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CO-OPERATIVES UK

The practitioners' guide to community shares

Jim Brown

Foreword

This guide is born of high emotions and is a gift for practitioners who need to find a way to live up to hope, answer fear and harness passion in the pursuit of community action and improvement. It is a guide that has been shaped by the people who have been in your shoes. It is a guide that they have contributed and no doubt wished they had access to before they started.

Over one hundred and sixty neighbourhoods have raised money from local people for co-operative forms of enterprise that serve their community. I would like to pay tribute to them, as well as to acknowledge the outstanding partnership we have enjoyed with Locality and Baker Brown Associates that has helped so many of these.

There is no money that works harder for the community than finance raised in share capital from members of a co-operative social enterprise. This is not the stock market, laundering your money around the world. It is a local enterprise, accountable to you as a member, serving you and benefiting your community. It is risk capital and, as equity, more valuable to the enterprise by far than loans.

There is more to do still if we are to see this model spread more widely still. There are pitfalls to avoid and the health warnings are not just small print. Even so, this guide will repay close attention and help you to understand whether community shares can work for you.

Now, more than ever, it is inspiring to find that people coming together can solve the problems they face – in the long and proud tradition of self help and community action.

Ed Mayo
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Introduction

A new approach to investment

All enterprises need risk capital to start, to grow, and to be sustainable. This risk finance has to come from somewhere, usually from shareholders, owners, investors, banks and, of course, from the business itself, reinvesting its profits. Risk capital allows the enterprise to ride the ups and downs of development, which are to be expected when pursuing ambitious, challenging or innovative objectives.

One of the main reasons why social enterprises can find it difficult to compete with private enterprises is their lack of risk capital. A root cause of this under-capitalisation is a belief that social enterprises should not have shareholders, the investors who provide capital to business. Equity investment is considered anathema, because shares give legal title, meaning that the enterprise is owned, controlled and run in the interest of investors.

Social investment institutions have developed alternatives: quasi-equity, patient capital, even social impact bonds. But most of these products are, ultimately, a form of debt. And indebtedness is a poor form of risk capital, especially for social enterprises, where the high levels of profitability that are needed to repay debt might be incompatible with their social aims. All debts, however patient, eventually have to be repaid.

Social enterprises have been defined as businesses that have "primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners." But what if the shareholders and owners are not driven by a need to maximise profit?

Community shareholders invest in local enterprises providing goods and services that meet local needs, and only expect a fair and modest return on their investment. This long-term alignment of the interests of owners, investors and customers, is at the heart of the community enterprise movement. And this works best when the community purpose of the enterprise is the primary motive for investment.

Another important and novel aspect of community shares is that it invites people to directly invest in enterprise, a new experience for most of the population, who are more used to handing over their savings to financial institutions to manage and invest.

Investing in shares is risky; investors can lose some or all of their money. Shareholders are last in the line of creditors if the enterprise gets into financial difficulties. There are no government-backed compensation schemes to bail out shareholders, as there are with savings accounts in banks, building societies and credit unions.

Community shareholders are also taking a risk, but it is a risk they can help to manage. They can be loyal customers, and many are willing to be volunteers and activists, using their skills, expertise and knowledge for the benefit of the enterprise and the wider community. Some community shareholders are prepared to get even more involved, acting as experts or advisers or even serving as elected directors. All of this can strengthen the business model, making the enterprise more competitive, resilient and sustainable.

At a time when many communities are faced with the loss of amenities such as shops, pubs, post offices, libraries, children's nurseries, sports facilities, local food suppliers, public buildings, open spaces, and affordable housing, and when people fear losing their life savings in complex investment products they do not fully understand and cannot influence, then the time might be right for community shares as a better alternative.

Community shares: a new asset class?

The Community Shares programme owes its success to the special nature of withdrawable share capital, which is unique to co-operative and community benefit societies. Withdrawable share capital has been in existence since the mid-nineteenth century; it was the building block of the co-operative movement. By 1935 there were over 1,000 local retail co-operative societies in the UK, with over 7.5m members who had collectively invested more than £135m in share capital, the equivalent of over £7bn at today's prices.

In the second half of the twentieth century the retail co-operative movement went through a prolonged period of consolidation, which saw the number of retail societies shrink to just twenty, including the giant Co-operative Group with a turnover in excess of £14bn. Their financial structure changed too, with a far greater reliance on accumulated profits and reserves that diminished the importance of members' share capital as a source of finance.

By the beginning of the twenty-first century, the potential of withdrawable share capital had largely been forgotten. A government review of the not-for-profit sector in 2002, described co-operative and community benefit society legislation, which underpins withdrawable share capital, as "a useful, but underused and outdated, legal form".

So, what is special about withdrawable share capital?

In order to understand the answer to this question, it is first necessary to understand how conventional share capital works. Most companies use a form of share capital known as transferable shares, which can be transferred or sold by shareholders to a third party at a mutually agreed price based on their personal valuations. Investors buy shares in the expectation of two types of financial return: a regular dividend on shares, and the possibility of capital appreciation, in which case they would expect to sell the shares at a higher price than they paid for them.

Shares also confer ownership, with each share carrying one vote. There are no limits on the proportion of shares in a company that a person can own. Most small and medium sized companies only have a handful of shareholders, typically the founder and perhaps their family or business partners. If these shareholders want to cash in their shares, they will usually find a buyer who will purchase all the shares in the company. Larger companies that decide to go public will normally be listed on a stock market, which provides a mechanism for buying and selling shares. Market forces and speculation on the future value of those shares determine share prices.

Because transferable shares are subject to market speculation, share prices can often be disconnected from the net present value of the business, its current earning power, profitability, assets or reserves. Shares in Facebook value the company at billions of dollars, even though the company has yet to go public or make its accounts available for inspection. New forms of share trading mean that traders can profit from the value of shares going up or down. Speculation about the long-term valuation of companies can drive the short-term profits of traders. Ultimately, investors expect to profit from speculation about the future performance of a business, rather than its actual performance: venture capitalists expect rates of return based on the future value that bear no relationship to the actual profits or reserves of the businesses they own.

Withdrawable share capital is completely different. This type of share capital cannot be transferred between people. Instead, the society allows shareholders to withdraw their share capital, subject to terms and conditions that protect the society's financial security. This means that a shareholder can cash in their shares with relative ease. Shareholders have a share account, and can increase or decrease their shareholding, or close the account altogether by withdrawing all their share capital. The value of shares is fixed and not subject to speculation, although some societies have the power to reduce share values if the society is experiencing financial difficulties. Shareholders have only one vote, regardless of the size of their shareholding, so the society is democratic. There is a limit on personal shareholdings, currently up to £20,000, and there is also a limit on the interest paid on share capital, based on the principle that interest should be no more than is sufficient to attract and retain the investment. Community benefit societies can adopt a statutory asset lock, which prevents the society being sold and the proceeds of the sale being distributed amongst shareholders. This removes the possibility of capital appreciation and the scope for investor speculation.

Withdrawable share capital provides a solution to the problem of finding a buyer for a minority shareholding in an enterprise that is too small to be listed on a stock exchange, by establishing a transparent exit route for investors. However, this solution creates a new problem for the enterprise. It must plan how it will finance the withdrawal of share capital. There are four main ways to do this: recruit new shareholders, encourage existing shareholders to invest more, pay interest and dividends into shareholder accounts, and build up reserves by retaining profits. Each of these methods is reliant upon the society being a profitable business.

The Community Shares action-research programme

The problems of capitalisation and equity finance for social enterprise have been recognised for a long time. A Bank of England report into the financing of social enterprises, published in 2003, concluded that "lack of access to equity finance is perceived by many in the social enterprise sector as a key barrier to growth and development".

Progress in addressing this problem was slow because, as the report noted, there was a great deal of confusion and misunderstanding about how equity finance would work in the context of social enterprise. Although the report cited a number of examples of co-operative and community benefit societies raising equity finance, it did not recommend this as an area for future policy development by government.

Meanwhile, there were a growing number of communities using co-operative and community benefit society legislation to raise equity finance. This was reported in the DTA publication, *Community Shares and Bonds: the sharpest tool in the box* (2007), and the Co-operatives UK publication, *Community Investment: Using Industrial and Provident Society and Legislation (2008).* The latter report identified 20 new societies that had raised equity finance in the preceding five years.

Later in 2008, when the government launched its Social Enterprise Action Research Fund, a proposal to investigate this new phenomenon was developed by the DTA (now Locality) and Co-operatives UK, in collaboration with the Department of Communities and Local Government. The aim of the programme was "to build a more robust evidence base on the potential for community share and bonds issues to increase community empowerment, grow social enterprises, and support wider government objectives, and for incentive funding from government to stimulate funding from non-governmental sources".

Launched in January 2009, the programme concentrated on market development through promotional events and workshops, a dedicated website with open source factsheets and resources, and an invitation to communities to participate in the action-research programme. The aim was to recruit ten communities who were planning to raise finance using community shares or bonds, and to learn from and support their endeavours. The following definition of community investment was established to aid research, and to distinguish community investment from other forms of activity:

"The sale, or offer for sale, of more than £10,000 in shares or bonds to communities of at least twenty people, to finance ventures serving a community purpose."

Using this definition, at the start of the programme 84 enterprises were identified as having community investment. Of these, 59 were co-operative or community benefit societies, 22 were plcs, and three had other legal formats. There had been no new cases of plcs raising community investment since Cafedirect in 2004.

