Levelling the Playing Field: Making the BVm Viable

By Zafar Shaikhli[1]

Since first bursting on the scene in Italy in the late 1980s, the notion of the 'social enterprise' has spread to nearly every corner of the globe.[2] In recent years, many jurisdictions have accommodated and stimulated this expansion by introducing legal frameworks specifically for social enterprises. From the United States to Denmark and from South Korea to France, countries are increasingly choosing to recognise social enterprises in their legal systems.[3] However, one country that has conspicuously lagged behind others in this regard, is the Netherlands. But this may soon change. In March 2021, the Dutch government published a proposal for the introduction of a private limited-liability company with a social purpose: the BVm. While drafting this BVm-proposal, the Dutch legislator adhered to the principle that social enterprising should be encouraged, without jeopardizing the level playing field between social enterprises and commercial enterprises.[4] This somewhat cryptic phrase was the legislator's way of stating that the BVm-proposal would not include any incentivising elements, such as fiscal advantages. After all, such advantages would distort competition and compromise the delicately balanced playing field. While this seems to be a justifiable line of reasoning, it is predicated upon an uncorroborated assumption: that a level playing field exists in the first place. In this blog, I will argue that social enterprises and commercial enterprises are currently placed on an unequal footing, as social enterprises face more difficulties attracting financing. The existence of this 'financial dead zone' thus merits the introduction of incentivising elements into the BVm, in order to satisfy the Dutch legislator's desire for a level playing field and to genuinely encourage and support social enterprises.

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[1] The author wishes to thank Kinanya Pijl, Nena van der Horst and Amy Lazell for their valuable input on this blog. This blog is part of the N-EXTLAW project which has received funding from the European Research Council under the European Union's Horizon 2020 research and innovation programme (Grant agreement No. 852990).

[2] Defourny, Jacques & Nyssens, M. (2008). Social enterprise in Europe: Recent trends and developments. Social Enterprise Journal. 4. 202-228.

[3] OECD. (2022). *Designing Legal Frameworks for Social Enterprises: Practical Guidance for Policy Makers*, Local Economic and Employment Development (LEED), OECD Publishing, Paris.

[4] Kamerstukken II 2019/20, 32637, nr. 426

1. The BVm-proposal explained

"*More recognition through accreditation*" – that is the government's intended goal of the proposed BVm-legislation. Under the proposal, a BV (private limited-liability company) may carry the title of 'BVm' if it meets certain conditions. This title will, according to the legislator, allow social enterprises to more visibly differentiate themselves from commercial enterprises, thereby drawing the attention of like-minded customers, financiers and other interested parties.

To qualify as a BVm, the BV must have a 'social purpose', as laid down in the enterprise's articles of incorporation. The proposal contains an exhaustive list of social purposes that a BVm may pursue, however this list is not new. The same list is already used to determine whether an institution qualifies as an 'ANBI' (public benefit organisation). These public benefit organisations enjoy various tax advantages under Dutch law. The BVM-proposal however, explicitly states that the BVm will not enjoy any tax advantages as compared to the regular BV.

Under the draft, the shareholders and board of directors must prioritise the social purpose of the BVm above all other considerations when distributing profits and deciding whether or not to pay dividends. In other words, while shareholders are not fully entitled to the profits of the BVm, there is no complete prohibition on their distribution. The draft does not even designate a minimum percentage of profits which must flow towards the attainment of the social purpose. Moreover, the primary responsibility for deciding whether or not dividends will be paid still lies with the shareholders. The board of directors is, however, allowed to block the shareholders' decision if there is "*more than a reasonable doubt that dividend payments will hinder the BVm from prioritizing its social purpose*".

Another salient feature of the BVm is that the board can decide to get rid of this 'social label' and revert back to a regular BV. Stakeholders have one month from the moment that the board expresses this intention to object in court. The court will forbid conversion if "*there are good reasons to believe that this decision conflicts with the interest of continued applicability of the BVm-law to the BV, taking into account the interest that the objecting stakeholder has in the continued applicability of that law to the BV*."

