



# Public Governance Guidance Note

## Introduction

In our two earlier guidance notes, we considered the set-up of a non-governmental organisation (NGO) for doing some public good. We explained that a limited liability company will be the usual form used for incorporating an NGO. We provided an incorporation checklist. Also, in practice, a charity commonly refers to a company that has obtained a tax exempt status under s.88 of the Inland Revenue Ordinance (s.88 exemption). This restricts the objectives of the company to either relief of poverty, advancement of education, advancement of religion or other charitable purposes in accordance with common law.

A question that company secretaries may face is – why should a company wishing to do public good be restricted to these charitable objectives? The answer is that companies are not restricted to these objectives – it is only when a company wishes to have tax-exempt status that its objectives are required to be restricted to the charitable objectives stated above. There is nothing preventing a company making a profit, donating part of it and distributing and reinvesting the rest back into the company if it does not require tax exempt status. This assumes that the shareholders who collectively own the company are agreeable to giving up part of the profits to address specific social concerns, instead of pursuing a pure profit motive.

For example, under the hypothetical scenario in our earlier guidance notes (where a business leader seeks to establish a

charity for budding musicians), the company secretary can advise that other scenarios can be explored. For example, instead of establishing a charity for budding musicians, the company could hold tutorial classes, and sell instruments and tickets to concert performances to earn profits, and use and/or reserve some of the profits to help budding musicians. The excess could be distributed to shareholders and reinvested into the company to expand its operations. The company can even help musicians that are not based in Hong Kong (a tax-exempt charity would need to focus on Hong Kong on certain matters), as long as the shareholders agree. Shareholders would need to agree to use part of the profits to pursue the desired social objectives, for example hosting of activities and concerts outside of Hong Kong. Invariably, there needs to be some professional accounting advice as to which items and to what extent are the expenses and donations are tax deductible. That is, the business of the social enterprise needs to be well-planned.

## What is the difference between a social enterprise and a charity?

The historical context is that a company should maximise its profits for shareholders. But with the recent development of environmental, social and governance (ESG) concerns, shareholders have now moved away from profit maximisation to address ESG concerns relevant to the company and which makes for more sustainable business operations. With this change of approach, social enterprises have become widely

accepted. For example, a company could employ disabled persons to make a profit and thereby provide job opportunities to the disabled. It could also, as explained, donate and reinvest some of the profits and distribute the rest to its shareholders as dividend. In contrast, a charity will seek donations and make gifts to the disabled persons. The difference between a social enterprise and a charity in this example is that the social enterprise provides the opportunity for the disabled to reintegrate themselves back into society. There is a strong element of trying to help people help themselves with a social enterprise.

### Useful resources

The HKSAR Government has a Social Enterprise website ([www.social-enterprises.gov.hk](http://www.social-enterprises.gov.hk)).



As explained on the website, there is no universal definition of social enterprises. In line with the above discussion, a working definition of a social enterprise is a business that seeks to achieve specific social objectives with profits principally reinvested in the business for the social objectives it pursues. The government explains that it is focused on employment opportunities for the disadvantaged to help them become self-reliant. The government has a directory of social enterprises to help promote them, and the Home Affairs Department has a Social Enterprises Promotion Unit (<http://www.social-enterprises.gov.hk/en/introduction/promotionunit.html>). Where the social enterprise reinvests 65% or more of its distributable profits for the social objectives, the company secretary can explore if it will be eligible to seek support under government initiatives. This is especially relevant where a social enterprise seeks to provide the disadvantaged with employment opportunities.

In appropriate cases, the social enterprise can also be a charity. For further reference, please refer to the '*Choosing a Legal Form and Recommended Practices*' which provides useful information on the unique characteristics of a social enterprise, how it is different from a charity, the structure and the legal form of a social enterprise.

In addition to the Home Affairs Department, which is the policy bureau for social enterprises, the Efficiency Office is another major government department driving social enterprise and social innovation proactively. If there is a good business idea or concept, whether for the employment of the disadvantaged or other ideas or concepts, it may be worth approaching organisations offering capacity building and incubation services. There are a number of these, including: The Social Innovation and Entrepreneurship Development Fund ([www.sie.gov.hk](http://www.sie.gov.hk)), Good Lab ([www.goodlab.hk](http://www.goodlab.hk)) and Good Seed ([www.goodseed.hk](http://www.goodseed.hk)). For a full list of these supporting platforms is available on the Social Enterprise website.