During the ten years before 2009, there were, on average, four new community share offers completed each year. So the plan to recruit ten organisations for the action-research programme seemed very ambitious at first. However, following a series of awareness-raising workshops held in different parts of the country, applications were received from 34 organisations. The selection criteria aimed to ensure diversity in terms of type of community, scale, location (urban-rural) and trade sectors. The following ten organisations were selected:

Ashington Minors: An established childcare nursery in the former mining town of Ashington, near Newcastle, which wanted to raise capital finance to consolidate the ownership and growth of the enterprise.

Brixton Green: A campaign group aiming to secure the transfer of Council-owned land and buildings in the centre of Brixton, with a view to redeveloping the site for a mix of residential, commercial and cultural uses.

Cybermoor: An established community broadband society in rural Cumbria planning to raise additional capital to finance the installation of next generation broadband access equipment.

FC United of Manchester: A community-owned football club established by disgruntled Manchester United supporters aiming to raise £3.5m to build a stadium, the first team having secured promotion in three of its first four years.

Hastings Pier and White Rock Trust: A development trust established to secure the ownership and regeneration of a derelict Victorian pier, with the aim of restoring it as a tourist attraction and source of local employment.

Hurst Green Community Shop and Centre: A local community group planning to convert a listed, redundant church into a retail store and community centre for youth and older people.

Oxford Cycle Workshop Training: A community spin-off from a well-established workers' co-operative that provides apprentice training and workshop facilities for cycle maintenance, to encourage greater use of cycles.

Sheffield Renewables: A group of environmentalists who are establishing a series of renewable energy schemes in and around Sheffield, financed through community investment.

Slaithwaite Co-operative: A community buy-out of the last greengrocery in the town following its closure in 2009, now trading as Green Valley Grocer, with the aim of working with local food producers.

Tutbury Eco Power: A newly formed community group in the small market town on the Staffordshire-Derbyshire border that wants to establish a hydro-electric scheme on the nearby River Dove.

Among the 24 organisations that were not selected, at least three went on to establish societies and successfully complete share offers, including Hudswell Community Pub in North Yorkshire, which raised £219,000 from 151 investors. Several other applicants that were not selected went on to establish societies and are planning community share offers.

As well as working with the ten selected applicants, the Community Shares programme maintained direct or indirect contact with more than 50 societies planning, making, or maintaining a community share offer. The experience of working with all these societies has provided much of the practical evidence contained in this guide.

Market development

Since the launch of the programme the number of new societies planning a community share offer has grown rapidly. 28 new societies were registered in 2009, followed by 42 new societies registered in 2010. A further 16 new societies were registered in the first three months of 2011, which means that the number of societies using this form of finance has more than doubled during the lifetime of the Community Shares programme, from 78 to 164.

Measuring market development is difficult. The Community Shares programme has relied on tracking the registration of new societies using model rules designed for community share offers. However, some societies register directly with the Financial Services Authority (FSA) and do not use the model rules offered by sponsoring bodies. Other societies have turned to community investment as a way of financing later stage growth or consolidation, many years after first registering as a society. Still other societies are registered with rules that allow them to make community share offers, but do not actually take up this option until many years after registration.

There are more than 8,200 co-operative and community benefit societies in the UK. The proportion of these societies using their structure to raise share capital from the public is very small: approximately 2% of the total. Prior to 2009, registrations of new societies were running at an average of about 200 per annum. Registrations increased to 237 new societies in 2009, and 279 new societies in 2010. The proportion of new societies being registered with the intention of raising community share capital has increased from 2% prior to the programme to over 15% in 2010.

The time taken between registration and the launch of a community share offer varies greatly from one society to the next. Some societies complete a share offer within three months of registration, others can take up to five years from registration to share offer. Slaithwaite Co-operative took just five weeks from registration to the completion of its initial share offer, raising the £15,000 it needed to buy the greengrocery business from its owner. Sheffield Renewables has already spent three years getting investment ready.

So it is important to distinguish between the registration of new societies and the launch of community share offers. Since the start of 2009 there have been 43 share offer launches, of which 11 are still under offer and 32 have been completed. Most of these offers have been made by start-up enterprises, 34 in total, with only three cases of societies seeking capital to finance later-stage growth. Six of the societies were seeking capital to finance the community buy-out of existing private enterprises.

Since 2009, the 32 societies that have completed their offers have raised over £5.74m from 6,164 members. The amounts raised by individual societies range from just under £8,000 to over £1m, with an average of £179,281 and a median of £85,000. The numbers of investors in each society range from under 40 to over 1,000, with an average of 192 and a median of 151.

Future growth

The outlook for future community share offers is very healthy, with 52 enterprises registered as societies and working on plans for a share offer. There are estimated to be at least 100 further projects under development that have not yet reached the point of registration. Based on the assumption that this growth rate is maintained over the remainder of the decade, it is forecast that there will be more than 750 societies with community shares by 2015, and 3,000 societies by 2020. This would approach the number of enterprises listed on the UK junior stock market, AIM. However, this growth will not be achieved if the government does not invest in the infrastructure needed to support community investment.

Currently, most of the growth in the number of societies comes from pre-starts and start-ups. These will continue to be an important source of growth, but it will be supplemented by a rapid expansion in the number of acquisitions and transfers by communities, stimulated by the community right-to-buy powers contained in the Localism Bill. There will also be a significant increase in the number of social enterprises converting into societies in order to facilitate later-stage growth and consolidation.

Another major source of growth will come from existing societies realising the full scope and potential of their legal format to address their capital needs. For instance, the Plunkett Foundation has helped to establish over 250 community retail stores, nearly all of which are registered as societies, but only a handful of which have turned to withdrawable shares as a source of capital. This is set to change, following the introduction by Plunkett of new model rules for community retail stores that allow societies to issue up to £20,000 of withdrawable shares to individual members. Previously, its model rules restricted shareholdings to a nominal amount. Many community retail stores borrowed capital from members, often relying on informal agreements about the schedule for repaying these loans. It is anticipated that many of these societies will ask their members to convert loans into withdrawable share capital, providing greater clarity to their financial relationship. As many as 100 existing community retail stores could go down this route over the next few years. Already, the great majority of new societies supported by Plunkett are opting for the model rules that allow for community investment in shares.

The practice of community investment using community shares has spread through its adoption and replication by specific sectors of activity. Community retailing is a good example, as is renewable energy, where a series of high-profile initiatives such as Westmill Wind Farm, an Energy4All project, and Torrs Hydro, have brought the idea of community shares to public attention. Other areas of activity which look set to grow include community pubs; community supported agriculture, especially local vegetable box schemes; community owned sports clubs; and regeneration initiatives, including community land trusts. The Community Shares programme worked with a number of national lead bodies in these areas of activity, including the Plunkett Foundation, Supporters Direct and the Soil Association.

The government and its agencies can stimulate this growth by removing the barriers faced by societies seeking to raise community investment. The most significant barrier is presented by the Charity Commission, which currently will not register as a charity any community benefit society that pays interest on withdrawable share capital, despite the fact that interest on share capital, like interest on loans, is a pre-tax expense as opposed to a post-tax profit share. Charitable status is very important for societies whose trade activities are charitable and who aim to be of public benefit. A growing number of charities are reliant upon trade as their principal source of income, but are disadvantaged in markets because of their lack of access to capital. Developing community benefit societies as the legal form for charities reliant on trade would help distinguish them from the charities that are reliant on voluntary income and philanthropy. Some community benefit societies have exempt charity status, granted by HMRC, but this is due to end soon for societies without a principal regulator. The Big Lottery Fund takes a more benign view than the Charity Commission, accepting all societies as eligible for funding under its various programmes.

Financial intermediaries can contribute to the growth in community investment by developing financial products that support community share initiatives. This is explored in greater detail below.

Towards a Community Shares Unit

The Community Shares programme formally came to an end on 31 March 2011. When it was launched, back in January 2009, the aim was to learn 'how to do it': the 'it' being a successful community share offer. Less than two years on, the programme aims have expanded to include a second 'how-to': 'how to regulate it'.

The offer of withdrawable share capital is currently exempt from regulation under the Financial Services and Market Act 2000 and its associated Regulatory Orders. Societies can sell shares to the public without having to bear the cost of expensive advisers or producing highly complex prospectuses. With the growth in community investment activity comes the concern that the reputation of community shares depends on societies maintaining high standards of practice. Last year, the programme published the Practitioners Guide to Governance and Offer Documents containing guidance on four different types of share offer.

If the regulatory exemptions for withdrawable share capital were removed, then its use in community investment would probably come to a halt because most community share offers are too small to bear the costs associated with increased statutory regulation. Co-regulation, based on a voluntary partnership between government, practitioners and development agencies, could be proportionate and affordable. A fully functioning co-regulatory body would be an excellent legacy for the Community Shares programme. This could be a central role for a new Community Shares Unit within Co-operatives UK.

Modelled on the highly successful Asset Transfer Unit within Locality, the new Unit could be steered by an independent stakeholder forum, composed of representatives from membership organisations, government, financial intermediaries, community shares practitioners and other expert professionals. In addition to market development and intelligence work, the Unit could develop co-regulatory standards of good practice, provide training to community shares advisers and practitioners, and encourage new financial mechanisms that align community investment with the broader social investment and ethical investment markets.