While the BVm-proposal has been lauded for its goal of helping social entrepreneurs gain more recognition for their social mission, several of its aspects have received their fair share of criticism. The BVm's non-committal nature and its lack of hard requirements with respect to profit distribution might open up avenues for abuse in the form of 'social washing'. In addition, the BVM-label has been described as merely a 'cosmetic' epithet, in light of the fact that the BVm-proposal does not offer any incentives to go along with the label.[5] This, of course, is a reflection of the Dutch legislator's desire not to jeopardize the level playing field between social and commercial enterprises. A question which can, and should, be asked however, is if this level playing field even exists in practice.

2. The 'unlevel' playing field – the financial dead zone

In order to ascertain whether there is a 'level playing field' between social and commercial enterprises, it is important to know what social enterprises are. While there is no universally agreed-upon definition, the OECD definition can provide some guidance:

> "*A social enterprise is any private entity whose activity is conducted in the general interest, organised with an entrepreneurial strategy, whose main purpose is not the maximisation of profit for the sake of personal enrichment but its use for the attainment of certain economic and social goals*."[6]

To further elucidate this concept, it is instructive to think of organisations as existing on a continuum. This continuum ranges from fully social organisations (such as charities) to fully commercial organisations (think of traditional businesses).[7] Social enterprises tend to occupy the middle of this continuum, as there is a commercial goal, but this commercial goal is subservient to, and in service of, the social goal.

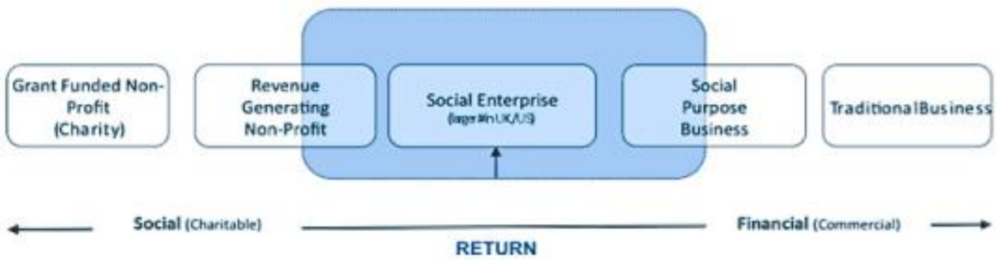

Figure 1 - Source: Cahill, Geraldine. (2010). Primer on Social Innovation A Compendium of Definitions Developed by Organizations Around the World. Philanthropist. 23.

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[5] Parijs, S. (2022). De besloten vennootschap met maatschappelijk doel (BVm). JutD 2021/0055.
[6] OECD (2022), *Designing Legal Frameworks for Social Enterprises: Practical Guidance for Policy Makers*, Local Economic and Employment Development (LEED), OECD Publishing, Paris.
[7] Cahill, Geraldine. (2010). Primer on Social Innovation A Compendium of Definitions Developed by Organizations Around the World. Philanthropist. 23.

An interesting question however, is how social enterprises go about attaining financial sustainability. At first glance, one might expect that such enterprises would have no problem meeting their financing needs. After all, combining commercial activity with social purpose might mean that social enterprises can obtain financing from commercial revenue, as well as grants, donations, loans and other streams.[8] While this is certainly true in theory, empirical studies paint a very different picture. Inadequate levels of financing are consistently found to be one of the most pertinent problems facing social enterprises.[9] In the UK for example, 40% of surveyed social enterprises considered lack of access to finance to be a significant barrier to starting-up and 39% found it to constitute a significant barrier to sustainability and growth.[10] Similarly, in the Netherlands, 38% of surveyed social enterprises named lack of access to capital as the single most important obstacle to growth.[11] Moreover, attracting financing is also the second most commonly cited obstacle to increasing social impact among surveyed social enterprises in the Netherlands.[12]

