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## Human resources and legal framework as factors affecting the development of social entrepreneurship in the Baltic Sea Region

This paper presents an overview of the two factors affecting the development of social entrepreneurship and social enterprises in the Baltic Sea Region: human resources and the legal framework, making reference to the pertinent literature and an existing theory. The authors base their research on the survey conducted among the representatives of social enterprises across the seven Baltic Sea Region countries and focus group interviews. The results of the study show that there is a great disparity in the level of support offered to social entrepreneurs from the researched countries and that the same human resources theories could be applied to traditional and social enterprises. The study has also shown that social enterprise legislation is not the key factor in the development of a social economy in the researched countries, but further work on an adequate legislation is needed.

Keywords: social entrepreneurship, entrepreneurship, social enterprise, social economy

JEL classification: L31, L1, L38

### Zasoby ludzkie oraz regulacje prawne jako czynniki determinujące rozwój przedsiębiorczości społecznej w regionie Morza Bałtyckiego

Artykuł przedstawia dwa czynniki wpływające na rozwój przedsiębiorczości społecznej i przedsiębiorstw społecznych w regionie Morza Bałtyckiego: zasoby ludzkie oraz ramy prawne. W artykule wskazano, że te same teorie zasobów ludzkich stosuje się zarówno do tradycyjnych przedsiębiorstw, jak i przedsiębiorstw społecznych. Autorzy opierają swój wywód na badaniu ankietowym przeprowadzonym wśród przedstawicieli przedsiębiorstw społecznych w siedmiu krajach regionu Morza Bałtyckiego oraz badaniach z wykorzystaniem grup fokusowych. Wyniki wskazują na znaczące różnice we wsparciu oferowanym przedsiębiorstwom społecznym w badanych siedmiu krajach. Wykazano, że istnienie aktów legislacyjnych dotyczących przedsiębiorczości społecznej nie jest kluczowym czynnikiem w rozwoju ekonomii społecznej w badanych

państwach, zalecane są jednak dalsze prace legislacyjne w tym obszarze w krajach, w których działalność przedsiębiorstw społecznych nie jest prawnie uregulowana.

Słowa kluczowe: społeczna przedsiębiorczość, przedsiębiorczość, przedsiębiorstwo społeczne, ekonomia społeczna

Klasyfikacja JEL: L31, L1, L38

## Introduction

Independent social entrepreneurs perform an important complementary role by engaging in highly flexible, decentralised innovation, experimentation, and problem-solving. Social entrepreneurship development is influenced by the three main factors: demand side factors (i.e., demand for the public services offered by social enterprises), supply side factors (essentially, the supply of social entrepreneurs), and contextual and institutional factors impacting on the relation between the two [Spear, 2006]. Contextual factors, especially institutional, legal and social environment factors, could either support or constitute main barriers to the development of social initiatives [Sekliuckiene, Kisielius, 2015].

The importance of this paper is grounded in a wide scope of analysis that researches two types of factors that affect the development of social entrepreneurship in the Baltic Sea Region. These factors are: the legal framework and human resources of social enterprises.

## 1. Theory review

### 1.1. Theoretical foundation of social entrepreneurship in the context of human resources

The concept of a social enterprise is entrenched in the social economy and its definition requires itself the identification of the factors preventing its development. Social enterprises are still in evolution, thus facing serious barriers and challenges. To successfully develop, they require an adequate legal framework, support mechanisms from the public administration, academia and traditional business representatives and, finally, capable human resources.

In their research paper, Borzaga and Solari [2001] underline corporate governance and human resource management (HRM) as the two crucial issues facing the sector of social enterprises. It is established that 'managing resourceful humans requires a constant balancing between meeting the human aspirations of the people and meeting the strategic and financial needs of the business' [Torrington, Hall, Taylor, 2005], but, in the context of social enterprises, one should add a social di-

mension, too. This section will concentrate on the human resources management and present the main barriers and challenges of the field based on the survey in which NGO representatives from the seven Baltic Sea Region states: Denmark, Estonia, Finland, Latvia, Lithuania, Poland and Sweden, involved in social economy development, outlined the main barriers they encounter in the context of human resources.

