**Developing a definition of Social Enterprise and Strengthening the framework for reporting impact:**

Traditionally, the social impact space is associated with not-for-profit legal forms like religious or charitable trusts and societies or co-operative societies. The conservative legal systems have created hardships for social enterprises to raise funds from different capital sources as well as structure efficient innovative financing models for impact interventions.

However, over the past few decades, 'for-profit' social enterprises and innovative blended finance models has emerged as a new and effective means to generate scalable social impact. This new trend has pushed governments across the world to adapt legal systems to allow for intermixing of commercial with philanthropic capital as well as create an enabling ecosystem for variety of social impact driven enterprises be it 'for-profit' or 'not-for-profit'.

Over **20 countries[1] now have a structured legislation with a legal or a working definition in place for social enterprises.** *(Refer Annexure 1 for a brief overview of regulations of select countries)***.** The Indian legal system also requires changes in the existing regulations to create an evolving ecosystem for the social impact enterprises. Having a clear definition for a social enterprise will allow the ecosystem to build and benefit, in not just their own growth, but that of the overall economy. Additionally, it adds more legitimacy on the social impact focus of the enterprise and re-validates the importance of 'social' impact generation.

## I. Definition of Social Enterprise

International policymakers and industry experts stress on the need for a clear definition of 'social enterprise' to prevent any scope for impact washing. It is important to include only enterprises that have a clear intent 'to create positive, measurable social or environmental impact' under the ambit of social enterprises.

The rationale behind the suggested policy reforms is to foster transparency, improve the ease of doing business for credible impact-driven enterprises[2], enable legitimate impact driven enterprises to attract a diverse group of investors (debt/equity) to finance its operations, including private foundations and impact driven for-profit investors and in turn allow for blended finance models to be structured with ease and at low costs.

Countries like South Korea, Italy, United Kingdom, United States of America, France etc have created an overarching framework including a definition, certification and reporting guidelines for social enterprises. Some economies have gone a step further to provide fiscal incentives, financial aid as well as formulate public procurement guidelines to support social enterprises. We have provided a more detailed overview of three country profiles in ***Annexure 1.***

A formal definition for social enterprises has proven to have a positive effect on the growth of the social sector by bringing in greater investments[3]. The Indian government should also define a 'social enterprise'. This can be aligned to globally aligned definitions, standards and frameworks.

[2] OECD, *Social Impact Investment 2019: The Impact Imperative for Sustainable Development* (OECD, 2019), https://doi.org/10.1787/9789264311299-en.
[3] World Bank Group, Legal frameworks for Social Enterprises, 2016

**Our Recommendation –**

**Pursuant a review of laws governing social enterprise definitions used in India and other countries, and keeping in mind the Indian context, we recommend that a social enterprise be defined as "any business which buys or sells goods or services (irrespective of its legal form and profit motive) with a clear intent and focus to generate measurable, positive, social and environmental impact".**

The enterprise should meet one of the following to qualify as a social enterprise-

- **Key sector and segments –** The business activities which would qualify as relevant for a social enterprise could be the same as those captured under Schedule VII Section 135, Companies Act, 2013.
- **Target Population of the social enterprise –** The target group should belong to lower to middle income groups, based out of rural, semi-urban, or Tier II and beyond cities
- **Focus on sustainability –** The enterprise is conscious of its impact on the environment. And if not through their operations, at least takes steps to reduce their own carbon footprint

An additional criterion from a business perspective would be that an eligible social enterprise should generate at least 50% (the limit can be modified) of its revenue from its social business activities (as described above).

A qualifying social enterprise will also have to comply with minimum reporting standards which the government decides to enforce.

## II. Reporting Standards

**Globally various green finance, sustainable finance, social impact reporting frameworks, standards, principles, and tools have sprung up in the last ten years – at global, national, regional and even corporate level – by public and private entities**[4]. For instance, as recent as September 2020, the trustees of the International Financial Reporting Standards (IFRS) Foundation published a consultation paper to assess the demand for global sustainability standardsi. IFRS Foundation proposes to establish a new Sustainability Standards Board (SSB), sitting alongside International Accounting Standards Board (IASB) to contribute to the development of global sustainability standards. Such an initiative would integrate ESG material elements in a single accounting body.