To explain why social enterprises have trouble attracting adequate levels of financing, it is useful to look back at the continuum displayed in Figure 1. Organisations at either side of the spectrum generally know what type of financing to target. 'Fully' social organisations, such as charities, generally subsist off donations, governmental subsidies and fees connected to their charitable activities.[13] Fully commercial organisations, on the other hand, finance themselves through commercial revenue, equity financing and debt financing. The social enterprises in the middle of the spectrum often fall between two stools. In the words of the European Commission, commercial sources of financing are not always available to social enterprise because "*banks often consider them too risky, while venture capital funds might consider their business models to be below preferred risk-return-profiles. The financing needs might be too large for microfinance, but too low for most other institutional investors.*"[14] Indeed, social enterprise often face 'double costs' - they not only face the ordinary costs associated with running an enterprise, but also the costs associated with pursuing their social mission.[15] Studies have shown that adherence to this social mission can in fact lead to lower profits and less economic benefits.[16] As a result of this internalisation of social costs, commercial sources of financing are thus often simply out of social enterprises'

[8] Teasdale, Simon. (2010). Explaining the multifaceted nature of social enterprise: Impression management as (social) entrepreneurial behaviour. Voluntary Sector Review. 1. 271-292.
[9] Abramson, Alan J. and Billings, Kara C.. "Challenges Facing Social Enterprises in the United States" *Nonprofit Policy Forum*, vol. 10, no. 2, 2019, pp. 20180046.
[10] Danish Technological Institute. (2016). Promoting social enterprise financing.
[11] Social Enterprise NL (2013). Stimulansen voor de social enterprise sector: ervaringen en lessen uit Europa.
[12] Social Enterprise NL. (2018). De Social Enterprise Monitor.
[13] Clifford, D., Mohan, J. The Sources of Income of English and Welsh Charities: An Organisation-Level Perspective. *Voluntas* **27,** 487–508 (2016).
[14] European Commission. 2020. Social enterprise finance market – analysis and recommendations for delivery options.
[15] Danish Technological Institute. (2016). Promoting social enterprise financing.
[16] Vansandt, Craig & Sud, Mukesh & Marmé, Christopher. (2009). Enabling the Original Intent: Catalysts for Social Entrepreneurship. Journal of Business Ethics; Liu, Gordon & Takeda, Sachiko & Ko, Wai Wai. (2014). Strategic Orientation and Social Enterprise Performance. Nonprofit and Voluntary Sector Quarterly. 43. 480-501.

reach. Similarly, 'social' sources of income, such as grants and subsidies, are not always available to social enterprises. So, while social enterprises often seek grants to fund their operations[17], their dual mission might mean they are not eligible.[18] Moreover, it has been shown that earning revenue can lead to a decrease in donative revenues.[19]

The term 'financial dead zone' has been coined to describe the phenomenon explained above.[20] Social enterprises, which are not fully social or fully commercial, are often left without viable financing options due to being located within this financial dead zone. This observation is enough to dispel the notion of a 'level playing field' between social and commercial enterprises. Social enterprises are at a structural disadvantage due to the difficulties they face attracting sufficient levels of financing. Consequently, the Dutch legislator's focus within the BVm should not be maintaining a level playing field, but creating one. This can be achieved through the introduction of incentives tied to the BVm, specifically geared at stimulating financing.[21]

3. Levelling the playing field – stimulating social enterprise financing

In determining what incentives should be tied to the BVm to 'level the playing field' and stimulate social enterprise financing, it is instructive to look at some of the attempts of other countries.

The United Kingdom has been at the forefront of stimulating social investment for decades.[22] In 2014, the UK introduced the Social Investment Tax Relief (SITR). Under the SITR, investors are granted tax relief on shares they buy from, or money they lend to, social enterprises. More precisely, individuals making an investment through this scheme can deduct 30% of the amount invested from their income tax liability. Moreover, capital gains on the investment in question are exempted from capital gains tax. Not all enterprises are eligible to receive SITR investments, however. For instance, enterprises mostly involved in dealing in land, property development, banking and power generation cannot qualify for SITR investments. It is also useful to note that the SITR initiative has wildly underperformed expectations. Before its introduction, the Treasury predicted £83.3m to be invested through

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[17] Lyon, F., Baldock, R. Financing social ventures and the demand for social investment. Third Sector Research Centre Working Paper 124 (2014).

[18] Lyons, Thomas & Kickul, Jill. (2013). The Social Enterprise Financing Landscape: The Lay of the Land and New Research on the Horizon. Entrepreneurship Research Journal.

