

# Community benefit clauses in public procurement: considerations on the role of partnerships in Scotland

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## Abstract

This paper explores features of business partnerships which involve public administrations, private for-profit businesses and social enterprises. In particular, the paper critically considers the role of *community benefits clauses* (CBCs) in procurement (with examples from Scotland) as a mechanism for ensuring a focus on social value-added in purchasing decisions. The questions we address are whether social enterprises effectively deliver value-added to the community (as compared to conventional businesses), and whether CBCs, as implemented so far, are suitable to capture such value added. The paper argues that one crucial, yet underestimated, element that can stem from the business relationship promoted by CBCs is, potentially, the evolution of the local business culture towards pro-social values and behaviours. The paper concludes with some open questions regarding the possibility of internalising community benefits in the governance structure of social enterprises, as well as with considerations regarding a possible wider role of social enterprises in the public procurement of social services and on the future role of CBCs in guaranteeing that the social benefits produced by of social enterprises are properly delivered and assessed.

**Keywords:** social enterprise, community benefit clauses, public procurement, social value, multi-stakeholder governance.

*This is a draft position paper prepared for the 2012 ASE Conference, Glasgow.*

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## 1. Introduction

This paper explores the evolution of business partnerships which involve public administrations and social enterprises. In particular, we look at public procurement of services and their purchase from social enterprises. The paper critically considers the role of the recently-introduced *community benefits clauses* (CBCs) in procurement (with examples from Scotland) as a mechanism for ensuring a focus on social value-added in purchasing decisions. The questions we address are whether social enterprises effectively deliver value-added to the community (as compared to conventional businesses), and whether CBCs, as implemented so far, are suitable to capture such value added.

The context is provided by the UK institutional system, where different legal forms of social enterprise coexist. Since 2000, when a Social Investment Task Force was established, the institutional framework has been shaped and reinforced by a range of industrial policy initiatives (Nicholls 2010). In Scotland, there has been a move to introduce community benefit clauses (CBCs) in public procurement contracts (typically in constructions), a move that might be seen to favour the involvement of social enterprises. Yet questions around how to evaluate the social impacts, and therefore desirability, of social enterprises have materialised around the implementation of such clauses.

The paper is structured as follows. We first outline the nature of social value produced by social enterprises, in comparison to more traditional investor-owned businesses. The prospect of social enterprises to deliver social value effectively provides a clear rationale for the public sector to find appropriate modalities for involving social enterprises in public procurement. We then look at some Scottish experiences involving CBCs in public procurement and discuss potentials and limitations.

## **2. Social enterprises**

Social enterprises are firms guided by social objectives, typically undertaking social and environmental activities. Social enterprises need to be economically self-sustainable and, in this respect, they are distinct from other third sector organisations that are mostly dependent on grants and donations. The management of resources is also different from traditional business, as social enterprises' surplus goes to an asset lock that is reinvested in the business or to the community (for example via lower prices or delivery of services with no charge).

These requirements recognize the position of social enterprises, as non-profit organizations, in supplying welfare services for communities. Non-profit, more generally, have supplemented public and for-profit production of social and other welfare services in many countries, coming to represent dominant actors in some cases (see the case of Italy). The non-profit objective and the social orientation has allowed these organizations to overcome contractual problems dependent on the presence of severe information asymmetries, and on risks of ex-post contractual opportunism by better informed decision makers. The social orientation of these organizations can take the form of a multi-stakeholder organization, where the relevant groups of stakeholders are actively involved in decision making and consultation. One of the outcomes is that multi-stakeholder governance strives to internalize the objectives and motivations of heterogeneous groups of patrons more than to pursue financial objectives.

The diffusion of non-profit oriented organizations in the supply of social and welfare services has been explained by quasi-public nature of these services (Weisbrod, 1988; Ben-Ner and Van Hoomissen, 1993), by their non-standardised and relational characteristics (Borzaga and Depedri, 2005; Gui and Sugden, 2005), and by the presence of severe asymmetries in information between the firms and its uninformed customers (Hansmann, 1996). In particular, the literature on nonprofits evidences that for-profit firms are not likely to deliver quasi-public services effectively (such as social and educational services). The major obstacles have been argued to be free-riding (as in the State-failure argument *a' la* Weisbrod), as well as ex-post contractual opportunism connected with asymmetric information (as in the market-

failure argument *a' la* Weisbrod). In these respects, non-profit organizations are expected to be more effective than their for-profit counterpart since they can accomplish the private provision of public goods, with weaker incentives to opportunistically exploit asymmetric information (Borzaga and Tortia, 2010).