Multiple countries like South Korea, Italy and the United Kingdom have laid out norms for social impact reporting by enterprises registered/ certified under the respective social enterprise regulations. The South Korea norms, for instance, mandate all certified enterprises to submit quarterly business performance reports which are subject to scrutiny and audit by the government authorities once a year. The government has also drafted voluntary impact reporting standards for enterprises (irrespective of their registration under the Act). A more detailed overview of reporting norms laid out for social enterprises in these countries are provided in ***Annexure 1***

Responding to increasing disclosure practices, the **European Commission** has introduced regulations to mandate disclosure obligations relating to sustainable investments and

[4] Some of the leading global voluntary framework providers and standard setters include the Carbon Disclosure Project (CDP), the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC), the Sustainability Accounting Standards Board (SASB), the Task Force on Climate-related Financial Disclosures (TCFD), and more recently, the Task Force for Nature Related Financial Disclosure (TNFD). For fixed-income markets, primarily used reporting and disclosure principles are the Green Bond Principles (GBP) by the International Capital Market Association (ICMA), and the Climate Bond Standards from the Climate Bonds.

sustainability risks towards end investors by institutional investors and investment manager effective March 2021[5] This also includes disclosure obligations with respect to adverse impacts/ negative externalities on sustainability matters at entity and financial products levels. The **United Kingdom** has also implemented a phased plan for mandatory climate disclosure for companies and other organisations by 2025. The UK Financial Conduct Authority (FCA) said that, premium listed companies in the UK will be required to make adequate TCFD guided disclosures about how climate change affects their business with effect from 1 January 2021[6].

**Our Recommendation -**

The Working Group Report on the proposed Social Stock Exchange provides for a minimum reporting standard. However, in order to attract global investments as well as leverage the already existing frameworks that exists locally & internationally, we recommend that the IMP framework be used as a reference to build the reporting requirement. We had also presented our recommendations in our submission titled 'Feedback on the Working Group Report on Social Stock Exchange (SSE)' dated August 14, 2020 (copy enclosed).

<table>
<tr><th>Recommended Frameworks</th><th colspan="2">Details</th></tr>
<tr><td rowspan="5">Impact Management Project (IMP)</td><td colspan="2">The IMP framework can be used as a reference to build the minimum reporting requirements -<br>IMP provides a forum for building a global consensus on how to measure, manage and report impact.<br>After several consultations with over 2,000 organizations around the globe, IMP reached consensus that impact can be measured across the five dimensions. In line with the working group report reporting standards, the first three dimensions could be used as 'minimum' reporting parameters.</td></tr>
<tr><td>Impact Dimension</td><td>Impact questions each dimension seeks to answer</td></tr>
<tr><td>What</td><td>▪ What outcome is occurring in the period?<br>▪ Is the outcome positive or negative?<br>▪ How important is the outcome to the people (or planet) experiencing them?</td></tr>
<tr><td>Who</td><td>▪ Who experiences the outcome?<br>▪ How underserved are the affected stakeholders in relation to the outcome?</td></tr>
<tr><td>How</td><td>▪ How much of the outcome is occurring – across scale, depth and duration?</td></tr>
<tr><td>IRIS+</td><td colspan="2">For more detailed insights on the measurable social impact performance of the social enterprise, IRIS+ can be used. IRIS+ has been developed after an extensive global study of impact metrics across sectors and can help provide much deeper understanding of impact.<br><u>For example</u> – in Employment sector, a reporting metric could be 'number of people who were placed in a part time, full time, temporary, or permanent job during the reporting period'.</td></tr>
</table>

KPMG & IIC recently conducted an extensive survey focused on Impact Measurement & Management practices adopted by 25 leading Impact Investment Funds in India**. Some of the**

[5] "Sustainability -related disclosure in the financial services sector", European Commission, Accessed on 19 January 2021, https://ec.europa.eu/

[6] 'UK Paves Way for Mandatory TCFD Climate Disclosure for Companies and Other Organisations by 2025 | LinkingESG | Blogs | Linklaters', accessed 18 January 2021, https://www.linklaters.com/en/insights/blogs/linkingesg/2020/november/uk-paves-way-for-mandatory-tcfd-climate-disclosure-for-companies-and-other-organisations-by-2025.