### Shareholders' agreement

Whether a company provides its own funding and/or seeks to have other sources of funding, it is important for the shareholders to be aligned. This is because a social enterprise diverts some profits for social good. The company secretary can suggest that the company drafts up a shareholders' agreement containing the provisions set out below.

**The purpose of the social enterprise.** It will be good to explain the purpose of the company as a social enterprise and what it is supposed to achieve. This will help all parties and future supporters to align themselves with the purpose and avoid future disputes.

**Shareholding.** The social enterprise is owned by its shareholders so, as with any other company, the register of shareholders should be set out. If there are significant issues to be decided, a majority of shareholders will need to vote on the issue. Certain matters designated as 'special business' may require a super-majority of three-fourths of those attending and voting to vote.

**Special business.** The special business matters that should be left to the super-majority to decide could include matters like acquiring real estate, and changes to the objects and distributions of the social enterprise. To address how a social enterprise uses its assets and distributes its profits to safeguard its social objectives, some social enterprises may, on a voluntary basis, adopt 'asset lock' and 'cap of profit sharing' provisions in the shareholders' agreement, meaning that any change to these key issues would require unanimous shareholder approval. The parties should work with the company secretary to identify these issues.

**Composition of the board.** The composition of the board is important. For example, is there any right conferred upon any particular shareholder to appoint a board member, and how many directors should there be? This affects the whole system of checks and balances on governance related issues like the operation of bank accounts and authorisations for enter into contracts.

**Key appointments.** There should be thoughts as to who has the right to appoint the company secretary, legal advisers, auditors and other relevant professionals to the business, unless this is controlled by the board.

There could be other issues to cover in the shareholders' agreement, such as the right of first refusal to purchase shares, tag along rights to sell shares, pre-emptive rights to buy shares, along with options to purchase shares on the death or disability of a shareholder. In addition, there may be provisions dealing with conflicts, financing of operations and other specialised provisions, which the company secretary could explore with those seeking to set up the social enterprise.

### The need for a business plan

It has become increasingly difficult for charities to open bank accounts in Hong Kong. Banks will require detailed customer due diligence (CDD) prior to establishing the account. This is partly because receiving money from the public brings with it anti-money laundering and counter-financing of terrorism (AML/CFT) risks. This is not a Hong Kong centric but an international issue for charities. As such, it will be useful to try to establish contacts with bankers to smooth out issues with opening bank accounts.


In contrast, a social enterprise operates as a company. It will have clearly defined investments, business plans and financial projections, and these should facilitate the opening of a bank account. The problems associated with opening bank accounts should not be underestimated and this needs to be addressed prior to deciding whether to establish a charity or a social

enterprise. In this connection, currently some banks offer support to social enterprises.

A social enterprise seeking to establish a bank account will need to provide the bank the documents set out by the Hong Kong Monetary Authority (<http://www.hkma.gov.hk/eng/other-information/ac-opening/documents.shtml>). The business plan should be disclosed under item three below (setting out the purpose of the account).

1. Corporate identification documents, for example:
  - Company's certificate of incorporation
  - Company report from a company registry
  - Company's memorandum and articles of association
2. Information on the beneficial owner(s), for example:
  - Identification document of the beneficial owner(s)
  - Details of the ownership and control structure of the company
3. Purpose and intended nature of account, for example:
  - Purpose of the account
  - Expected account activities
  - Business nature and mode of operation
4. Information of the person acting on behalf of the customer, for example:
  - Identification document of the person acting on behalf of the customer
  - Authorisation document

### What's next?

Our guidance notes to date have covered the advice company secretaries can give on the setting-up of charities and social enterprises. A further area where company secretaries can offer advice would be the compliance issues under the Companies Ordinance where a company is the vehicle used by an organisation to deliver public good. We will consider these and other governance issues in further guidance notes. 

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