The cooperative behavioural attitudes supporting the provision of quasi-public goods, however, need appropriate regulatory frameworks, as they would not be spontaneously repeated over time without enforceable rules (Ostrom, 1990; Sacchetti and Tortia, 2010). In the UK support to the realisation of social aims comes from the normative framework, and in particular from the 2005 law constituting the Community Interest Company (CIC). These new forms of socially oriented businesses can take the form of investor-owned businesses, community companies, charities, cooperatives. In the first case, they are controlled by investors, but undergo stringent constraints on the distribution of profits, as surplus is intended exclusively to support the development of the organization (which need to include the relevant stakeholders) (Sacchetti and Tortia, 2012). CICs, in fact, represent hybrid organizational form conjugating different control rights, firm objectives and governance solutions. But because of such variety, the law protects the interest of communities through a number of features, including an asset lock, as well as caps on the distribution of dividends and interest rate on debt. When they are controlled by investors, however, it can be presumed that the interests of capital owners are dominant, which raises questions on the actual social value delivered by the social enterprise (ibid.) There is, in this respect, a normative element in the regulation that places duties on the CICs to pursue and demonstrate their benefits to the community (Nicholls, 2010), although the validity of the measurements is still debated, especially where exclusive reliance on simplified measures of financial impacts (such as the social return on investment index) runs the risk of downplaying the less tangible and more prominent impacts of social enterprises (Gibbon and Dey, 2011).

The same applies, on the other hand, to social enterprises that are not controlled by investors, which need to prove to be able to deliver social services effectively to the community. An example is represented by the sustained spread of social enterprises (in the form of cooperatives) in Italy, regulated in 2006. Starting from scratch at the end of the Seventies and the beginning of the Eighties of last century, social cooperatives developed into an integrated network of about 10.000 small and

medium sized enterprises delivering social services and integrating disadvantaged people in the labour market. This evidence seems to point to the fact that multi-stakeholder social cooperatives can generate social value without inflating, or even lowering, production and governance costs. This is accomplished mainly in sectors where for-profit firms are unable or unwilling to operate. In the case of social services, profit making companies are rarely observed because of the quasi-public nature of the services produced, and because of the low profitability of these activities, which are often not compatible with the private-benefit orientation of for profit firms (Tortia, 2010).

### **3. Social value in community benefit clauses (CBCs)**

Besides the explicit social mission of social enterprises, the quality of outcomes and the costs of production are a fundamental question for the public sector as a promoter of public welfare. Specifically, community benefit clauses in public procurement require contractors to deliver social value added to communities. These clauses are generally meant to maximise the social welfare generated by public demand, e.g. for infrastructures or specific services, e.g. employability services.

Specifically, policies at local and regional level in the UK have identified the production of value added with respect to employment, training and urban regeneration. The criteria set by those public administrations that have embraced the community benefits strategy, so far, aim at delivering wider social benefits than those associated exclusively with the provision of a particular good or service. The clauses basically require that contractors can create local employment and offer training. In general terms, this means that social clauses aim at stimulating local economies by means of public demand to local firms.

Also an overview of the pilot cases presented by the Scottish Government (2008) highlights that social value is primarily measured in terms of employment and training. Specifically some tenders can specify particular employability niches to be taken into account, such as disadvantaged workers, or the regeneration of poor areas. A number of examples reveal that construction tenders support the view that the

main contractors have contracted out specific tasks to social enterprises, with the aim of fulfilling employability and regeneration requirements. Glasgow City Council, for example, included CBCs in tenders for projects related to the 2014 Commonwealth Games. The policy has been included in the procurement to Sir Robert McAlpine as the main contractor for the National Indoor Sports Arena and the Sir Chris Hoy Velodrome in Glasgow. Two years of catering services have been subcontracted to Unity Enterprise<sup>1</sup>, a Glasgow-based social enterprise that employs local people who would otherwise be marginalised in the labour market. Unity Enterprise will then re-invest the turnover (expected to be £200k per year) in other areas of activities of Unity Enterprise.<sup>2</sup> In these respects, the governance structure, social mission, and accumulated competences clearly place social enterprises in a position to contribute (and, by means of re-investments, multiply) the delivery of community benefits.