**key findings of this study[7] include the usage of the globally accepted standards mentioned above. Thus, the adoption of the above standards would not entail mammoth efforts.**

**The implementation of global standards will lay the foundation for standardization of minimum reporting requirement within each sector and foster comparability of impact reports across enterprises.** As discussed, countries across the globe are now working on a framework to mandate standardised impact reporting and India should not be far behind to implement the same.

The working group report has recommended only self-reporting of impact by enterprises for the immediate term. We recommend all enterprise should be asked to report on a bi-annual and a detailed review by the regulator/stock exchange government should take place at least on an annual basis.

### III. Audit and Performance Monitoring

To ensure that the legitimacy of the 'social' impact being created is intact, an audit of the social parameters is necessary. In accordance with the global trend, all social enterprises should get independent verification of impact reports done by social auditors. This should be made mandatory to ensure maximum amount of transparency in reporting.

As was suggested in the Working Group Report on the proposed Social Stock Exchange (SSE), a potential solution could be that the 'capacity building' fund ( fund to create a capacity building unit that will foster overall sector development) formed by the SSE should cover the cost of the social audit in the initial years of SSE. Additionally, the expertise of corporate and philanthropic foundations could be leveraged to conduct a social audit.

An audit would need to be carried out on an annual basis, and a fixed timeline like for a financial audit will need to be put in place.

**Our Request –**

We request you to consider our recommendations to build a framework which captures the overall success and reach of the social enterprise. This is of key importance to foster transparency and create legitimacy of the 'social' enterprises.

In addition to the above recommendations, if further clarity or support is required in conceptualizing a framework or formulating 'minimum requirements' for reporting, we would be happy to provide our support.

Please let us know if you require any further clarifications or information in this regard.

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7 Impact Measurement and Management in India – A Position Paper, IIC-KPMG,2020, https://iiic.in/wp-content/uploads/2020/10/IIC-KPMG-State-of-IMM-in-India.pdf

# ANNEXURE 1: Country Profiles

## South Korea – Country Snapshot

South Korea enacted Social Enterprise Promotion Act (SEPA) in 2007. The SEPA lays out the national strategy to enable impact investment in the country. The Korea Social Enterprise Promotion Agency (KoSEA) oversees its implementation alongside the Ministry of Labour.

Several large corporates have also started embedding impact within their businesses. The impact investment market in the Republic of Korea has grown due to policy changes in the recent years. Overall, the Government has provided immense support to the industry through impact investing wholesalers and fund-of-funds. Ministry of Labour, Ministry of Strategy and Finance, Ministry of SME and Start-ups, and Financial Services Commission have been instrumental in the movement.

### I. Social Enterprise Definition

The SEPA defines a social enterprise as “an organization which is engaged in business activities of producing and selling goods and services while pursuing a social purpose of enhancing the quality of local residents' life by means of providing social services and creating jobs for the disadvantaged”.

These enterprises “have to contribute to the integration of society as well as to the enhancement of the quality of the people's life thereof, by means of expanding social services, which are not sufficiently provided in society, and creating jobs” (SEPA, Article 1).

A social enterprise could be registered as an association, company, corporation or non-profit organization under relevant laws.

### II. Certification

An eligible social enterprise receives certification for a period of five years under the Act and is then entitled to avail a suite of benefits from the government. Since the start of the certification system in 2007, about 3000 social enterprises received certification under the SEPA framework.

KoSEA oversees impact monitoring and evaluation of certified social enterprises. KoSEA also helps social enterprises improve their performance by providing them with professional services, specialized training courses through the Social Entrepreneurs Academy, incubation support and access to social venture competitions.

