Briefing

Policy support for co-operative start-ups

1 Overview

1.1 Good public policy can help create the right conditions for people to set up and grow successful co-operatives. An assessment of the environment for co-operative start-ups should consider four crucial factors: **social solidarity**, **knowledge and knowhow**, **legal frameworks** and **finance**.

1.2 When the conditions are right, people for whom the co-operative option is potentially relevant recognise and act on their shared interests and have good access to knowledge and knowhow about their co-operative options. In such a benign environment co-operative entrepreneurs would also have user-friendly choices when it comes to the laws of incorporation. And they would also have suitable finance options.

1.3 This paper provides a very brief overview of the current state of play in these four areas and suggests how public policy could change to create a more benign environment in each regard.

2 Social solidarity, knowledge and knowhow

2.1 Co-operative formation is a process in which people with common needs and aspirations organise themselves through solidarity into a functioning partnership, with a workable plan and a readiness to act. In most circumstances, but not all, it is about a group of people deciding to go into business together.

2.2 This process requires that people participate in rich, resilient and even radical modes of civil society, through which communities of interest can organise and empower themselves, motivated by a combination of solidarity and pragmatism. But long-term underinvestment in grassroots community development and capacity building has left too many communities of interest without the means to participate in this degree of active social solidarity.

2.3 Furthermore, to begin even an early exploration of this process people need to be aware of their co-operative options. But public understanding of co-operatives as a practical organisational tool or an approach to business is very limited.[1] Whether it is a group of citizens setting up a community enterprise, a group of web designers looking to go into business together, or a business owner planning to exit as they retire, awareness of the co-operative options is likely to be extremely low. Most people for whom the co-operative option is potentially relevant simply do not know it exists at all in any meaningful sense.

2.4 This lack of awareness is perpetuated in part by a paucity of useful information and advice provided through public and quasi-public channels. It is well documented that accurate and practical information about co-operatives rarely features in educational curricula or careers

[1] Co-operatives UK public perceptions research undertaken with You.Gov

advice. Furthermore, the programmes provided by the skills, employability and entrepreneurship industry, usually on public contracts, rarely help people explore their co-operative options either. This includes advice and support provided alongside the New Enterprise Allowance and Start-up Loans. And finally, the key official information and signposting provided on government websites suffers from a lack of accuracy, context, clarity and consistency. Co-operative options tend to be misleadingly presented only as a subset of social enterprise and more often than not in the context of choosing between legal forms. This is true of the UK and devolved government websites.

2.5 Policy options:

- **Investment in community** - national government could use the next tranche of dormant assets to nurture and mobilise rich, resilient and even radical modes of civil society within communities, including investment in grassroots community development, organising and capability building and the accumulation of community capital; this could be done by endowing a national network of funds under the control of local communities and communities of interest
- **Community economic development** – national government could provide more resource and support for a form of grassroots economic action in which communities are helped to develop entrepreneurial solutions to meet their needs and aspirations, in areas such as livelihoods, ecology and wellbeing, with co-operatives among the practical tools available; we believe a nationally facilitated and locally delivered programme for community economic development should be funded through the UK Shared Prosperity Fund; the non-partisan Localism Commission recently recommended that community economic development be adopted as part of a new more diversified approach to local economic strategy in the UK [2]
- **Co-operative options in new enterprise support** - the knowledge and knowhow imparted as part of the New Enterprise Allowance and Start-up Loans programmes needs to be augmented with a 'plug in' programme that helps people to explore and develop their co-operative options; this could be delivered by regional and national partners along the lines of our own co-operative business development programme, The Hive, and the contracts could again be funded through the UK Shared Prosperity Fund
- **Improving online information** – BEIS could work with Co-operatives UK to review and revise the official information on co-operatives provided by GOV.UK and the Great Business service

3 Legal frameworks

3.1 Once a group of co-operative entrepreneurs is ready to incorporate, it is important for government to provide them with a user-friendly legal framework. While the UK government has created a system that allows someone to register a standard 'off-the-shelf' company simply in 24 hours for just £12, the process for registering any type of co-operative is less

[2] https://locality.org.uk/wp-content/uploads/2018/03/LOCALITY-LOCALISM-FULL-ONLINE-REPORT.pdf

straightforward, takes longer and costs more. This makes the co-operative option less user-friendly from the outset.