In order to answer the question of whether it is necessary to formulate a separate human resource management approach suitable for the management of employees in social enterprises, one should determine the relevant barriers and weaknesses in terms of human resources that hinder the functioning of social enterprises. Due to the fact that, in general, social enterprises work in different markets than traditional businesses focused on profit, they require a special HR management, which may be seen as a key challenge. The studies have shown that the practical techniques of managing the workforce in social enterprises rarely differ from the ones used in traditional, solely business oriented enterprises; therefore, human resources theories may be applied to both types of business activities. Furthermore, 'while accepting the need for contextualisation of models and practice, social enterprise managers find themselves facing challenges familiar to those of front-line managers in other sectors' [Royce, 2007].

The leadership strategy is explained extensively in the reviewed literature, proving that social enterprises must overcome serious barriers and challenges such as: constantly balancing between social and business goals trying to combine them smoothly, dealing with part-time/full-time and volunteer employment challenges, as well as with 'high expectations from a wide variety of stakeholders regarding their integrity, accountability and openness for stakeholder participation' [Heineke, Kloibhofer, Krzeminska, 2014]. In this context, it is important to add that according to Raymond E. Miles's study, not one, but two theories of participative leadership ought to be adopted by modern enterprises, as the same conclusion may be applied to social enterprises. In his research, he concluded that 'for their subordinates, managers prefer a *human relations* approach, aimed at improving morale and reducing resistance to formal authority. For themselves, however, they prefer a *human resources* approach, whereby they want their superiors to recognize and make full use of their own currently wasted talents' [Miles, 1965].

Based on the research and the in-depth studies of social enterprises in the seven countries of the Baltic Sea Region, it is possible to select main human resources theories applicable to social enterprises. These are:

- the labour market relationships within the social enterprise,
- leadership strategy including: human relations approach and human resources approach,
- operational HR management theory,
- strategic HR management theory.

## 1.2. Theoretical foundation of social entrepreneurship in the context of a legal framework

An incredible diversity of the legal forms of social enterprises is outlined in the international scientific and policymaking literature on social entrepreneurship. As Wilkinson et al. [2014] assume, social enterprises adopt a *variety of legal forms and statuses*: (1) existing legal forms such as associations, foundations, cooperatives, share companies, (2) new legal forms exclusively designed for social enterprises by adapting or 'tailoring' the existing legal forms, (3) legal status that can be obtained by selected or all existing legal forms which comply with a number of legally defined criteria, and (4) new types of legal forms that allow traditional non-profit organisations to undertake economic activity.

Besides, it is worth noticing that according to Wilkinson et al. [2014], there are two main approaches that can be observed across Europe. On one hand, the creation of a *separate, new legal form* for social enterprises by adapting the cooperative legal form. On the other hand, the creation of a social enterprise legal status and the introduction of *transversal 'legal statuses'* that cut across the boundaries of various legal forms and can be adopted by different types of organisations, provided they meet the pre-defined criteria. Moreover, a classification of the legal acts of social enterprises has been introduced on the basis of their legal forms. To be precise, Borganza and Defourny [2001] distinguish between two types of legal acts: the first one governs social cooperatives, whereas the second one is related particularly to social enterprises. Furthermore, Cafaggi and Iamiceli [2008] consider that there are three possible legal forms of social enterprises in Europe: a *cooperative model* (social enterprises as cooperatives with social objectives), a *business model* (resulting from the traditional business form but with a social purpose and a limited distribution of profits), and an *open-type model* (without any specific legal form).

Apart from that, Haugh [2005] emphasises that a social enterprise is a collective term for a range of organizations that trade for a social purpose, adopting one of a *variety of different legal formats* but sharing the principles of pursuing business-led solutions to achieve social aims and reinvesting the surplus for community benefit. The objectives focus on socially desired, nonfinancial goals and their outcomes are the non-financial measures of the implied demand for and supply of services. Respectively, Mair and Martí [2006], and Peredo and McLean [2006] assume that social entrepreneurship brings about social change and should be viewed as a *cross-sectoral domain* where legal form and sectoral belonging are less important and social change prevails.

