation thus enhancing the sustainable development of society. Societies’ Centre for Public Policy PROVIDUS is promoting social entrepreneurship idea in Latvia. This association has made substantial study of social entrepreneurship, such as “Latvia on their way to social entrepreneurship” and “Social enterprises – Latvian non-governmental organizations”, as well as they are providing advice and conducts training on social entrepreneurship.

Some higher educational institutions deliver study courses on social entrepreneurship (e.g. Latvia University of Agriculture and Riga School of Economics) (Kalve, 2012, 240). Currently, the only Latvian education institution that offers professional master’s study program “Social Business Administration” is Latvian Christian Academy.

**Local authority support**

Some local governments provide social entrepreneurs with an infrastructure – premises being at the disposal of the local government (for instance, renting out the premises at a lower rental, reducing maintenance costs of the premises). However, this support can be extended. The local government can design mentoring programmes, hold training and seminars on social entrepreneurship.

To foster the development of social entrepreneurship in Latvia, it is important to introduce new, special support instruments for social entrepreneurship. Based on international and national scientific studies (Lešinska et al., 2012, 58; Pūķis, 2012, 62) and expert interviews, several additional support instruments that are important and appropriate for fostering social entrepreneurship in Latvia were identified in the research.

**Income tax reliefs**

Given the high burden of taxes on enterprises in Latvia, one of the alternatives is to reduce the rates of enterprise or personal income tax or to eliminate these taxes for social enterprises; as such enterprises do not pay their profit in dividends but reinvest their profit in their expansion.
Government subsidies

One of the most acute problems to social enterprises is a lack of funds for their establishment. It is especially important to those social enterprises that need specific and extensive equipment for starting up their activity. The case of “SinaVita” reveals that a lack of personal funds to purchase capital assets for capital-intensive activities is the limitative factor for starting up social entrepreneurship.

That is why the government has to introduce subsidies for social enterprises so that they can purchase capital. This subsidy does not have to be paid back on the condition that no significant violations in the operation of a social enterprise are discovered. The local authority could coordinate the support instruments introduced by the government, as they are better aware of the problems and need of their local area.

To effectively introduce social entrepreneurship in Latvia, several consecutive activities have to be executed and interaction among various stakeholders is necessary. A functional model of social entrepreneurship in Latvia developed by the author is shown in Figure 3.

Figure 3. Functional model of social entrepreneurship development in Latvia (author’s own construction)
One can conclude that in order to foster successfully the development of social entrepreneurship in Latvia, it is important to design a legal framework for social entrepreneurship and to introduce support instruments for it, as well as to promote cooperation among local authorities, enterprises, third sector organisations (mainly associations) and educational institutions.

Conclusions

There are no legal and institutional frameworks for social entrepreneurship in Latvia, yet, the conception of social entrepreneurship meets the basic principles of a socially responsible state, which are stipulated in the Constitution of the Republic of Latvia and international documents. There is no need to establish a new legal form for social enterprises in Latvia, but the status of social enterprise has to be integrated in legal acts. The most appropriate legal forms of social enterprises in Latvia are as follows: an individual merchant, a limited liability company, a cooperative, and a farm or fish farm.

In Latvia, it is urgent to design a new law “On Social Entrepreneurship”, which would incorporate general rules of social entrepreneurship, criteria to identify a social enterprise, procedures of identifying and amending the status of social enterprise, as well as tax reliefs for social enterprises. According to the fact that in Latvia has not yet developed the legal framework for social entrepreneurship, the social enterprises are not able to receive special support. However, it is important to stipulate financial support instruments for social enterprise, given their need to adopt infrastructures for individuals from socially sensitive groups of people, the lower labour productivity, as well as greater time consumption for training such employees.

At the moment social enterprises are able to use the same support mechanisms that are available for traditional businesses in Latvia. They can apply for support programs for business start-ups, take a part in business incubators and receive tax credits (the same as traditional companies). However, to foster the development of social entrepreneurship in Latvia, it is important to design a legal framework for social entrepreneurship and to introduce special support instruments for it (income tax reliefs, subsidies for equipment purchase). Also it is highly important to promote cooperation among local authorities, traditional enterprises, third sector organisations (mainly associations) and educational institutions to provide consultative support for social enterprises and to disseminate information about social entrepreneurship and its importance in society and economy.

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Latvian Christian Academy
Sociālās uzņēmējdarbības attīstības tiesiskais ietvars un atbalsta instrumenti Latvijā

Kopsavilkums

Latvija sastopas ar dažādām sociāli ekonomiskām problēmām, piem., augstākā bezdarba līmenī (paši sabiedrības sociālā riska grupās) un nabadzības riskiem. Valsts finansēlie resursi ir nepietiekami, lai risinātu valstī esošās sociāli ekonomiskās problēmas, savukārt labdarības/žēlpirktības organizāciju finansējums ir ierobežots.


Atrzītājvārdi: sociālā uzņēmējdarbība, tiesiskais ietvars, atbalsta instrumenti.

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