Alan Greig
Principal
SENTECH (Social Enterprise Technologies)

To: The Secretary
Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

RE: Submission regarding the mechanisms and options for the development of a capital market for social orgnisations.

On the issue of “creating a capital market for social organisations”, I would commend the attached UK research report called “Community Investment – Using the Industrial and Provident Societies Legislation” (published by Cooperatives UK in 2008). My comments below are based on the content of this report.

Community investment is the practice of communities investing capital in business ventures serving a social or community purpose. It is not a new phenomenon. It is an essential element that is being overlooked in the social investment debate in Australia. It is also an element that has not so far featured in submissions to the Senate Enquiry.

The element missing is the role that the “retail investor” plays in social investment – usually through member financed and owned social businesses such as cooperatives.

The attached report documents the many successful cooperative social enterprises (including several award winners) that have been set up in the UK based on member ownership and involvement in the capitalisation of the business.

There are many similar social organisations in Australia which have succeeded in the same way but which are currently lacking the attention of established institutions - be they researchers, social enterprise developers, policy makers or funders.

The thrust of this UK document is that it is “community engagement” that drives effective investment into not-for-profits and social enterprises. Community investment in fact is wholly dependent on community engagement: the ability to actively involve a community in the social purpose and mission of the venture.

On the other hand, in Australia, the emphasis in social investment policy consideration and research (including through the Senate Enquiry) seems to be on the disengaged “institutional investor” – the “fund manager” who manages other peoples’ money for investment in social purpose ventures.

The near monopoly support for this finance model in the social investment arena in Australia overlooks the fact that many successful social enterprises in this country today have been started by individuals investing in “community based” business ventures through the process of “community investment” - very much along the lines as described in the report attached.

Creating capital markets in the not-for-profit and social enterprise sectors along the corporate “institutional investor” line being suggested will likely result in the individual “community investor” being further “crowded out” of the market in the process.

Also, much of the debate around social investment here seems to be an extension of the “grants culture” and pays little heed to community engagement and the provision of locally based finance for social ventures. This is especially a problem when the evidence is that it is “community investment” that provides the breadth of support that will see a trading social enterprise through to long term sustainability.

The other important aspect of “community investment” – to which little policy consideration is being given - is that it delivers the key “social impacts” that are not currently measurable in the conventional social impact measures being developed – those positive, long term results such as “building social capital” and “increasing community wellbeing”.

In the last decade, governments everywhere have been keen to promote social enterprise and its close cousin, social investment. They have launched a range of initiatives to support and encourage social investment, including - most recently in this country - the Social Enterprise Development and Investment Fund (SEDIF), a new $20m risk capital investment fund for social enterprises, matched by $20m from private investors, with the aim of building relationships between social enterprises and commercial investors.

Community investment is different. Instead of turning to the private sector and wealthy individuals for support, community investment is about engaging communities to invest in themselves. By harnessing the collective investment power of whole communities, relatively large amounts of capital can be raised in relatively small amounts from members of the community. There are several examples along these lines in Australia, most notably “Hepburn Community Windfarm” (http://hepburnwind.com.au/) and “West Belconnen Health Centre” (http://www.westbelconnenhealth.coop/) - both of which are incorporated as cooperatives.

The full power of community investment does not stop with the amount of capital raised. Community investors are often the best customers of the venture, their loyalty contributing to its sustainability. It provides a new business model for communities to help themselves, and create viable ventures where the private sector has failed. This extension of community engagement is central to the success of many social enterprises. For instance, in a growing number of regional and rural communities, people have come together to rescue vital facilities and services from closure - stores, service stations, pubs, and picture theatres etc - transforming them from a failing private business into a vibrant community owned enterprise. Democratic community engagement therefore provides a powerful competitive advantage over other business models in these cases.

Community investment relies on a major shift in public attitudes towards how community initiatives can be funded. Buying shares in community ventures involves a leap of imagination for many traditional community activists, more used to organising charitable fund-raising events than planning a community share launch. The full potential of community investment is easy to imagine. Most people’s savings and investments are far greater than the amount they could afford to donate to good causes. So if mechanisms are created to enable people to invest and save in good causes in their communities, there is the potential to raise far greater sums of money than are currently raised through charitable giving.

As the report attached shows, it is the “Cooperative” legal form that provides this potential – it is a highly suitable format for community investment, addressing longstanding problems faced by many communities in a more radical and exciting way.