### III. Certification Benefits

#### A. Fiscal Incentives and Other Financial Support

Tax incentives have worked as a strong facilitator for the increase and expansion of social enterprises in South Korea. Social Enterprises benefit from reduced corporate taxes, tax exemptions, tax breaks for corporate purchases of social enterprise goods and services, long-term low interest loans. (SEPA, Article 13 & 16). The Ministry of Labour offers financial incentives including a wage subsidy for disadvantaged or underprivileged people, other financial support towards labor costs, operating expenses, and consultation expenses (SEPA, Article 14).

#### B. Public Procurement and Business Consulting

The government provides operational support, such as specialized advice, information, in areas of administration, technology, tax, labor, and accounting. The government supports site expenses, facility expenses, or leases state-owned land in order to help establish social enterprises.

A law enacted in 2014 “Public Purchases and Marketing Support for the Products of Social Economy Organizations”, provides for preferential access to social enterprises in public procurement. Public procurement policies require 5 per cent of sourcing from certified social enterprises. As a result of these laws, the public procurement market for social economy in Seoul grew by KRW 80 billion (approximately $63 million) in 2015.

### IV. Audit and Performance Monitoring

The Act requires all the certified social enterprises to report quarterly to the ministry, on both, social and financial aspects of the business performance. An independent review of the activities is run on an annual basis by the government.

The certification is valid for a period five years. After this period, it is assumed that the social enterprise is capable of functioning independently, without consultation and financial support. However, the social enterprise does continue to remain and benefit from the larger social economy and network including investments from government funded fund managers. It is expected to contribute and work towards mitigating social and environmental challenges.

## Italy – Country Snapshot

### I. Social Enterprise Definition

Italy has enacted Impresa Sociale in 2017, which recognizes an organization as a social enterprise *(regardless of the legal form)* if they carry out commercial activity in order to pursue, mainly and permanently, “civic, solidarity or social utility objectives”. The government has laid down a series of criteria or sectors which qualify as ‘social’.

The social enterprise is allowed to share profits and operational surpluses in a limited form.

The following enterprises do not qualify as social enterprises as per legislation: (1) companies established by a single shareholder who is a natural person, (2) public administrations and (3) entities whose articles of incorporation limit supply of goods and services to members or associates only.

Additionally, Italy also recognizes companies as benefit corporations or ‘***Società Benefit***’, which is a company that combines the goal of profit with the purpose of creating a positive impact for society and the environment and which operates in a transparent, responsible and sustainable way. It is neither a social enterprise nor a not-for-profit company. As opposed to a social enterprise, a benefit corporation will not have limits on its commercial activities. The impact focus of these companies however be explicitly stated in their mission. They will be expected to measure and document the positive impact created by them and by nature be ESG compliant.

### II. Fiscal Benefits

The fiscal framework in Italy is in a transition phase, wherein, its final design depends on the full application of Reform of the Third Sector and Social Enterprise (Decrees 112/2017 and 117/2017), which is waiting for approval from the European Commission.

According to the current tax regime approved by Decrees 112/2017 and 117/2017, the social enterprises in Italy can at present avail the following exemptions and breaks –

- Corporate tax exemption
- Tax reduction on donations & investments
- VAT exemptions or reductions
- Exemption from social security contributions
- Full exemption or reduced IRAP (taxation on income generated by productive activity basis region)
- Exemption from registration charges & inheritance tax

### III. Audit and Performance Monitoring

While there are no marks, labelling schemes or certification systems for social enterprises as recognized by 'Impresa Sociale'. There is however a system of 'social reporting', which are specifically targeted at social enterprises.

The social enterprises are required to compile a social report (*bilancio sociale*) every year, following the guidelines provided by the Ministry of Labour and Social Policy. The report is to be deposited at the Companies Registrar of the Italian Chambers of Commerce – and should be aimed at providing information about the compliance of social enterprises with its social objectives and identifying the added value generated and its distribution within the generated company. Besides describing the mission of the organization, the report also entails the resources used, results achieved and the impact generated by the organization's activities.