## 2. Discussion

The development of social economy is stimulated and supported in all countries within the European Union. Moreover, the European Commission proposes a common social economy policy and solutions at the European level. Various European countries have passed new laws to promote social enterprises. However, the level of the development of social enterprises differs across the countries depending on their history, the field's heritage, experiences, law makers and their interests, as well as the meaning of social economy.

### 2.1. A legal framework: The case studies of the Baltic Sea Region countries

There exists no special legal form for social enterprises in Latvia. The official work on the legal framework for social enterprises was initiated by the Ministry of Welfare in March 2013. The draft on 'The introduction of social entrepreneurship opportunities in Latvia' was submitted to the government in February 2014 and the process of governmental review was finalised in October 2014. The support pilot project was launched in January 2016 and will continue up to December 2018.

In Estonia, there is also no special legal form for social enterprises neither. Nevertheless, in terms of running a business, this country offers quite an easy procedure, the same for social and any other enterprises. Most social enterprises are registered as civil society organisations: non-profit associations (governed by its members) or foundations (governed by its boards). There are also a few limited liability companies identifying themselves as social enterprises.

In 2004, the Social Enterprises Law (IX-2251) came into force in Lithuania outlining the criteria for adopting the status of a social firm, as well as presenting incentives provided to those companies. To qualify as a social enterprise, a company just needs to employ at least 4 people from a vulnerable group who have to comprise a minimum of 40% of the total work force of a company. Apart from that, there exists the legal form of a public non-profit company that can be owned by individuals, NGOs and public institutions. According to the law on public non-profit companies, such an entity has to reinvest its operational profit back into its activities and can carry out commercial activities. In this respect, this legal form is quite close to the common understanding of the definition of a social enterprise, since it already complies with several main criteria. The draft on social entrepreneurship in Lithuania was developed by the Commission of the Ministry of Economy and approved in April 2015.

In Sweden, social enterprises operate under several legal forms, such as limited liability companies, non-profit economic associations, non-profit organisations or foundations. The majority of social enterprises are non-profit organisations, while

a smaller share choose the legal form of a foundation. At the same time, cooperatives are common among WISEs (work integration social enterprises) supported by the Organization Companion – an institutional actor in the field of social economy and social enterprises. Hybrid legal solutions are also a rather common fact.

The Danish Registered Social Enterprises Act (Law No. 711 of June 25, 2014) was passed by the Danish Parliament in June 2014. It states that since January 2015 any social enterprise that meets the 5 set criteria can be registered. As the criteria formulate a very broad definition of a social enterprise, the registration scheme is really flexible in terms of a company's choice of a legal form; consequently, it can choose a company form fitting to its activities. In addition, a new law for public tendering has been in effect since October 1, 2015.

The Finnish law, in turn, does not distinguish a social enterprise as a separate legal form, thus allowing it to adopt any organisational form. The limited liability company law states that the aim of a limited liability company is to make profit for its shareholders, unless otherwise stated in company statute – which leaves room for it to establish itself as a social enterprise. Most social enterprises operate as limited liability companies; some of them choose the form of a foundation, an association or a cooperative. As mentioned in the cooperative law, only a cooperative as a business form can have other than economic goals. The only term related to social entrepreneurship recognized by the Finnish legislation is a *social firm*, which employs long-time unemployed or handicapped people – it is a so-called work-integration social enterprise.

The development of the modern Polish social entrepreneurship sector started in 2006 with the Act on Social Cooperatives, which indicates that the main objective of a cooperative is to bring people at risk of social exclusion and people of low employability back to the labour market by running common enterprises and promoting professional activation of the unemployed. Moreover, in August 2014, the government adopted the National Programme for Social Economy Development, according to which social economy entities can be grouped into four main categories: (1) social enterprises, which constitute the basis of the social economy; (2) reintegration entities, which support the social and professional reintegration of people at risk of social exclusion; (3) public benefit entities, which are non-governmental organizations carrying out public benefit activities, both chargeable and free of charge; and finally, (4) economic actors, which are established to achieve the social objective of a common interest in addition to their main commercial goals.