The Community Shares Unit could also develop a third 'how-to': 'how to finance community shares'. Banks and other financial intermediaries could have a vital role to play in supporting community share offers that could be pivotal for the future development of the sector.

Support is needed in three important areas. Firstly, many new groups struggle to obtain the resources they need to fully investigate and develop their proposals in a timely fashion. This document promotes the concept of pioneer share offers, where members and known supporters invest in withdrawable share capital at an early stage. There is a role for financial intermediaries, especially grant-giving bodies, to support these pioneers by matching their investment and sharing the risk of investing in pre-start organisations.

Secondly, there are many people who want to invest in community enterprises but do not have the ready cash with which to do so. Investment by subscription, where members make small monthly payments over a number of years, is a way of making investment affordable. To incentivise such investment, financial intermediaries could provide short-term bridging finance, secured by the sale of subscription investments, which would provide the society with capital immediately, rather than having to wait several years for subscriptions to accumulate.

Finally, financial intermediaries could play a part in co-regulation by offering to underwrite community share offers. The due diligence entailed in underwriting offers would ensure that offer documents comply with guidance and best practice, as well as giving potential investors the confidence that an offer has been professionally vetted and approved.

The government has promised to create a Big Society Bank, using at least £60m of unclaimed banking assets, plus a further £200m investment from Britain's banks. Given the success of the Community Shares programme, the Big Society Bank could hit the ground running by enabling financial intermediaries to back community share offers.

This guide

This guide is the culmination of two years of action-research into community investment, during which time some important lessons have emerged about how to raise equity capital from the public for ventures serving a community purpose. The most important lesson of all has been to discover that there are four key elements to all successful community investment propositions: the business case for investment, the community, the governing document, and the offer document. All of these elements are interdependent; weaknesses in any single element will undermine the overall strength of the proposition.

In recognition of the importance of these four elements, this guide has been divided into the following four sections:

> **Section One: The business model** Community investment is only viable if the venture can work to a business model. It is not suitable for charitable organisations that are reliant on grants, gifts and donations as their main source of income. Some community organisations are engaged in activities that can only be financed through charity, whether from the public purse or private sources. However, there is a growing range of community services where the business model is best. Shops, housing, energy supplies, transport, leisure, sports, entertainment, food, childcare, adult education, even telecommunications and media services, all affect the quality of community life and are predominately delivered through a business model. Developing a strong business model is crucial, and one of the best ways of doing that is to engage the community in the ownership and control of the enterprise.

Section Two: Community engagement Community investment starts with community engagement. Without a community that has a shared identity and a common purpose, the idea will not work. But with a fully engaged community providing the capital for a community enterprise, there is real scope to improve the quality of community life. Ownership and investment go together to form a strong bond, engaging communities in enterprises that serve their interests. Investors are more likely to become loyal customers, volunteers and activists that support the enterprise in achieving its community purpose. Community investment can strengthen the business model, but it also carries the risk that people's money will be lost or their expectations will not be met. So part of community engagement must also be about community education, ensuring that people understand the enterprise, the risks they are taking, and what they can do to make the enterprise sustainable.

Section Three: Governance Community investment works by selling a share in an enterprise to people in the community. These people, as shareholders, control the enterprise. Their rights as shareholders are embodied in the constitution of the enterprise, which is more generally known as the governing document. A governing document generally does two things: it expresses the purpose of the organisation, its aims and objectives; and it describes how the organisation will operate. If the organisation plans to sell shares to members it must adopt an appropriate legal format for its governing document, either as a company or as a co-operative society or community benefit society.

Section Four: The offer document Inviting people to invest in an enterprise and risk losing their money must be carried out in a responsible manner. The offer document is the term used in this guide for this invitation to invest, whether it is in the form of a document, website, video, or even a presentation at a public meeting. In most but not all circumstances, inviting members of the public to invest is a regulated activity covered by the Financial Services and Markets Act 2000. Statutory regulation provides some protection for investors: they have the right to complain to the Financial Ombudsman and they may be eligible for compensation from the Financial Services Compensation Scheme. But some types of financial promotion, specifically those described in this guide, are exempt from regulation, or fall outside the scope of the Act. However, even in the absence of statutory regulation there can still be legal liability towards investors. It is therefore vital that the information given to investors through offer documents is accurate, is not misleading and is the result of careful consideration. The lack of statutory regulation reinforces the importance of developing robust standards of voluntary self-regulation and good practice if the reputation of community shares is to be maintained.

Section One: The business model

Communities going into business

Throughout the twentieth century the predominant model for community action has been the voluntary, granted-aided, not-for-profit organisation. Designed to address local needs, community organisations have been heavily reliant on public funding, community fundraising and countless numbers of volunteers. There are estimated to be over 750,000 community organisations in the UK, almost all of which are reliant on philanthropy.

And now, in the twenty-first century, a new type of community organisation is emerging. These new organisations are not about to replace traditional community groups, or do away with the need for philanthropy and voluntary action. Instead, they are opening up new fields of endeavour for communities, in response to the market failure of the private sector and the withdrawal of the public sector. Communities are going into business to provide goods and services that the private sector is unwilling or unable to deliver. A new age of community enterprise has arrived, and with it new concepts of community investment and community shares.

The basics

Before devoting a large amount of time, money, and energy to developing a community investment proposal, it is important to decide whether this is the right way to go. There are five basic questions that should be addressed:

- Is it a business?
- Is it viable?
- Is it profitable?
- Is it too risky?
- Will it (ever) happen?

Is it a business? Community investment will only work if it is used to finance profitable enterprises. It cannot be used to replace grant income or to meet the running costs of an organisation with an underlying shortfall in its income. It cannot support organisations that need capital but have no way of paying for that capital. Long-term profitability is essential for the viability of any community investment proposition. It is very important not to confuse community needs with market opportunities. Just because a community lacks a service or facility it sorely needs, this does not mean that there is a viable business solution to meeting this need. A business opportunity only exists if there is sufficient market demand from customers willing and able to pay a reasonable price for using this service or facility. However, community investment can help make an enterprise more robust and more profitable, by engaging shareholders in making it more competitive; shareholders have an incentive to become loyal customers, volunteers, free sources of expert advice or even low-cost suppliers, where circumstances permit. They can provide much needed capital, which in turn can lever in support from public funders and commercial lenders prepared to match community investment.

Is it viable? One of the most difficult decisions facing any new group is to determine whether their dreams are really viable. Some projects may simply be too big for community investment. The largest amount raised by a community share offer to date has been just over £4.5m. Scale is an important factor: is the size of the proposal in keeping with the size of the community? Some proposals, especially those that are based around a physical asset such as an existing property or business, are too large for local communities to sustain. Even if it is able to raise the capital required to establish or acquire the business, will the business be able to generate sufficient revenues from that community to be viable? For instance, a proposal to acquire a large redundant building and convert it into small business units may come unstuck because there are simply not enough small businesses in the locality.

Is it profitable? In the early days of community investment some societies were able to raise substantial amounts of capital without offering their shareholders any return at all, and with very restricted withdrawal terms. These offers were more akin to charitable appeals and, with strong promotional campaigns, some were far more successful than a request for donations would probably have been. The notion of becoming a shareholder and part-owner of an enterprise was an exciting proposition, and enough in itself to persuade people to invest. But with the growing number of community share offers, it is less likely that this approach will work. Potential investors are more likely to expect some form of compensation for the risks they are taking, in the form of interest on share capital, dividends on transactions, or some other form of financial incentive. They will also want to know that their share capital is secure, and that they can withdraw their money when they want to. All of this points to one thing: the business needs to be profitable. Profit is needed to generate the cash for interest and dividends. It is also needed to build up reserves, which can be used to finance future share withdrawals.

Is it too risky? Shareholders are always last in the line of creditors. If the enterprise makes losses then it is the shareholders' investments that are at risk. If the accumulated losses exceed the shareholders' investments then the enterprise is insolvent and the directors have a duty to stop trading, unless there are good grounds for thinking that the enterprise can become profitable in the foreseeable future, and therefore, continuing to trade is in the best interests of its creditors. There are several reasons why a business proposal may be too risky. Insufficient work may have been done to investigate and develop the business case for investment. The promoters may have little experience or expertise in the proposed activity and are unable to fully assess the risks. Or there may be something inherently risky in the business model; this could include proposals where the capital will be spent on revenue expenses without generating a balancing income stream, or the capital is invested in other organisations that are not owned and controlled by the enterprise.

Will it (ever) happen? Currently, much of the interest in community shares comes from pre-starts: groups of highly motivated people with a promising idea for a community enterprise. Community shares are a good way of financing community enterprises, but the first thing a pre-start group has got to do before it invites the community to invest is to make itself investment-ready. This means converting ideas into plans that are backed up with the necessary agreements, legal permissions and support. The main stumbling block for most pre-start groups is mustering the resources, especially the financial resources, to get investment-ready. Groups at this stage will inevitably encounter setbacks, some of which may be impossible to anticipate and will challenge the viability of the proposal. Pre-start groups must be resilient, opportunistic and flexible, adjusting to circumstances as they change. A strong social purpose will hold a group together through these setbacks. This is why community purpose is so central to community shares. Being motivated by a strong sense of community purpose will help groups overcome the adversities of entrepreneurship. Community engagement is a prerequisite to community investment, which in turn will provide the resources required to become investment-ready.