Perhaps because of their “unconventionality” in social economy “culture” in Australia, the use of the cooperative business model to deliver public and community services is a controversial one for many people. As a result, it is very under-used in current social enterprise development practice. This situation obviously needs to be re-considered, as cooperatives are a proven mechanism for channeling new finance into social ventures. It needs to be stressed though that cooperatives are business enterprises which respond to market needs in an efficient way - they are not - and never can be, given their member control stucture - instruments of public policy.

Community investment also adds a new dimension to the social business model, making the community not only the investors but also the owners of these new ventures. By ensuring that ownership is in the hands of the community, rather than a private or social investor, there is a far greater likelihood that these community ventures will continue to serve the interests of the broader community. They also provide for social inclusion in that – unlike most ‘social programs’ – they are delivered “with and by” people rather than through “doing something for and to people”.

Cooperatives legislation embodies the ‘inclusion’ ethic by providing a governance structure based on the democratic principle of one-member-one-vote, rather than one share-one-vote. This is wholly different to companies limited by shares in the private sector. It is also very different to companies limited by guarantee in the not-for-profit sector which are unable to apply these democratic ownership and control provisions (lacking the equity base to do so).

The democratic nature of cooperatives reinforces the inclusion ethic by treating every member as an equal, regardless of how much they have invested in the cooperative, with members being encouraged to focus on their mutual and community interests, rather than their narrow self-interest. The ability of some members to invest more than others confers no special privileges, but this does not appear to discourage wealthier members from investing more.

Whilst there is a compelling logic linking community investment and engagement, it still requires a major shift in public attitudes towards investment and community benefit. Owning shares and pursuing a social purpose simply don’t go together in most people’s minds: they are far more comfortable with the idea of donating to a good cause, rather than investing in one.

One of the best ways of learning how to harness community investment is to examine the many practical experiences of those who have already done it. The UN International Year of Cooperatives, 2012 will offer this opportunity through the events and activities that are being planned for the year. This will include a major research component to produce the kind of “case studies” on the situation in an area that has been neglected in recent years.

The following are some conclusions I would like to provide based on various, current research studies on the so-called social investment “shortfall”:

1. The expansion of social enterprise has been hindered since the 1990s as a result of a failure to consider what the appropriate legal structure for such enterprises should be and, in particular, a failure to consider how equity for effective social business growth might be provided.

2. Research studies have revealed the problem of serious under-capitalisation of social enterprises over time which is not helped by their prevalent structure as companies limited by guarantee, with the consequent constitutional barrier to attracting equity.

3. Most community businesses fail when Government funders withdraw revenue subsidies. Those that do survive have usually built up an asset base. The pervasiveness of the charitable ethos in the not-for-profit sector – combined with the “grants culture” - is a huge barrier to the potential growth of social enterprise

4. There has been a widespread failure on the part of social enterprise developers today to look to cooperatives and mutuals to deliver their objectives. Cooperative and mutual organisations have historically provided very appropriate structures for the ownership and governance of social enterprise, as well as the financing of them.

5. There is a need for a much more sophisticated approach to finance in the social enterprise sector (including 'patient' equity and more innovative debt and loan instruments). There is also a vital cultural need to formulate a framework of management skills and expertise specific to more "bottom-up" development of social enterprise, both by looking to the emerging work of practitioners in the cooperative development field and by rediscovering the rich, historic tradition of cooperatives and mutuals.

Recommendations:

1. Community investment needs to be more positively promoted by Governments. The Senate Enquiry should therefore encourage more active Government and community support for cooperative development agencies in the Australian economy. The UN International Year of Cooperatives in 2012 should provide momentum for this through organisations such as Social Business Australia. (Disclosure: I am Director of this organisation).

2. The identified lack of social venture capital that the Senate Enquiry is addressing should be met through increased support for cooperative social enterprises and the more equitable, 'patient', 'up close', participation finance that they can provide.

3. The Senate Enquiry should also seek advice from tax experts on the legal and other corporate design issues that are an impediment to more member based and financed social enterprise 'corporate entities' meeting the "community benefits test" for tax exemption purposes (thus providing an incentive for more "community investment" activity).

I hope you find these suggestions helpful.

I have no problem with this submission being made public through placement on the "Submissions Received" web-site.

Yours sincerely

Alan Greig
Principal
SENTECH (Social Enterprise Technologies)