Approaches are different however. Some CBCs do not refer to social enterprises at all, whilst focusing on local SMEs and local employment. Others adopt different strategies. In its tender for the regeneration of Raploch, one of the Council's most deprived areas, Stirling Council has adopted a different approach, with the creation of a ten-years partnership (the RURC, Raploch Urban Regeneration Company) amongst the main local stakeholders.<sup>3</sup> RURC works for the "creation of 900 new homes, 225 training and job opportunities, infrastructure and public realm in the Raploch area of Stirling"<sup>4</sup>. The CBC in the procurement contract to R3 (the main private contractor which resulted from the creation of a consortium between George Wimpey and Cruden Homes) requires (amongst support for trainees, employment generation and environmental improvements) capacity building with the local community and support for the start-up and development of local social enterprises (Scottish Government, 2008).

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<sup>1</sup> Unity Enterprise is an inter-church charity funded in 1989: <http://www.unity-enterprise.com/default.asp> (accessed May 2012).

<sup>2</sup> Real PR Press Office for Unity Enterprise (21 June 2010): [http://www.real-pr.co.uk/press-office/view/social\\_enterprise\\_catering\\_contract\\_for\\_national\\_indoor\\_sports\\_arena/42/](http://www.real-pr.co.uk/press-office/view/social_enterprise_catering_contract_for_national_indoor_sports_arena/42/) (accessed May 2012).

<sup>3</sup> Partners in the board of RURC are Stirling Council, the Scottish Government, NHS Forth Valley, Raploch Community Partnership (representing the community), Skills Development Scotland and Forth Housing Association.

<sup>4</sup> Scottish Government, <http://www.scotland.gov.uk/Topics/Built-Environment/regeneration/17735/raploch> (accessed May 2012).

#### **4. Social value in business partnerships**

If we limited the consideration of social value added to employability and training figures, though, we would certainly miss the big canvas, the more complex set of effects that the interactions between public, private for-profit and private not-for-profit endeavour by working in synergy. Further aspects needs to be taken into account to appreciate what social benefits can entail over time. In particular, we underpin the adoption of a broader perspective on the meaning of social value, over and above the yet central effects of economic activities on employment, training and regeneration.

Focusing on the possible advantages of the partnerships promoted by CBCs, we would argue that *within the remit of the CBC*:

1. The initiation of for-profit and not-for-profit partnerships within CBCs has the potential to activate processes of mutual learning through which social enterprises can build expertise in delivering services cost-effectively, whilst for-profit businesses can improve their awareness of stakeholders and public interests across business sectors and within the community.
2. Communication and interaction between business forms holds also the potential, under certain conditions, to increase trust and social capital, despite the diversity of aims.

At the same time *beyond the CBC and community wide*:

3. Sustainable public-private partnerships can increase the efficiency and independence of social enterprises from direct public funding, thus increasing demand variety and reducing uncertainty for the involved stakeholders (e.g. weaker categories of workers).
4. For-profit and not-for-profit partnerships can initiate expectations of pro-social behaviour by conventional businesses beyond the remits of the CBC.

5. For-profit and not-for-profit partnerships can reinforce expectations on social enterprises to effectively deliver social services and increase community welfare.

By contracting out to social enterprises, the conventional business firm, in practice, expresses the adoption of socially responsible practices, clearly encouraged by the institutional framework defined by CBCs. The contractor enters not only a “legal contract,” but a “social contract” in which they implicitly commit themselves to comply with specific rules of behaviour also in the management of their core activity (Degli Antoni and Sacconi, 2011). In fact, following behavioural theories, the agreement to enter a contract that requires the production of community benefits can change the expectations also internally to the organisation. Other stakeholders (e.g. employees) may start to expect consistency of behaviour with respect to a number of organisational issues, and also over time.

The values and practices learned under the CBC have therefore the potential to embed pro-social strategies beyond the requirements of the bid. The firm builds a reputation that will shape also other stakeholders’ expectations, after the contract has come to an end. A contractor that has delivered under CBCs which involved social enterprises will be reasonably expected to observe pro-social strategies towards weak stakeholders also in other contexts. In this respects, as suggested by Degli Antoni and Sacconi (2011) conventional for-profit businesses enter a social contract, signalling their values to the public. Other organisations with similar values will be then willing to collaborate, starting a process of self-selection within the business community (Sacchetti and Sugden, 2009 RSE). Behavioural contributions have emphasised that the adoption of pro-social behaviour by some can start conformist behaviour on principles that are community regarding, leveraging on the fact that others will start to have expectations on the one hand and, on the other hand that firms wish to maintain their reputation (Degli Antoni and Sacconi, 2011). For example, publics within the community would be taken by surprise if the velodrome constructors in Glasgow adopts non-cooperative strategies towards other stakeholders within the firm or across the community. When this occurs, there is a case for talking about behavioural change, and in particular of changes in the business culture of a locality.