Starting points

It is easy to think that community investment is all about financing new community ventures, where significant amounts of capital are needed to meet the start-up costs of launching the new venture. But community investment can be appropriate at any stage in the life of a community enterprise, from pre-start proposals to mature enterprises in need of new capital to consolidate their trading position. Table One identifies five starting points for community investment, three of which involve established enterprises that already have a trading history.

In the last two years nearly 90% of community share offers have been made by start-ups. In the private sector, investing in pre-starts and start-ups

Table One: Starting points for community investment

Starting points	Key characteristics	Programme organisations
Pre-start	New groups or projects that need resources and support to get investment-ready	• Hurst Green Community Shop and Centre • Brixton Green • Sheffield Renewables • Tutbury EcoPower • Hastings Pier and White Rock Trust
Start-up	Investment-ready ventures, developed by the community, with or without the support of agencies	
Acquisition and transfers	Community buy-out or rescue of established enterprises facing closure or ownership-succession problems, as well as the acquisition and transfer of community assets, such as land and buildings	• Slaithwaite Co-operative
Early-stage growth	Established ventures trading for less than three years, seeking investment capital to finance growth	• FC United of Manchester • Oxford Cycle Workshop Training
Later-stage growth and consolidation	Established ventures trading for more than three years, seeking investment capital to finance growth, replace capital outflows, or consolidate their trading position	• Ashington Minors • Cybermoor

is considered to be highly risky, and is shunned by most investors unless there is an opportunity to make large amounts of money. For community enterprises the motivation to invest is driven by the social purpose of the enterprise. Early stage investment by the founders and community entrepreneurs will take the form of hard work, long hours and voluntary commitment with no prospect of any financial return. It can and often does rely on these dedicated people dipping into their own pockets to finance the development costs of getting investment ready.

The Community Shares programme worked with five pre-starts. Two years on, only one of these groups, Sheffield Renewables, is close to becoming investment-ready. Despite this apparent lack of progress, all five groups have taken huge steps forward in tackling the many obstacles they face in achieving their ambitions.

The first challenge for all pre-starts is to establish the business case for their proposal. This was one of the most challenging tasks facing Hastings Pier and White Rock Trust: identifying the business case for rescuing the pier. Local people could see that the pier was a neglected asset in need of much investment, but that did not mean that investing in the pier would necessarily be a good idea. So the Trust developed a business plan that concentrated on generating rental income from the hire of a large number of small retail and business units on the pier. It plans to develop a second stream of income through a series of education initiatives with the local further education college, schools, and visitors interested in the heritage and engineering aspects of the pier.

Even where the business case appears solid from the start, pre-starts can face other obstacles, many of which are hard to predict in advance. The story of Tutbury EcoPower illustrates why it can take so long to get investment-ready. This small-scale hydroelectricity scheme was started by a group of local residents in 2009. Initially, they focused their attentions on a disused mill fleam that ran alongside a local park. But after two years of work on this idea, and with professional support, they came to the conclusion that a small hydro-electric scheme powered by the mill fleam would not viable. Meanwhile, progress had been made in building support for the idea in the community, and getting the support of key stakeholders. Attention switched to developing a much larger scheme at a weir on the nearby River Dove, which fed the mill fleam. This seemed like an excellent idea until the Environment Agency required the group to develop the scheme on the opposite bank of the river to protect fish stocks. The river forms a boundary between two local authorities, which means that work now has to begin all over again in building relationships with another local authority.

The journey from pre-start to start-up is all about getting investment-ready. Start-ups face the challenge of converting dreams into reality. The business plan stops being a theoretical exercise and becomes a practical tool for directing the work of the group and measuring its performance against agreed goals. Having a great idea turns out to be the easy bit; making great ideas happen usually proves to be much harder.

In the face of these difficulties, buying an existing business may become an attractive alternative. When news leaked out that the last remaining greengrocery in Slaithwaite was about to close, a group of people involved in the local Transition Town network felt they had to act. In the space of five weeks they went from the idea, to registering as a co-operative, to raising the £15,000 needed to buy the business. They knew they had to act fast if they were to retain the existing customer base; any gap in service could have resulted in customers going elsewhere. They also knew they needed to strengthen the business model, which they achieved by renting out part of the premises to a complementary business, The Handmade Bakery. This not only reduced overheads but also added to their customer offer and footfall.

From an investor's point of view, investing in an established enterprise with a proven track record and trading history is far less risky than investing in a new enterprise. Early-stage growth in recently established enterprises is most often hampered by a lack of finance to fund the cash flow requirements of growth. Engaging the community, as members and investors, can be a powerful way of strengthening the business model, increasing customer loyalty, and making the community enterprise more financially secure.

FC United of Manchester, launched in 2005, knew from an early stage that it would need to raise a large amount of capital if it were ever to have its own stadium. The business case was straightforward: the savings from not having to rent a football stadium, offices and training ground, the additional match day income from catering and bar sales, and the scope to generate additional income from other uses of the stadium, would cover the cost of capital for a new stadium. The following year, in 2006, it launched the Development Fund, a campaign to raise £0.5m in donations. But FC United soon realised that it needed to raise its target to £3m or more, and this was more than could be raised through donations. By 2009, FC United had over 2,000 members and it made sense to ask them to become investors as well as donors.

Oxford Cycle Workshop Training was formed in 2008. It grew out of Oxford Cycle Workshop, a retail bike shop and workers' co-operative. The concept behind Oxford Cycle Workshop Training was simple: the main reason that people do not use their bikes is because they are broken and they do not know how to fix them. So why not provide workshop facilities where people could learn how to fix their bikes? They decided to set up Oxford Cycle Workshop Training as a community co-operative, inviting local people to become members, paying an annual subscription in return for free, supervised use of the workshop facilities. Short courses, spare parts and paid-for maintenance provided additional income streams, as did the recruitment and training of apprentice bike mechanics. Soon the co-operative had over 200 members, and this early stage growth has led to a need for additional working capital. It has also raised questions about whether it would be better to merge the workers' co-operative with the community co-operative, to form a larger, more sustainable multi-stakeholder co-operative.

Ashington Minors and Cybermoor are both examples of later-stage growth and consolidation. Ashington Minors, a childcare nursery in the former mining town of Ashington, was established in 2004 as a private business. When the founders and owners decided to sell the business in 2007, the management of the nursery considered buying it, but could not raise sufficient finance. At this stage, the local development trust stepped in and, together with a local business person, the nursery was purchased by the Trust, with the management and local business person as partners. But by 2009 the nursery was making a loss, and much of the capital was tied up in fixed assets, placing pressure on cash flow and strains on the relationships between partners. Community investment was seen as a way of bringing new investment into the nursery and providing an exit route for the partners.

Later-stage growth and consolidation can be an attractive investment proposition because older, established community enterprises are more likely to have built up financial reserves, which provide greater security for community investors, or, at the very least, they can provide evidence of their actual performance in recent years. Because there is greater security on offer, investors may be prepared to accept lower financial returns, reducing the cost of capital to the enterprise. Potential investors will be attracted by the community purpose of the enterprise and the social returns on their investment.

Cybermoor was established in 2002 as a community co-operative dedicated to providing access to broadband services in rural Cumbria. Based in the small town of Alston, it provides local wireless connections for broadband services and has built up a customer base of over 400 members. In 2008 it secured grant funding to lay a fibre optic cable between Alston and Nenthead, an isolated village six miles from Alston. Cybermoor joined the Community Shares programme in order to find out how it could raise the additional capital needed to expand its fibre optic network.

For established community organisations, developing a community share offer can require major changes in the ownership, control, membership and governance of the organisation. Raising additional capital is not, in its own right, a sufficient reason for making such big changes. However, community investment is not just about raising finance, it is also an excellent vehicle for community engagement and empowerment, giving real meaning to the concept of membership, where members have legal title to the organisation. Developed correctly, community investment can also strengthen the underlying business model of the organisation, making it more competitive and resilient.

Developing a competitive advantage

Community investment is only suitable for profitable businesses that are able to compete with other businesses targeting the same market. Developing a competitive advantage is essential, and community investment can play a central part in this process. The next section of the guide focuses on community engagement: a key component of community investment. Engaging the community as members and investors opens the doors to engaging the community in ways that will strengthen the competitive advantage of the enterprise.

Take the example of a community retail business, such as The Natural Food Store in Leeds or Exeter Local Food, both of which have raised well over £100,000 from hundreds of local members. These members, having invested in the enterprise, are likely to make very loyal customers. As customers they may be comfortable with the idea of paying slightly higher prices if they know that they will benefit from any resulting profit. Members may also be persuaded to provide voluntary labour, or to offer their expertise as a lawyer or a plumber, or to get involved in local campaigns, or, at the very least, tell other people about the enterprise and act as its ambassadors. Community engagement can be a powerful source of competitive advantage that is not easily available to private sector businesses that operate purely for private benefit.

According to the Plunkett Foundation, only ten out of the 259 community-owned village shops have closed during the 25 years that it, and its predecessors, have supported such businesses. This 96% survival rate is extraordinary, given that the starting position of these businesses was the loss of the last remaining retail outlet in the village. This success provides powerful evidence of the competitive advantage and resilience of the community-owned business model, compared with private enterprise.