## UK – Country Snapshot

### I. Social Enterprise Definition

Social enterprises can take a variety of forms in the UK, from being an enterprise which ensures that all its assets are only used for its social purpose, to be able to provide financial returns to investors. There are various legal forms an enterprise can adopt basis the nature of their business model and end goals, such as – unincorporated associations, trusts, charitable incorporated organizations (CIOs), companies limited by guarantees, community interest companies (CICs) and registered societies.

As per the CIC regulations, **"*Community Interest Companies (CICs)*** *are limited companies which operate to provide a benefit to the community they serve. They are not strictly 'not for profit', and CICs can, and do, deliver returns to investors. However, the purpose of CIC is primarily one of community benefit rather than private profit. Whilst returns to investors are permitted, these must be balanced and reasonable, to encourage investment in the social enterprise sector whilst ensuring true community benefit is always at the heart of any CIC*."

CICs are enterprises which aim to generate social impact alongside financial returns. While they can generate profits, the dividends are subject to a cap of 35% of profits. A CIC is subject to an asset lock, wherein, majority of the assets are retained and applied exclusively for the benefit of the company.

### II. Audit and Performance Monitoring

The companies Act does not offer any specific strategies or mechanisms for CIC governance, but the UK government made clear that a CIC must publicly file a 'CIC Report' within twenty months of incorporation, describing the actions taken by the CIC has taken to benefit the community in line with the company's initially stated community interest purpose.

The Office of the Regulator of Community Interest Companies randomly selects annual reports filed by the CICs for examination. The CIC Regulator's powers derive from the

Companies Act, and the Regulator's Office works with the Companies Investigation Unit of the Insolvency Services to determine whether a deeper investigation is necessary[8].

[8] https://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?article=1808&context=njilb

**Table 1 Overview of 'Social Enterprise' Legislations in Select Countries**

| Country/ Legal Provisions | United Kingdom | France | South Korea | Italy |
|---|---|---|---|---|
| **Legislation** | Community Interest Company | Social and Solidarity Economy Law (ESUS) | Social Enterprise Promotion Act | Decree 112 2017 on Social Enterprises<br>Società Benefit (Benefit Corporation) |
| **Distributable Profits to Shareholders** | Yes | Yes | Yes | Yes for both |
| **Fiscal Incentives** | No | Yes[9] | Yes[7] | Yes[7] for Social Enterprises<br>No additional tax benefits for a Benefit Corporation |
| **Access to multiple sources of Capital (Commercial/ Not-for Profit)** | Yes | Yes | Yes | Yes for both |
| **Reporting Requirements (In addition to annual statutory audit)** | Yes. Community Business Report to be filed annually. Report is open to public scrutiny. No Standardised Impact Reporting system in place as yet. | Not yet. The implementation of impact standardised reporting MESIS (Measurement and Tracking of Social Impact) is under progress. | Yes, Business Reports to be submitted twice a year. No Standardised Impact Reporting system in place as yet. | Yes. Social Reports are required to be filed by Social Enterprises<br>Benefit Corporations are required to submit an extensive annual benefit report showcasing their social and environmental performance using third party evaluation |
| **Additional Legal Requirements** | Asset Lock; Transparency of Director's remuneration; Other checks and | Yes restrictions on remuneration of employees, trading of equity securities | | |

[9] Corporate tax exemption on retained profits; Tax reductions granted to private and/or institutional donors; Reduction in VAT rates and social insurance costs with some restriction.

| | | | | |
|---|---|---|---|---|
| | balances provided by CIC legislation | | | |

Source: European Commission '*Social enterprises and their ecosystems in Europe' 2020; ;* UK, *Office of the Regulator of Community Interest Companies: Information and guidance notes*, accessed 11 January 2021, https://assets.publishing.service.gov.uk/; GSG 'Catalysing an Impact Investment Ecosystem - A Policymaker's Toolkit' 2018; www.societabenefit.net accessed on 12 January 2021; EVPA Reports

[i] IFRS Foundation Trustees consult on global approach to sustainability reporting and on possible Foundation role. IFRS, 2020. https://www.ifrs.org/news-and-events/2020/09/ifrs-foundation-trustees-consult-on-global-approach-to-sustainability-reporting/