Vice versa the social enterprise, beyond the social contract implicit in its mission, enters a legal contract in which it commits to fulfil its social mission sustainably for themselves and for the other business partners. A well known critique addressed to non-profit organizations, and socially oriented businesses is, in this respect, that they lack adequate economic incentives to accomplish efficient production processes (Hansmann, 1996). Solutions to efficiency shortcomings have been found in the implementation of governance structures in which social, more than private, preferences and objectives take centre stage. In particular, social enterprises also differ from conventional businesses in the nature of individual motivations. In this respect, Becchetti et al. 2012 show that intrinsic pro-social motivations support efficiency over and above the effect of extrinsic and monetary incentive systems. It follows that the overcoming of the dominance of the profit motivation can favour the emergence of more inclusive (and therefore more complex) structures that pursue social goals.

In this respect, Sacchetti and Tortia (2012) have emphasised the benefits of multi-stakeholder governance, analysing in practice how the development of an open system approach to the governance of social enterprises can capitalise on the knowledge of multiple interested publics across the community by including them in the governance of the organisation. If the for-profit contractor that delivers a CBC procurement contract activates expectations of pro-social behaviour, the social enterprise that effectively delivers subcontracted services within its social remit will build a reputation in the community and expected to be in a position to maintain quality standards and efficiency consistently with its mission. In order to fulfil their social contract, social enterprises need to explore and discover emerging community needs, and engage with publics in order to integrate their interests in their activities. This implies that the governance of the enterprise is tailored towards social inclusion. By imitation, social enterprises that successfully do so can set the standards for other organisations and contribute to improve social inclusion through the delivery of welfare services. In turn, such outcomes could possibly extend reputational effects to the sector, and legitimise social enterprises as viable business forms.

## **5. Advantages of multi-stakeholdership**

The attainment of the governance forms that can position groups of stakeholders, with different missions and aims, in deliberative positions without putting the social aims of the organisation in jeopardy is, as argued, the outcome of a lasting evolutionary process which commits social enterprises to constantly engage with interested publics, so that the social mission can evolve together with the needs of communities (Sacchetti and Tortia, 2012).

When relating the multi-stakeholder governance typical of social enterprises to production performance, we observe that the correct positioning of each group of stakeholders in the governance grid is expected to be positively correlated with production efficiency and with the quality of product and services delivered. For example, a virtuous reduction of asymmetric information, and the achievement of a better convergence of the objectives of different groups of stakeholders by means of appropriate governance contrivances is expected to bust trust and reduce transaction costs, this way increasing efficiency.

Similarly, by promoting deliberative processes and communication, multi-stakeholder governance is expected to be able to reconcile the different, and in some cases diverging, objectives of individual groups of stakeholders. In some cases, in fact, multi-stakeholdership may be necessary to understand and deliver specific social services to the community. Also, Inclusion in decision-making processes has been argued to increase individual satisfaction and overall wellbeing (Erdal, 2011; Deci and Ryan, 2000). These effects can overcome simple contractual constraints between the organization and non-controlling stakeholders. Involvement in decision-making also promotes the the development and accumulation of firm specific knowledge, thus improving product and service quality. Coordination and deliberation across groups of actors can however increase the costs and timing of decision-making. In the case of social enterprises, however, higher costs of decision making can be rewarded by increased benefits, in terms of accumulation of specific social capital and knowledge. Both these elements can ease decisions and improve product and service quality (ibid.).

The attainment of mutual compatibility between potentially diverging objectives is one of the main functions of governance. Still, misfit between stakeholders' objectives and their positioning within the governance structure can reduce the circulation of information and increase the risk of contrasts. However, the concomitant presence of more than one active stakeholder adds complexity to this function. It follows that multi-stakeholder governance is more difficult regulate by law. Consequently, its specific configuration may be often left the decisions of individual organizations, with the law defining only the broadest constraints, within which individual organizations can find their most appropriate solution (ibid.).

With scope for defining governance solutions, social enterprises can differ from each others in a number of respects. Sacchetti (2012) suggests a conceptual scheme that can be used to distinguish between two types of social enterprises. The criterion is the degree to which organisations act to internalise community benefits in their choices and governance structure. More specifically, she suggests looking at whether the organisation shows entrepreneurial social preferences by actively searching for impacted publics, and then involves them as stakeholders. The discovery of impacts and interests relates to strategic aspects of the organisations, whilst the subsequent integration of stakeholders in the organisation relates to governance choices. Along this line of analysis, at one extreme we can observe social enterprises can reveal a strong social mission pursued through an exclusive governance system (for example a charity whereby governance relies on the main funders' decisions). On the other extreme, social enterprises based on multi-stakeholder governance and mutuality feature inclusive orientation both in their strategies and decision-making structures (ibid.).