3.2 The registrar of co-operative and community benefit societies, the Financial Conduct Authority (the FCA), does not provide an online registration portal and takes a minimum of 15 working days to process an application. Overall it takes on average one month for a group to incorporate as a co-operative society, following an offline bureaucratic process that is often opaque and sometimes confused. It also costs between £40 and £950 to register a society, depending on deviation from model rules, whereas it costs just £12 to register a company and £47 to register a CIC.

3.3 Incorporating as a society also comes with difficulties in relation to HMRC that are not experienced by companies, CICs or LLPs. The FCA Mutuals Register is not electronically linked to HMRC, so new societies do not automatically receive a Unique Tax Reference and are not contacted by HMRC with information about paying tax. Making Tax Digital is also disadvantaging societies, as due a short-sighted design brief, they cannot use the free tax return software HMRC is rolling out.

3.4 Society law is also in need of both routine maintenance and strategic reform. The legislation is clunky and in some places outright dysfunctional. Many of the legal tools found in the best co-operative legal codes around the world are lacking in the UK. This forces suboptimal choices onto co-operative entrepreneurs and limits their ability to operate as they would like. It also prevents co-operatives in the UK from emulating some of the best co-operative practices seen around the world.

3.5 If we want the co-operative option to be user-friendly, then the disparity between the ease of incorporating as an off-the-shelf company and a co-operative is unacceptable.

3.6 Policy options:

- **Primary legislation** - UK government could commit to a wholesale review and reform of the legal framework for co-operatives through primary legislation; to make legislative action easier, responsibility for maintaining the co-operative legal framework should move from Banking and Credit in HM Treasury to Business Frameworks in the Department for Business, Energy and Industrial Strategy (BEIS) [*]
- **Improved registry service** - The registry function for co-operatives needs urgent investment in digital to provide a faster, more straightforward and less expensive registration process; this might be more feasible if the function moved out of the FCA into a better-purposed, better-resourced institution, closer to the orbit of BEIS and Companies House[*]

4 Finance

4.1 There are some distinct challenges for co-operatives around raising start-up and early growth capital that go beyond those experienced by new ventures in general. The degree of the challenge depends on the type of co-operative and the sector.

[*] We have been working with BEIS officials to see if these arrangements can be improved as part of the Industrial Strategy's business environment theme; we also note that the Law Commission recommended that these arrangements be reviewed with a view to change

4.2 Co-operatives have a corporate purpose focused on member value rather than investor return and also strictly limit, or in most cases exclude, non-member ownership and influence. This means the scope to raise any form of venture capital is very limited. It also means that more than any other group of businesses, co-operatives rely on retained earnings to grow, or on capital contributed by mission-aligned partners motivated as much by solidarity as by financial return. For many co-operative new starts this is not a major problem, though it can become one if they develop capital needs that their retained earnings and borrowing cannot meet. And for co-operatives that have bigger capital requirements early on, such as those seeking to utilise powerful digital platforms, grow large memberships quickly or make extensive use of land and premises, a significant finance gap can appear at the beginning.

4.3 Government policy to support venture capital investment through tax reliefs like the Enterprise Investment Scheme (EIS) provide little or no help to these co-operatives.

4.4 The situation is different for some community or consumer co-operatives, as here the co-operative model can itself be a vehicle for raising finance by crowdfunding it from a larger pool of members. This is even the case when a lot of capital is needed from the beginning. The key finance model here is community shares, which has developed into a £100 million market since 2009 and has led to broad community ownership of land, property and even renewable energy plant. [3]

4.5 However, community shares are not a viable option for many types of co-operative and it is important to recognise the limits of their utility overall. For freelancer and worker-owned co-operatives for example, mission-aligned forms of debt-based investment, such as community investment bonds, tend to be more useful. Unfortunately, while Social Investment Tax Relief (SITR) supports social investment bond issues, co-operative societies, the most common type of co-operative, are not eligible to benefit from the relief. Furthermore, the knowledge and knowhow required to use such investment models is also currently limited, but could be spread through an increase in community economic development (see 2.3 above).