Financing development through community shares

Table Two shows the connection between the starting points of initiatives and the different types of community share offer. Each starting point has particular financing needs, each requiring a different approach to community shares. This is reflected in the contents of Section Four of the guide, which explores four different types of community share offer: membership offers, pioneer offers, time-bound offers, and open offers.

For some pre-starts, such as Brixton Green and Hastings Pier, building membership is far more important than raising money at this initial stage. Both these initiatives need to demonstrate they have the support of the public, so engaging their communities, and encouraging supporters to become members is central to their mission. A membership offer uses share capital as a membership ticket, conferring membership rights and legal title through the purchase of a share nominally priced between £1 and £10.

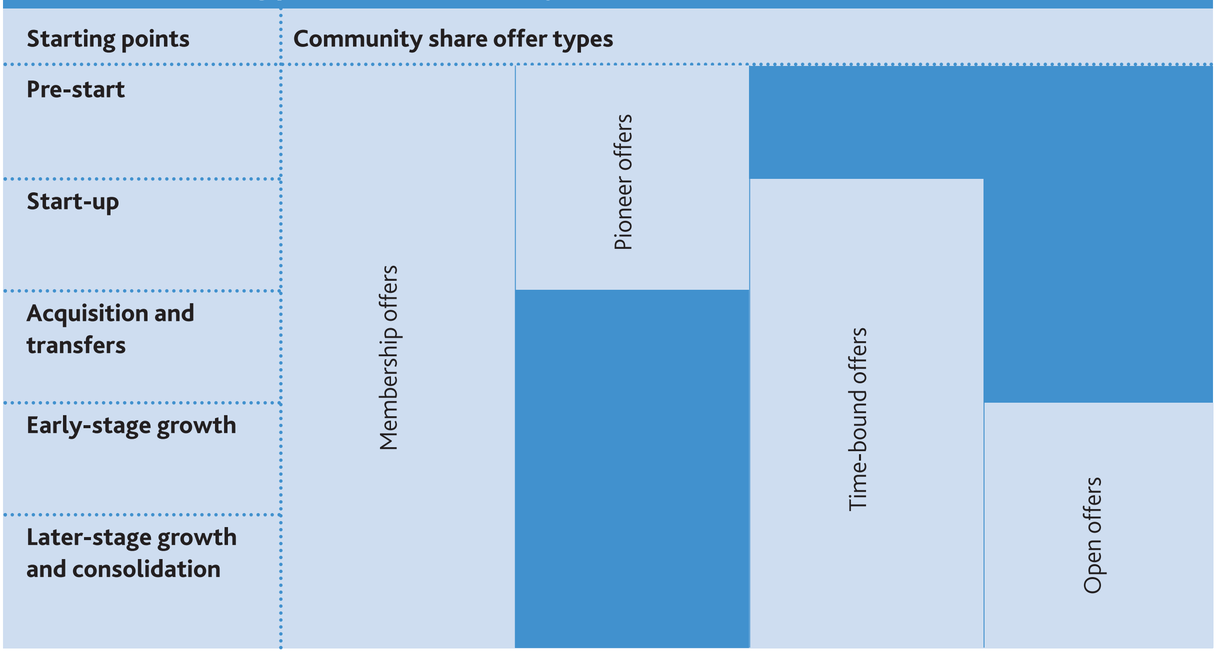
Pre-starts face a chicken-and-egg problem; they need finance to get investment-ready, but they need to be investment-ready to get finance. There are two ways of cracking this conundrum: ask for donations or find people prepared to invest in a very high-risk proposition.

Sheffield Renewables has used both methods: it has obtained grants and donations to fund its development work, and has raised over £7,000 through a pioneer share offer. This was matched by a £5,000 investment from Key Fund Yorkshire. The money is being used to develop two hydro-electric schemes in the city. Costs have included employing project staff, hiring consultants, commissioning technical studies and obtaining expert advice. Sheffield Renewables has so far spent over £50,000 on getting investment-ready, financed by the pioneer investment, public grants and donations.

Pioneer offers can only be made to existing members and known supporters. This restriction exists because of the very high-risk nature of the investment. The money will be used to get investment-ready without any guarantee of success. The shares are non-withdrawable unless and until the society starts trading and making sufficient profits to be able to afford withdrawability.

FC United of Manchester went down the donations route. It launched its Development Fund in 2006 in order to raise £0.5m towards the non-recoverable costs of developing its new stadium, including architects fees, planning applications and project management. So far it has raised over £350,000 and is confident that it will reach its target by the time it is ready to start work on the new stadium. For the last six months, its Development Fund has been running at the same time as its time-bound offer, without any discernable negative impact on the success of either.

Table Two: Starting points and community share offers



Time-bound offers seek to raise a target amount of capital within a set timescale, in order to finance a specific initiative or project. This works best for established societies seeking to finance growth, such as FC United, or for start-up societies with well-developed business plans, where a large part of the capital raised will be invested in tangible assets such as property or renewable energy generation equipment. FC United is seeking to raise £1.5m through its time-bound offer, which will make it the largest such offer of withdrawable share capital in the recent history of community shares.

The Introduction to the guide explained the special nature of withdrawable share capital, providing, as it does, an exit-route for investors when they want to cash in their shares. It also places special responsibilities on societies to ensure that they can meet future requests for withdrawals, and provide liquidity for their share capital, so it can flow in and out of the business. In order to do this, most established societies make an 'open offer' of investment to members. This means that new and existing members are invited to invest in the society, not to finance a particular investment project but to support the broader aims of the society and provide liquidity to share capital. Section Four of the guide recommends that open offers should be restricted to societies that have a proven track record of meeting requests for withdrawals, and a published history of social and financial returns. Other ways of making provisions for withdrawals are presented later in this section.

Bonds

A bond is a form of loan, which makes it possible for many people to lend money to an enterprise. Capital is loaned in smaller denominations, typically £50 or £100, and evidenced by a piece of paper, a bond, which promises to pay interest and return the capital to the bondholder on a set date. Bonds are usually transferable between third parties. Bonds are widely used by public authorities, credit institutions and companies, but are rarely used by smaller community enterprises. Bonds do not confer ownership or voting rights.

The Community Shares programme was originally called the Community Shares and Bonds programme; it soon acquired its shortened title as it became obvious that nearly all organisations preferred equity to debt. The reasons for this are fairly straightforward. Debt has to be repaid according to a pre-agreed schedule, and normally carries a pre-arranged interest rate. Equity, particularly withdrawable share capital, is not subject to any pre-arranged repayment schedule or interest rates.

There are, of course, situations where bonds are appropriate. Because bonds offer greater security and certainty they may be a more attractive financial proposition for investors. Registered charities cannot issue equity that bears dividends, so bonds may be a good alternative. Other organisations, such as workers' co-operatives, might like the idea of raising capital from their supporters but are not willing to compromise their principles of workers' control. Bonds provide a good solution to this problem because no voting rights are attached to them. Bonds may be attractive to members who have already invested the maximum £20,000 that any individual is allowed to hold in withdrawable share capital, and want to invest more. It is possible that some investors would prefer bonds with fixed interest rates and redemption periods.

But there is not much evidence that bonds are more attractive to the public. Of the 160 plus societies listed in the Community Shares directory, only two have issued significant quantities of bonds: Shared Interest and Allia (formerly Citylife). Shared Interest uses bonds to attract additional investment to supplement withdrawable share capital. Allia uses bonds as its primary vehicle for raising capital to invest in partner organisations.

Some larger co-operatives and housing associations have turned to the London Stock Exchange bonds market to raise capital, but as these issues are not targeted at the public, they cannot be considered a form of community finance.

Bonds do not provide for community engagement. Bondholders are not members, and they have no voting rights in the affairs of the society. There is not the same scope to engage bondholders in the business activities of the society as customers, volunteers or elected directors. Bonds do not give legal title to the enterprise or convey community ownership.

There are other disadvantages to bonds. They must be repaid by a fixed date, which means that profits will have to be made and set aside to fund these repayments. Although it may be possible to replace old bonds with a fresh issue, this means re-incurring the cost of raising capital, with the attendant risk that investors may not want to renew their bonds. Bonds can also be more expensive, especially if they are issued with a high fixed rate of interest that turns out to be more than the cost of commercial debt over the same period.

There are other ways of raising loan capital from the public, including the offer of loan stock or debenture stock: the former is fully at risk, while the latter is usually secured against a specific asset held by the enterprise. Selling any form of debt product to the public is a regulated activity, subject to the Financial Services and Markets Act 2000 and its associated Regulatory Orders, unless there are exemptions. Co-operative and community benefit societies are usually exempt.

Working with withdrawable share capital

The Introduction to this guide explains why withdrawable share capital should be treated as a new class of asset, with its unique properties of withdrawability, member democracy and non-speculative share value. Withdrawable shares are wholly unlike transferable shares in companies, which are traded at speculative prices and are subject to the controlling interests of a majority shareholder.

Withdrawable shares solve a major problem associated with having a relatively large number of shareholders in a small enterprise. Small enterprises with a capital value of less than £5m, are usually owned by one or two people, or a handful of family members and friends. It is very rare for companies of this size to have more than ten shareholders. The definition of community shares is based on there being at least 20 shareholders. Many community share initiatives involve hundreds, sometimes thousands, of shareholders. People are motivated to buy community shares because they identify with and want to support the community purpose of the enterprise, whether it is a local shop, pub or football club, a community building or a renewable energy scheme. The financial rewards of share ownership are secondary to the community purpose.