The benefits derived from inclusive attitudes towards publics and governance structures need to be verified empirically on a case-by-case basis. As mentioned, greater inclusion has been argued to improve individual well being across groups of stakeholders, as well as the competences and quality of the services delivered. The effects, however, would not be captured by the current CBCs requirements, their nature being immaterial, uncertain, and only observable over a long span of time.

## **6. Open questions**

CBCs have been specified, as in the Commonwealth Games example, to prescribe the integration of activities in public bids that fall in the remit of social enterprises. When the relationship with the social enterprise is defined by a subcontracting agreement with the main contractor, conditions of efficient delivery of service are expected to be monitored and controlled by the prime contractor, which respond in turn to the public agency that issued the procurement contract. In other cases, the requirements may not be that stringent, as when the relationship is one of support for welfare services that are not related with the core activity of the tender (as in Stirling regeneration projects).

Considerations of efficiency in the attainment of social aims are clearly central for public administrations, as exemplified by the “value for money” principle that seems to underpin all procurement strategies (Scottish Government, 2008). We have argued, however, that a fair assessment of community benefits should account for the extent to which the involvement of social enterprises together with conventional businesses can generate dynamics of reciprocal learning, communication amongst groups of actors leading to the discovery of opportunities, reciprocal needs and interests, as well as to the creation of trust and social capital. Overall these are typical features of cooperative relationships, which we have argued may be beneficial, in principle, for investor-owned businesses, for social enterprises and for communities overall.

Consistently, CBCs in procurement reinforce the interconnectedness between sectors and communities. They emphasise that conventional businesses are a potential stakeholder for social enterprises. Firms working to improve the employability of disadvantaged workers, for example, may benefit from networking with conventional businesses as potential outlet of their beneficiaries. Employers of disadvantaged workers, similarly, can benefit from an extensive network of contractors for their products.

We have suggested that cooperative attitudes across the two sectors in particular can be embedded in the business community and continue to generate social value when, on the one hand, conventional business commit to the social contract initiated with CBC procurement and, on the other, the social enterprise commits to develop and capitalise on its network of stakeholders whilst safeguarding its social mission. We have also argued that for social enterprises one way of achieving this outcome is to engage with open governance models, and in particular with multi-stakeholdership.

Focusing on social enterprises (although a similar line of analysis is applicable to for-profit contractors), a long-term perspective on the creation of social value would then include the monitoring of what happens after the CBC procurement contract has been accomplished, in terms of changes in the governance structure as well as regarding the mission and objectives of the social enterprise. In these respects CBCs have the potential to reveal public interests to firms and initiate cooperation across sectors.

Building on these advantages, we would advocate for the institutional recognition of cooperation and trust as part of social value generated in the locality. Building on the capital of reciprocal knowledge, reputation, spill-over and trust generated by the first round of contracts, procurement rules could evolve to specify a general framework for cooperation, including the identification of guiding principles for multistakeholder governance in social enterprises. This would have the aim of reinforcing diversities and complementarities between conventional business and social enterprises. We would argue that particular attention should be given to the intrinsic aims, motivations and modalities of social enterprises, so as to guarantee that the interests of conventional business do not take over on social aims.

Also, facing the possibility of extending CBCs more prominently to the public procurement of social services (e.g. in health and education), social enterprises could act as main contractors, and therefore be subject to the same monitoring criteria currently in place. This means that social enterprises could directly face the competition of other forms of business, should CBCs act as an incentive that renders the provision of quasi-public goods attractive also for local conventional business organisations. This eventuality would raise a number of analytical questions, in line

with the considerations advanced earlier in the paper, supporting the scope of non-profit organisations as against for-profit ones. Were social enterprises to bid competitively with investor-centred businesses, the assessment of the social value-added of social enterprises would occur at the margin. In other words the question for public administrations would be what social enterprises can deliver which conventional businesses cannot. By placing social enterprises side-by-side with other typologies of organisations, holding different sets of values, governance structures and processes, the evaluation of community benefits must consider a wider set of impacts, beyond the generation of local employment and training.

### **Acknowledgements**

We would like to thank Ermanno Tortia for insightful discussions on the matter. Usual disclaimers apply.

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