## 2.2. Human resources: The case studies of the Baltic Sea Region countries

The most common challenges observed in the social enterprises operating within the BSR diagnosed by the NGO's representatives in the survey carried out

as part of Erasmus+ project entitled 'The social entrepreneurship development in the Baltic Sea Region' are:

- unclear separation of roles, duties and responsibilities,
- lack of self-development mechanisms for employees,
- lack of vocational training,
- lack of competencies and insufficient knowledge of: management systems, teambuilding, customer service, streamlining processes, sale, quality improvement, finance and accountancy, PR and marketing, conflict solving and management.

The research shows no significant differences in business skills deficit between the countries – it can be observed that the above-listed skills are often seen as barriers to running an enterprise – for example in Latvia, Denmark and Poland. The biggest challenge of all is to provide a social enterprise with skilled workforce that could support its activities just as competently as the workforce in a traditional, business-oriented enterprise.

One of the reasons for hiring less-skilled employees is the type of employment contract used by a social enterprise. It is an established trend observed throughout the EU that a social enterprise is characterized by a heavy reliance on part-time employees and volunteers, with only a small percentage of full-time employees [EC, 2015]. The same could also constitute a potential threat for a social enterprise, as noted by Pearce [2003], who cautions against the 'dangers associated with over-reliance on a small number of active people who will be difficult to replace if geographical moves or life changes prevent them from continuing their involvement with the enterprise'.

Another reason is the perception of social enterprises as entities providing solely social and community care services, and employing 'workers with minimal possibilities of finding a job in traditional enterprises' [Borzaga, Defourny, 2001]. The research conducted in Latvia also shows that working in a social enterprise is often mistakenly viewed as limited to dealing with socially excluded groups of people, and, as such, offering worse employment opportunities than a traditional, business-oriented enterprise. Skilled, educated and experienced employees thus refrain from applying for job positions in social enterprises. The survey also confirms that most of the workforce employed in Danish and Estonian social enterprises possess strong social competencies, but lack business skills. The staffing process is generally perceived as crucial to a social enterprise in the context of human resources. According to the latest studies, 'staffing refers to the capacity of an organization to attract and to manage various people, such as volunteers, employees and social clients' [Royce, 2007], and the research shows that the BSR social enterprises struggle to acquire committed and skilled employees. Moreover, according to the organization theory, the organizational structure and people management

practices affect the capacity of entrepreneurs to guide individual action and build a sustainable organization, thus being imperative for the existence of social enterprises [Imperatori, Ruta, 2015].

As the representatives of work-integration social enterprises claim, Swedish enterprises 'combine revenue from sale of work rehabilitation services to local or national authorities, public subsidies compensating for individuals' reduced working capacity and income from sale of products or services such as carpentry, art work, cafés or hotel accommodation' [Gawell, 2015], but this is not a general trend for all types of social enterprises in the region.

Overall, it is visible that the skills necessary to further develop social and traditional entrepreneurship are usually the same. In the case of social enterprises, though, a high level of innovativeness is also required, as social entrepreneurs should bring improvement for the social sector or the whole society; in other words, his innovative work must benefit humanity. In order to be innovative, however, one must first acquire the above-listed competencies related to the decision-making process, self-planning, self-organization, etc. It is not possible to learn innovativeness *per se*, as it combines and is the result of possessing other human talents necessary to become a successful social entrepreneur.

### 2.3. Data collection methodology and characteristics of the sample set

The questionnaire was created between June and August 2015 and the answers were collected online between September and November 2015 from 7 organisations in the Baltic Sea Region involved in the support of social entrepreneurship. In total, 97 replies were received. The number of collected replies is statistically valid for analysis. The survey was conducted in English.