Small enterprises structured as private companies, including community interest companies, can issue a form of equity known as transferable shares. These shares can be traded between buyers and sellers at a mutually agreed price. Most small private enterprises are owned by a handful of people who might sell their shares to each other or to a third party. But most third parties will want to buy the whole business, which means that at least three-quarters of the shareholders must agree to the sale. The sale of minority stakes in private businesses to third parties very rarely happens. Larger companies, including many public limited companies, are listed on stock exchanges, which facilitate the trade in shares and enable companies to have many small shareholders. The smallest businesses listed on stock markets have a minimum capital value of between £5m and £10m.

The problem with owning transferable shares in a community enterprise is the lack of any market for such shares. Buying shares in a community enterprise that needs the capital to get started, provides the investor with a clear social motive. But buying those same shares from an existing shareholder only helps that shareholder get their money back; it does nothing for the community enterprise; there is no social motive. Of course, it might be possible for the community enterprise to create a financial motive, by offering attractive dividends on the shares, but this starts to defeat the original purpose of the enterprise, which is social, not financial.

Withdrawable share capital solves the problem of transferability by allowing shareholders to withdraw their capital instead, subject to the terms and conditions laid down by the society. These terms and conditions are designed to protect the interests of the society at the same time as not being so onerous that they will put off potential investors. Typically these terms and conditions include:

- A minimum period of notice of the intention to withdraw capital. This may range from one week to one year, but is more typically between one and three months.
- There may be limits on the amount of share capital that can be withdrawn in one financial year, on a first-come-first-served basis. Typically these limits are about 10% of total share capital.
- Most societies will have a rule granting the directors the discretion to suspend withdrawals if in their opinion withdrawal might seriously weaken the financial security of the society.

- Some new start-ups suspend all withdrawals for an initial period, typically up to three to five years, to enable the society to establish the business and build up the reserves to meet withdrawals.

Withdrawable shares do not usually change in value. Some societies have rules that allow withdrawable shares to go down in value if the net asset value of the society drops below the value of the share capital issued. Withdrawable shares cannot go up in value. This means the only financial incentive for owning withdrawable shares comes in the form of interest and/or dividend payments. (See below.)

Making provisions for withdrawals

Although withdrawable shares solve the exit route problem for investors, they can also create a new problem of liquidity for societies. Societies must make provision for withdrawals in the longer term. There are three main ways to do this:

- Make and retain profits as cash reserves in the society, earmarked for meeting future withdrawals of shares.
- Attract new investment from existing members and recruit new members who can also invest.
- Pay interest and dividends into members' share accounts, thereby increasing members' shareholdings

Very little research has been conducted into share withdrawal rates among more established societies. Evidence for individual societies, such as The Phone Co-op, shows that withdrawal rates of between 10% and 15% per annum are normal. Membership of The Phone Co-op has increased every year for the last ten years, during which time member investment has always far exceeded withdrawals. It currently has nearly 8,000 members who between them hold just under £2.9m in withdrawable share capital. Members of The Phone Co-op are only required to give one week's notice of withdrawal.

The amount of member investment into The Phone Co-op is boosted by paying interest and dividend payments into members' share accounts, leaving it up to the members to decide whether to withdraw any or all of these payments, unless they have reached the £20,000 limit. In 2010, this reinvestment of interest and dividend payments amounted to over £100,000, or approximately 20% of new member investment that year.

Relying on new member investment to replace withdrawals is fine for societies that trade with their members because, like any business, they will always be seeking to attract new customers, and new customers can be invited to become members and investors. But this method cannot be used so easily by societies that do not trade with their members. This is typically a problem for renewable energy schemes. Energy4All Limited, experts in regulated share offers for community-owned renewable energy schemes, recommends that societies provide for future withdrawals by setting aside a proportion of profits in cash reserves, equivalent to the full value of the share capital over the lifetime of the scheme. This can be linked to the terms and conditions of withdrawal.

How much capital can be raised?

The Introduction to this guide provided some information about how much capital has been raised by recent community share offers. Focusing on the 26 time-bound offers that completed in 2009–10, the amounts ranged from just under £11,000 to £1m, with a mean of £156,000 and a median of £85,000. The average amount invested by members was £636, although this figure varies significantly from one society to another. Bishops Castle Community Land Trust raised £13,340 from 185 members, an average investment of just £72; its offer document required a minimum investment of £5 and made no mention of any financial return on the investment. In contrast, Sustainable Hockerton raised £167,550 from 41 members for its wind turbine: an average investment of over £4,000. It set the minimum investment at £250 and stated an aspiration to pay interest on share capital of between 5% and 8% per annum.

The offer of a financial return on the investment does appear to have an impact on the amount invested by individual members. All of the societies where the average investment was significantly over £1,000 aspired to pay interest rates ranging from "competitive" (Hudswell Community Pub), to "10% per annum from year four of operations" (Energy Prospects, an Energy4All project). There was no mention of any financial return among those societies where the average investment was less than £500.

The average amount invested by members in a society is usually very different from the median amount invested. Typically, a handful of members investing large amounts results in the average being far higher than the median. For example, The Real Food Store in Exeter raised £152,775 from 287 members: an average investment of £532. But the median investment was £100, the same as the minimum investment allowed. Five members invested over £5,000, and between them provided more than one-third of the total capital raised. On the other hand, over half of their members invested just the minimum amount, and between them contributed only 10% of the total capital raised.

However, research suggests that the Real Food Store may be the exception rather than the rule. A report investigating the behaviour of community shares investors found that most members invest at least double the minimum amount asked for, even when this minimum is £500. The research by Wessex Community Assets for the Asset Transfer Unit of Locality, analysed the share registers of eight societies. The minimum investment allowed by these societies ranged from £100 up to £500 and at least half the investors in all but one of these societies invested at least double the minimum amount. Average investments ranged from £327 to over £3,500. In almost every case, a small number of larger investors lifted the average amount invested well above the median. The research also found evidence that while most investors lived nearby, the larger investors tended to live further afield.

An important observation made by the Wessex research is that community share offers tend to attract a range of different types of investor, who they labelled as 'local community investors', 'community of interest investors', 'social investors' and 'ethical investors'. Larger offers, seeking to raise more than £100,000, are more dependent upon attracting members from outside the local community.

Another way of stimulating investment by members is to allow members to invest in instalments, signing up to a regular monthly subscription that will mount up to a significant sum over a number of years. This in turn would enable societies to increase the minimum investment without excluding members on lower incomes, who may not be able to afford to invest a large amount in a single payment.

Gearing

Gearing is a financial term that refers to the ratio between debt and equity. Typically, financial institutions are reluctant to lend more than an enterprise holds in equity and reserves unless there are physical assets on which they can take security. So, increasing the amount of equity invested in a society also increases the likelihood that financial institutions will lend to the society. Raising a mix of debt and equity might be the most practical solution to a society's capital needs. 4CG Limited in Cardigan, south-west Wales, raised over £200,000 in share capital from over 450 local people, towards the cost of purchasing land and property in the centre of the town. This share capital enabled it to lever in commercial debt amounting to a further £180,000. This meant 4CG had enough capital to purchase the site and carry out the first stage of its redevelopment. The knowledge that financial institutions are willing to lend to a society can be of comfort to members thinking of investing. It can even lead to members offering to replace commercial debt with equity as a simple way of reducing the costs of the scheme.

Interest and dividend payments

Section Three of the guide explains the differences between two types of society: co-operative societies and community benefit societies. There are important financial differences between these two types of society. Only community benefit societies can have a statutory asset-lock (see page 24), and only co-operatives can pay dividends.

The term dividend has a specific meaning in co-operative societies, which is different from its meaning in relation to companies. Dividends in co-operative societies refer to a profit distribution to members, proportionate to their transactions with the society: what used to be known as the co-op "divi". Co-operative dividends are a financially prudent device to encourage member loyalty and also to persuade members to accept a cautious approach to profitability. The logic is that members will accept higher prices if they know they will get back some of the profit in the form of a dividend. This is preferable to lower prices with the attendant danger that the society makes a loss that would threaten its sustainability.

Most of the traditional consumer co-operative societies still pay a dividend, but hardly any new co-operative societies have adopted this way of rewarding members. The Phone Co-op is one of the few; it paid a dividend equivalent to 1% of members' purchases in 2010.

Both types of society can pay interest to members on the withdrawable share capital they hold in the society. However, the interest rate should be "no more than is necessary to attract and retain the investment". The Financial Services Authority (FSA), which oversees this requirement, does not provide guidance on precisely what this means. It could be interpreted as meaning that higher risk schemes are free to offer higher rates of return. In practice, most societies only set their interest rates after the year end, when it is known how much profit has been made, and what can be afforded by the society, along with its other priorities for reinvestment and spending on its social objectives.

Interest on withdrawable share capital should be seen as fair and reasonable compensation for the risks members are taking when they invest in the society. These risks are far greater than those associated with savings accounts that are protected by the government's Financial Services Compensation Scheme. Therefore, a reasonable interest rate might arguably be above the interest rates on savings accounts, but below the interest rates payable on commercial debt.