[19] McInerney, P. B. 2012. "Social Enterprise in Mixed-Form Fields: Challenges and Prospects." In *Social Enterprises: An Organizational Perspective,* 162–84. Houndmills, Basingstoke, Hampshire, UK: Palgrave Macmillan.

[20] Danish Technological Institute. (2016). Promoting social enterprise financing.

[21] Liao, Carol, Early Lessons in Social Enterprise Law (June 27, 2018). Forthcoming in The Cambridge Handbook for Social Enterprise Law (Cambridge University Press) B. Means & J. Yockey, eds.

[22] Belinda Bell, 2021. "Social Investment in the UK: The Emergence of a Hollow Field," Springer Books, in: Thomas Walker & Jane McGaughey & Sherif Goubran & Nadra Wagdy (ed.), Innovations in Social Finance, pages 463-482, Springer.

the scheme within the first three years, however the actual figure turned out to be a paltry £5.1m. Commonly cited reasons for this failure include the limited scope of investments allowed under the SITR and the lengthy, complicated approval procedure - factors which could both be amended, but have not. Despite this, the SITR has been lauded by many social entrepreneurs and the scheme has been extended until 2023.

In Italy, the birth place of the social enterprise, steps have also been taken to accommodate social enterprises. Under the Reform of the Third Sector and Social Enterprise,[23] new fiscal advantages will be introduced to improve access to financial resources for all social enterprises.[24] Individual taxpayers will be granted the possibility to deduct 30% of the capital invested into new social enterprises from their tax payroll, up to a maximum of €1m. For businesses, the same rule applies but the maximum is capped at €1.8m. Apart from this, social enterprises (with the exception of social cooperatives) will be exempted from corporate tax payments on retained profits.

As of 2022, there are no such schemes targeting social enterprises in the Netherlands. However, a scheme specifically pertaining to environmentally sustainable projects does exist. Under the *regeling groenprojecten*, green banks and funds can apply for a 'green certificate' (*groenverklaring*) on behalf of their clients. If a project is given this designation, it can be financed by said bank or fund against a lower interest rate, thus stimulating financing. Individual taxpayers participating in a green fund are exempt from paying capital gains tax on green investments up to €61.215. Additionally, these taxpayers receive a tax credit to the tune of 0.7% of the aforementioned exemption. The *regeling groenprojecten* has been growing in success in recent years, as can been seen in Figure 2.

[23] Decrees 117/20017 and 112/2017.

[24] European Commission (2020) Social enterprises and their ecosystems in Europe. Updated country report: Italy. Author: Carlo Borzaga. Luxembourg: Publications Office of the European Union.

Figure 2 - Source: Dutch Government

4. Making the BVm viable

The examples in the preceding section have demonstrated the viability of incentivising social enterprise financing through fiscal mechanisms. In order to satisfy the Dutch legislator's desire for a level playing field between social and commercial enterprises, it would be prudent to incorporate similar incentives into the BVm. Analogous to the British SITR and the Italian Third Sector reform, this incentive could take the form of a 30% tax relief on investments in BVms. This tax relief should apply to both debt and equity investment, and should be open to individual taxpayers as well as businesses. This would go a long way towards mitigating the negative effects of the financial dead zone.

Of course, this suggestion is contingent on satisfactory changes being made to the BVm-legislation. As it stands, the BVm-proposal is too non-committal in nature and therefore runs the risk of being a conduit for social washing. In its current form, it would thus be unwise to add fiscal advantages to the proposal. The exact question of how to make the BVm more 'abuse proof' unfortunately goes beyond the scope of this blog, however a good starting point would be to ban the conversion of the BVm to the BV and to instate hard requirements with respect to profit distribution.[25] As only once the baseline specifications are changed and *all* BVms prioritise and uphold their social purpose, will applying fiscal advantages genuinely help to encourage and support social enterprises by enabling them to attract financing - creating a more level playing field overall.

[25] In both regards, the British Community Interest Company (CIC) can provide guidance. CICs can only be dissolved or converted into charities. Moreover, CICs are subject to a dividend cap of 35%.