4.6 There is varied government support for community shares around the UK, including devolved government funding for Community Shares Scotland. The UK government formally supported the community shares model between 2010 and 2016. However, while its 2016 Social Investment Strategy recognised the importance of the model,[4] the UK government withdrew formal support for the Community Share Unit's work on sector-led self-regulatory standards, before this was established on a self-sustaining footing.

4.7 In the past, community shares was well served by the UK's venture capital schemes, particular by EIS and for a short while SITR. At one point there was a lot of hope that SITR would become especially useful for the model. But its utility for community shares has been significantly reduced by recent changes that exclude common approaches to community asset ownership and renewable energy generation.[5]

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[3] For more information on community shares see here: https://communityshares.org.uk/
[4] https://www.gov.uk/government/publications/social-investment-a-force-for-social-change-uk-strategy-2016
[5] For a brief summary see here: https://www.uk.coop/budget-2017

4.8 There are no government financing programmes specifically for co-operative start-ups anywhere in the UK. There are various public, private and charitable finance streams for social enterprise and community business (Big Lottery Funding, Big Society Capital, various grant makers) but these are restricted in the types of organisation they can fund and co-operative societies and companies limited by shares or guarantee, the most common co-operative forms, are almost always ineligible.

4.9 The government's main programmes for business start-up are the New Enterprise Allowance and Start-up Loans. While there are no specific barriers to using these funding sources to help establish co-operatives, both the financing and the accompanying enterprise advice have been designed with lone entrepreneurship in mind. For example, Start-up Loans are made to individuals not corporations and business partners must apply for and be approved for loans separately. And looking at the makeup of Start-up Loan Providers, only 8 out of 31 appear likely to offer pre-application support or mentoring on co-operative options.[6]

4.10 Policy options:

- **Co-operative options in new enterprise support** - the knowledge and knowhow imparted as part of the New Enterprise Allowance and Start-up Loans packages needs to be augmented with a 'plug in' programme that helps people to explore and develop their co-operative options; this could be delivered by regional and national partners along the lines of our own co-operative business development programme, The Hive, and again could be funded through the UK Shared Prosperity Fund
- **Co-operative and community ISAs** - BEIS and HM Treasury could convene co-operatives, crowdfunding websites and socially-purposed financial institutions, such as credit unions, to explore the opportunities presented by co-operative and community benefit society bonds now being eligible for holding in the Innovative Finance ISA[7]
- **Co-operative new venture funds** - Around the world the strongest co-operative sectors have their own new venture funds capitalised by co-operatives for co-operatives;[8] to support the capitalisation of such funds in the UK, government could reduce corporation tax payable on any profits co-operatives contribute to such funds; these funds would have to be mission-locked, asset-locked, non-profit distributing and democratically controlled by the co-operative sector
- **Making social investment work for co-operatives** – Government could: extend SITR eligibility to include investments in asset-locked co-operative societies, reverse recent changes to SITR that have reduced its utility for community shares, and restore previous levels of support for community shares by funding work on standards assurance

[6] Our own desk-top review of the information published by providers on their own websites
[7] For more in the ISA opportunity see fourth item in this briefing: https://www.uk.coop/promoting-co-ops/influencing-policy/finance/autumn-statement-2016-and-related-good-news
[8] See EU Working Group report: http://ec.europa.eu/DocsRoom/documents/10450/attachments/1/translations

- **Co-operative Reinvestment Scheme** – Government could provide an EIS-equivalent level of tax support for those new co-operatives that rely on internal reinvestment to finance their growth; for example, in their first seven years of trading, asset-locked co-operative societies could receive a corporation tax relief on profits that are reinvested in their non-distributable reserves, perhaps up to the value of £1.7 million a year [9]

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[9] EIS benefits firms with a maximum tax relief of £12 million for external equity investment raised in the first 7 years of trading