Interest and dividend payments are a pre-tax expense for the business. The rates are set by the board of directors after the financial year end, and approved at the Annual General Meeting of members. Normally, a society would have to be in a financially healthy position to consider paying interest or dividends. Most societies credit interest and dividends to the members' share accounts, which means that this money is automatically reinvested in the society, unless and until the member withdraws some or all of their capital. Interest and dividends are paid gross of personal income tax. Members are responsible for informing HMRC about their income from the society.

Asset locks

An asset lock is a legal device to prevent the distribution of residual assets to members of a corporate body. Asset locks are intended to prevent private gain from the dissolution of an organisation whose purpose is to benefit the public. Asset locks are central to the definition of a not-for-profit organisation.

Any type of organisation is at liberty to include an asset lock in its governing document, but the only types of asset lock that are backed by law are those found in charities, community interest companies, and community benefit societies that have opted to have a statutory asset lock. Section Three of the guide examines asset locks in more detail from a legal and governance point of view.

By removing the possibility of individual private gain, asset locks prevent the carpetbagging of organisations. But an asset lock does not prevent the sale of a society to the private sector; it only means that any residual assets from the proceeds of the sale have to be transferred to a suitable asset-locked body, and cannot be distributed to members. Some people were surprised when ECT Recycling, a community interest company, was sold to the private sector company May Gurney in the summer of 2008. But this was entirely within the law because the residual assets of ECT Recycling were transferred to its parent organisation, Ealing Community Transport, itself an asset-locked body.

Asset locks are very important for societies that want charitable status or hope to attract public funding. FC United of Manchester, which was registered as a community benefit society in 2005, amended its rules in 2010 to introduce a statutory asset lock prior to the launch of its £1.5m community share offer in October 2010. It hopes to raise £2m in total from its members and supporters with a further £1.5m coming from public funds and grants.

Tax relief on investment

HM Revenue and Customs (HMRC) operates a number of tax relief schemes to encourage investment in enterprise. These schemes are subject to constant change, so it is important to obtain up-to-date advice from a tax expert before developing a community share offer. The scheme most used by societies is the Enterprise Investment Scheme (EIS). FC United of Manchester has made use of this scheme, and Sheffield Renewables and Tutbury EcoPower both hope to include EIS in their offers. The scheme provides 30% tax relief to investors, which means that 30% of the amount invested can be offset against personal income tax liabilities in the year the society starts trading. The shares must be held by the investor for a minimum of three years.

EIS is only open to "qualifying investments". Excluded activities, which do not benefit from this tax relief, include: renewable energy schemes receiving Feed-in-Tariffs; property development; farming or market gardening; holding, managing or occupying woodlands, and any other forestry activities or timber production. Under the scheme, all shares must be paid up in full, and the minimum investment is £500. The enterprise must not be seeking to raise more than £10m. Shares must be fully at-risk, with no preferential rights to any form of financial return. And there must not be any arrangements to protect the investor from the risks associated with investing in shares, or any arrangements guaranteeing the sale of shares after the minimum three-year period for which they must be held.

Discussions have been held with HMRC about the circumstances under which co-operative and community benefit societies issuing withdrawable share capital can qualify for EIS. The main concern of HMRC is that a society issuing withdrawable share capital should not offer a guaranteed or pre-arranged exit for the investor. HMRC will provide advance assurance that investment in a society will qualify for EIS. In order to obtain advance assurance, a society must submit a copy of its business strategy to HMRC, usually in the form of its business plan, its draft offer document, and a copy of its governing document. Obtaining advance assurance can take between 8 to 12 weeks, so if this is to be included in the offer document, adequate time must be allowed. It is not mandatory to obtain advance assurance.

There are other tax relief schemes, including Community Investment Tax Relief (CITR), but these are generally not applicable to or appropriate for community share offers. CITR is only available to investors in accredited community finance development institutions.

Charitable status

At the time of writing this guide the situation regarding community shares and charitable status is still uncertain. Changes in charity law, combined with the innovative nature of community shares, has resulted in a novel situation where the Charity Commission is being asked to consider whether a community benefit society, with an asset lock and shareholders, can be registered as a charity. At issue here is whether such a society is operating for private or public benefit, and whether interest on share capital constitutes a profit distribution.

At the moment, community benefit societies can apply to HMRC for exempt charity status without having to register with the Charity Commission. But this is set to change in the near future when exempt charity status will be restricted to societies with a principal regulator, such as housing associations and higher education institutions, and all other societies with charitable objects will have to register with the Charity Commission. And because raising capital through community share offers is still relatively new, there is limited case history relating to how HMRC treats applications for exempt charity status from such societies.

Section Two: Community Engagement

From giving to investing

Community shares are still a rather strange idea for most people. Traditionally, local good causes have been supported by means of gifts and donations, or by participating in fundraising events. Most community retail stores have been at least part-funded through these methods. So the proposition that communities should buy shares in enterprises that serve a community purpose is often met with scepticism and even mistrust.

Furthermore, most people have no direct experience of buying shares, and often do not know how shares work. People can easily be put off by unfamiliar financial and legal jargon, but on the other hand, some apparently simple terms can be misleading.

Community investment starts with community engagement. Without a community with a shared identity and a common purpose, the idea will not work. But with a fully engaged community providing the capital for a community enterprise, there is real scope to improve the quality of community life.

The basics

Community investment will only work if there is, at least potentially, a community that is willing and able to support the enterprise. Before developing any plans, there are five basic questions that need to be addressed:

- What community?
- What community purpose?
- Can the community afford to invest?
- Are the founders competent?
- Is there scope for community engagement?

What community? The concept of community, whether it is a community of place, a community of interest, or a combination of the two, should never be mistaken for the real thing. The term has been devalued through glib over-use, assuming a condition of connectedness and belongingness in areas where people experience only isolation, exclusion and alienation. Community is more than a boundary on a map or a category of interest. It cannot be a passive label attached to people without their engagement or even knowledge. Community is an active condition, reinforced by active membership, with people choosing to belong to and identify with a community's values and purpose.

What community purpose? People will support proposals where the community purpose is clear, for instance, to save the last shop or pub in a neighbourhood, or prevent the loss of some other local service. The proposal might address an issue of local, national or even international interest or concern, but it also needs to address the issue in a way that enables the community to participate. For example, a community renewable project to install solar panels on local community-owned buildings, might be a good way of enabling communities to act in response to concerns about climate change.

Can the community afford to invest? This is more than just a question about the wealth or poverty of a community: it is also about the scale of the community in comparison with the proposal, and the mechanisms that can be put in place to make investment affordable to people on low incomes. Community investment is not a solution to poverty and inequality, but it can work for people on low incomes if the business case is sound and there is a strong community purpose which will benefit them.

Are the founders competent? People can become very enthusiastic about proposals that serve a strong community purpose. But it takes more than just enthusiasm to establish, finance and run a successful community enterprise. There are three sets of essential skills: financial know-how, community development and, most importantly, technical competence in the trade activity of the enterprise. This latter skill is often the weak spot for many groups; the quality and accuracy of the business plan, and the effectiveness of the community engagement plan, are contingent upon a thorough understanding of the chosen trade activity. Take, for instance, a proposal to acquire and develop a community building. The capital costs will be determined by the quality of the redevelopment of the building, while the income forecast will be dependent upon a detailed knowledge of the local rental market and the scope to recruit local organisations as tenants.

Is there scope for community engagement? Community engagement is absolutely central to community investment. It is the principal source of competitive advantage for community enterprises, and the principal reason why community investment is so successful in addressing market failure. Business activities that allow the community to engage in multiple ways, as members, investors, customers, volunteers, employees, activists, experts, suppliers, service users and/or donors, will be far more successful than those where the engagement is limited to a single role. Community investment is most effective for business activities where members can take on multiple roles, as investors, customers and volunteers, such as community retailing, food and farming, or community sports. Business activities that only offer limited scope for engaging people beyond the role of investor are less effective but still possible, as many community renewable initiatives have shown.

The concept of community

In an increasingly complex world, most people inhabit many different communities and may occupy many different roles within those communities. People may live in one community and work in another. They may be members of a faith group, volunteers for a charity, or regulars at a local pub or club. They may play in a sports team, or be part of a society engaged in a specific interest, hobby or leisure pursuit. Almost every human undertaking that involves people acting together has the potential to create a community. Some of these activities may be suited to the market mechanisms of enterprise, and it is these community business activities that are the focus of this section.

The power of community shares is that they give people legal title, membership, ownership and control of the enterprise. Compare this with the passive form of membership employed by many community organisations, which often define membership on a geographic basis, without individuals actually doing anything to become members. Passive membership structures do not engage people.

Community shares promote an active form of membership; people have to act to become members, investing their money and perhaps their time too in a community enterprise. As members and investors, they can be encouraged to take on more roles: as loyal customers and service users; as volunteers, activists or experts; as employees, suppliers and directors; as donors and lenders. This challenges a fundamental aspect of stakeholder theory that places people into narrowly defined roles.

Community shares challenge the notion that enterprises should be run in the interests of a single class of stakeholder: the investor, customer, employee or supplier. This is as much a challenge to old style co-operation as it is to capitalism, both of which structure enterprise in the interests of a single class of stakeholder. Community shares encourage everyone with an interest in the enterprise to become a member, and to become active in the enterprise through a multiplicity of roles.