More than a half of the surveyed social enterprises have NGO status; others operate as limited liability companies, cooperatives, etc. The average period of their operation in the market is around 5–7 years. The average number of employees varies considerably, however the assumed average is 10.6% of the analysed social enterprises work in the gastronomy sector, 8% in the printing and advertising sector, 6% in childcare, 10% in elderly care and the handicraft sector, and 60% in other sectors.

### 2.4. The results of the online survey

Due to the differences in the legal systems of the Baltic Sea Region countries, the legal framework aspect is not analysed as a part of the online survey.

One of the aims of the online questionnaire was to identify the current availability of competent human resources to social enterprises. The respondents were asked to indicate 3 most relevant areas in which the staff could use support (see:



Table 1). The next question inspects barriers of human resources at social enterprises. The respondents were requested to choose 3 most relevant barriers or weaknesses in terms of human resources, hindering functioning or the development of a social enterprise (see: Table 2). According to the data from the online survey, the three leading support methods are business advisory and coaching, professional expert advisory and grants for the establishment of social enterprises.

Table 1. Key areas in which additional support for staff is required

Key areas in which support is required	Total replies	Percentage
Our staff does not need any extra support	10	10.2
Legislative issues	38	38.8
Finance and accountancy	37	37.8
Organization management	25	25.5
Human resources management	18	18.4
PR and marketing	44	44.9
Sales techniques	41	41.8
Specific qualifications connected with the offered products or services	30	30.6

Source: Own elaboration based on the survey results.

Table 2. Main barriers and weaknesses in terms of human resources

Main barriers or weaknesses in terms of human resources	Total replies	Percentage
There are no such barriers or weaknesses	10	10.2
Legal regulations related to the employment of staff	30	31.3
Dependence of employment on external financial support (grants, financial support from the labour office, etc.)	38	39.6
Low competencies and professional qualifications of staff	22	22.9
Insufficient management skills	21	21.9
Low salaries due to insufficient resources	47	49.0
The specifics of working with socially excluded people	34	35.4
Other	8	8.3

Source: Own elaboration based on the survey results.

## 2.5. The results of the focus group interviews

The focus group interviews were held within the framework of Erasmus+ project in six Baltic Sea Region countries: Latvia, Lithuania, Estonia, Finland, Poland, and Denmark, among the representatives of the social economy who support centres and networks of social entrepreneurs, social cooperatives, non-profit companies, NGOs, public institutions, and private sector companies. Almost all of

them took place in September 2015, except the one in Latvia (conducted in October 2015). The number of participants varied from 7 to 15 persons.

The questions were structured so as to identify the main challenges facing new social enterprises, touching upon such key aspects as: legal framework, human resources, support mechanisms, and external image. However, due to the limited scope of this paper, only the first two factors have been analysed. Nearly all the respondents admitted that their countries lack a well-developed legal framework, with the exception of Denmark, where the appropriate definition has already been introduced into legislation, but is still considered too narrow as it excludes businesses with an extended social purpose. The Danish employment law impedes social enterprises from employing more disadvantaged people; however, since October 1, 2015, the new law for public tendering made it possible to reserve certain contracts for social enterprises.

The draft on social entrepreneurship has been approved in Lithuania, although the ministries in charge of coordinating its implementation – the Ministry of Economy and the Ministry of Labour and Social Affairs – have not agreed on how to divide their responsibilities and what action plan to adopt. Moreover, the Lithuanian Ministry of Economy established a commission to elaborate the draft and provide input into the development of the action plan; its work, however, has been infrequent and inefficient.

In Estonia, the debate has been triggered as to whether it is necessary to introduce a special legal form for social enterprises or not. Those in favour stress that none of the present legal forms exactly addresses the needs of businesses that strive towards an explicit public benefit, whereas the main counterargument states that the legal form of a business is not crucial, as even NGOs can establish and hold 100% of shares of a limited liability company.

In Poland, there is no clear social enterprise legislation and the appropriate legal act has been in preparation for several years. There exist accompanying laws, such as the act on social cooperatives, employment, and unemployment elimination, yet most of them are incoherent. As there is no clear definition of a social enterprise, it can take any legal form, including social cooperatives, associations, foundations, and institutions of social and professional reintegration. Depending on the chosen legal form, social entrepreneurs will face various difficulties connected with the registration and management of their company.

Another of the indicated crucial challenges is the issue of human resources in social economy entities. For example, in Estonia all the participants of the survey agreed that the majority of social enterprise leaders have yet to develop their leadership and management expertise, especially in relation to business administration. In Lithuania, the general level of awareness about social entrepreneurship is quite low. Therefore, new social businesses lag behind in understanding the key principles of social impact, which results in a lack of resources that can be used to

supplement that missing knowledge. As for the people able to establish social enterprises there, it was noted that they came from different sectors, including private, public and NGO.

In Latvia, three main groups of people who could potentially establish social enterprises were identified. First, the leaders of NGOs, who already have a social mission and perceive social entrepreneurship as a possibility to reach their aim. Secondly, the young people, eager to start a business and, at the same time, to solve social problems. Thirdly, the experienced people from mainstream businesses, the so-called burned-out managers who have re-evaluated their lives and now wish to benefit the society – and, owing to the necessary work experience, might actually make social businesses sustainable, giving them better chance of survival. Although the competencies of all these groups are very different, their motivation is more or less the same – to make a positive change in the society.

In the Polish social economy system, the greatest challenge is to find a social entrepreneur who embodies a profound businessman, sensible coach and thoughtful psychologist, whose overall aim is to benefit the society.

## Conclusions

In the Baltic Sea Region, social enterprises are perceived as a dynamic, diverse and entrepreneurial movement encapsulating the drive for new business models that combine economic activity with social mission and the promotion of inclusive growth [EC, 2015]. The purpose of the above study was to identify the factors affecting the development of social entrepreneurship in the Baltic Sea Region as well as the main challenges facing new social enterprises in two key areas: human resources and legal framework.

In relation to human resources, the study has established that running a social enterprise is very similar to running a traditional, strictly business-oriented enterprise; thus, the same human resources theories could be applied to both of these entities. In general, it seems that the same requirements are posed for managers and employees of social enterprises and other types of business activities. Likewise, the research has shown that social entrepreneurs are expected not only to possess typical business skills but also to have a high level of social competencies, as they are often required to successfully deal with the specific (usually excluded) groups of people, work in a team, or engage in external fundraising. One of the more significant findings of this study is that social entrepreneurs themselves are aware of the fact that the lack of business skills and market knowledge is their weakness and perceive achieving them as the biggest challenge of running a social enterprise.

Concerning the second key area, the study has shown that in the majority of the researched Baltic Sea Region countries, social enterprises and similar legal entities are usually established by the third sector organisations without any specific legal framework. They often create national or local networks of social entrepreneurship stakeholders interested in the establishment of an adequate legal framework in their countries, thus initiating the process of legislation. As a result, in such countries as Denmark, Lithuania, Finland or Poland certain laws have been passed to promote new legal forms of business activities which focus on the social dimensions, but they need further development. The least advanced countries in terms of the social enterprise legislation are Estonia, Sweden and Latvia, though in each the work on introducing the legal framework has been initiated and pilot programmes have been launched.

The results of the study show the existence of two most common ways of implementing the legal framework for social enterprises in the Baltic Sea Region: social enterprises either create new legal forms or adopt and adjust the existing ones, introduced and used for a long time by traditional, business-oriented companies in their countries.

This research may serve as a base for future studies on enhancing social entrepreneurship in the Baltic Sea Region, not only in the seven countries which participated in the survey, but also in others. This work contributes to the existing knowledge on the barriers and challenges affecting the development of social entrepreneurship in general and provides a more detailed insight into two aspects: human resources and legal framework. A further and constant research is required, especially in the field of legal framework, as new laws have been passed recently and the preparation of legislation on social entrepreneurship is an ongoing activity in most of the researched countries.

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