The Ethical Consumer Research Association, publishers of the Ethical Consumer Magazine, began life as a workers' co-operative in 1989. Twenty years on, it decided to convert into a multi-stakeholder co-operative, opening up membership to its readers. It now has over 140 members, who together have invested over £140,000 in the enterprise. Oxford Cycle Workshop, a bike shop and workers' co-operative established in 2001, created a sister organisation, Oxford Cycle Workshop Training, in 2008, as a community co-operative providing training and workshop facilities for local people. It also created Oxford Cycle Club for people who enjoyed cycling. These experiences of engaging the community have raised the issue of whether it would make more sense to merge all three organisations into a single entity, with open community membership.

Establishing a community identity

Before community engagement can begin, it is necessary to create an entity that the community can identify with, starting with a name for the society that is unique, easy to remember, easy to get right, not too long, and, if possible, refers to the purpose of the enterprise and the community it serves. FC United of Manchester is a memorable name because it plays with the identity of Manchester United FC. And its acronym, FCUM works well for internet searches. Brixton Green is another name that instantly communicates a message about place and purpose. In contrast, Oxford Cycle Workshop Training is a bit of a mouthful, but at least it does what it says.

Of course, it is possible to develop more than one name and identity. Slaithwaite Co-operative had to be registered quickly to allow the buy-out of the greengrocery to take place before it closed. Although proud of its co-operative identity, the founders needed to distinguish the shop from The Co-operative, so it adopted the trading name of Green Valley Grocer.

Logos are another way of building identity. FC United's logo uses similar colours to that of Manchester United. The logo for Hastings Pier and White Rock Trust plays with the idea of saving the pier. Sheffield Renewables has opted for a simple iconic representation of a windmill. Tutbury EcoPower invited local schoolchildren to participate in designing its name and logo; the organisation was previously known as Tutbury Hydro Electric Project, the logo incorporates a stylised image of a castle tower, a well-known local landmark.

Websites have become essential for all enterprises, and are particularly important for any enterprise that wants to communicate with its community. Electronic communication is also the most affordable way of maintaining contact with a large number of supporters and members. 60% of UK adults access the internet every day or almost every day. 43% of internet users visit social networking sites on a regular basis, so it is essential for societies to have a presence on these too.

Membership building

The central task of all community shares initiatives is to build membership. This involves four main steps: defining the community and measuring its population, attracting an audience within this population, recruiting supporters from this audience, and converting supporters into members.

1. Defining community and measuring population

A community is defined by its membership, so deciding the eligibility criteria for membership will help to define a community. Geographic criteria will limit the potential size of a community to no more than the total population of that area. Communities of interest, with no geographic limitations will not be able to measure the total population of their defined community.

The rules of a society must state who is eligible to be a member. (See Section Three.) Membership of a co-operative society is usually restricted to people who use the services of the society as customers, suppliers or workers. Since 2006, investors have been accepted by the Financial Services Authority (FSA) as an eligible category of non-user member. Membership of a community benefit society is usually not restricted to specified user groups and can be very broad, including anyone who supports the objects of the society. Membership can also be restricted to specific geographic communities.

For instance, Brixton Green decided to restrict its membership to a specific geographic community. The founders know that they have to build a large and robust community membership base if their plans to regenerate part of Brixton are to be achieved. They want to acquire a site owned by Lambeth Council, which would be developed in partnership with the local authority, housing associations and other third sector partners. But first the society has to prove that it has community support. The founders have set themselves the target of initially recruiting 5,000 members. A lot of thought went into how to define membership, ultimately focusing on people who lived and/or worked in the four local authority wards that include or are adjacent to the development site. They chose not to offer membership to people living or working outside this geographical area, even though this may deprive them of thousands of potential members drawn from the many hundreds of thousands of people around the world who identify with Brixton through music, cultural identity, or as a social cause. Instead, they decided to focus on those who will be most directly affected by the development of the site. Their recruitment target represents approximately 10% of the estimated 50,000 population of its defined community.

Hurst Green Community Shop and Centre has no geographic restriction on membership, but it knows that the purpose of the society, to act as a local food retailer, cafe, and community centre, will only appeal to the local village population, which is estimated to be approximately 1,450 people living in about 600 households. Of course it is possible that, when it starts to recruit members, it may attract people who live far outside the local area. One of the 151 members of Hudswell Community Pub in North Yorkshire, lives in California and found out about its community shares offer through the internet. It is now possible for local campaigns to have a global reach.

The point of defining community and measuring population is to provide a starting point for the recruitment campaign. It will assist in deciding what promotional methods will be most effective in reaching the population, and provide a benchmark for measuring the success of the campaign.

2. Attracting an audience

An audience is a body of people who have seen or heard about a proposed initiative. In order to establish an audience it is necessary to devise a communications strategy targeted at the whole community. A good understanding of the scale and demography of the target population will aid the choice of communication methods.

In the early stages of its campaign, Hastings Pier and White Rock Trust (HPWRT) did everything it could to put the fate of the pier in front of the local media. It worked with the local newspaper, which launched an online petition urging the local council to start proceedings for the compulsory purchase of the pier. The petition attracted over 3,000 signatures. HPWRT used the publicity generated by the petition to organise a protest march, which attracted 2,000 people, followed by a Facebook campaign site called 'The Battle for Hastings Pier'. It set up campaign headquarters in a derelict shop near the pier. But the big breakthrough came when a local ward by-election was called, and it organised a public 'Question Time' meeting, inviting the three main candidates to attend. In front of a packed audience each of the candidates pledged their party's support for the Council to take out a compulsory purchase order on the pier.

Key methods for developing an audience include websites, public meetings, events, campaigns and even door-to-door leafleting. Speaking at events and meetings can be another useful way of reaching out to a local community. Tutbury EcoPower invited local schoolchildren to participate in a competition to design its logo, as well as to come up with a name for the society, which had previously been known as Tutbury Hydro Electric Project.

3. Recruiting supporters

The purpose of attracting an audience is to ensure that the target community is aware of the proposed initiative. It should then be possible to recruit supporters from this audience. A supporter is someone who is interested in, and identifies with the aims of the society. But before these people can be counted as supporters it is vital to have their contact details.

Using social networking media, such as Facebook and Twitter, is a highly effective means of building up lists of known supporters. Hastings Pier and White Rock Trust has over 4,200 Facebook members, and FC United of Manchester has accumulated over 14,000 Twitter followers.

Hastings Pier uses Facebook to drive most of its campaigns and to publicise all its events. The homepage of its website has links to its Facebook and Twitter accounts, along with six other ways of becoming a supporter by providing it with contact details. These include options to subscribe to its newsletter, comment on its website via Word Press blogs, donate to its funds, sponsor a plank, become a member of the Trust, or register an interest in its community share scheme. Brixton Green uses its website to invite people to complete a short online opinion survey commenting on Brixton Green's proposals, leaving their contact details at the same time.

Other ways of obtaining the personal contact details of supporters include the use of petitions, attendance records, keep-me-informed lists, or even raffles. Societies should make it clear that personal contact details will only be used for communications from the society. Any organisation keeping personal data on individuals is obliged to be registered with the Information Commissioner's Office.

Building up a contact list of known supporters is invaluable for new societies planning a community share offer. It enables direct communication with people who have a strong interest in the initiative, and may be prepared to invest at an early stage.

4. Converting supporters into members

The final step is to convert supporters into members. For new societies it is important to decide whether membership will be offered prior to, and separately from, an investment offer. Some organisations, such as Brixton Green and Hastings Pier, have decided to build their membership well in advance of making a community share offer. This enables them to demonstrate the level of their public support, and to gauge the level of interest in a community share offer at a later date.

Because building a large membership is so important to Brixton Green, it has taken the radical step of selling membership through four local outlets using £1 membership scratch cards. The scratch card panel reveals a unique membership number that has to be used when registering membership online or by post.

Hastings Pier has launched a membership offer, charging an annual fee of £10 (or a concessionary rate of £5). Annual fees contribute towards the revenue costs of maintaining and servicing a membership. They are also a good way of maintaining an active membership; members have to actively decide to remain members, rather than joining and then remaining members for life. At the time of writing, Hastings Pier has over 400 members and the number is rising rapidly.

Annual membership fees can be an important source of revenue for societies. Oxford Cycles and FC United both charge annual membership fees, and for FC United, with over 3,400 members, the income from membership fees is substantial. However, it is important to think about how annual membership fees will interact with withdrawable share capital. Will member-investors be required to pay an annual membership fee, or have to withdraw their capital if they decide not to renew? Section Three examines the options for societies when drafting membership rules. These include having two separate classes of membership, waiving annual fees for members who have invested a specified large amount, or deducting annual fees from members' share accounts.

Many new societies tie membership and investment together in a pioneer offer or time-bound offer. Section Four provides more details about these different types of offer, and how these offers should be made. For instance, Sheffield Renewables made a pioneer investment offer to 25 of its founders and key supporters. Twelve of these people became members, investing over £12,000. Since it made this offer in early 2010, it has built up its supporter base to over 700 people in preparation for a succession of time-bound share offers to be launched in 2011.

Members are more than just investors

Community investment is at its most effective when members are more than just investors. Section One emphasised the importance of engaging members not only as investors but also as customers, service users, volunteers, activists, experts, and even as suppliers or workers. Engaging members in multiple ways strengthens the competitive advantage of the business. Members who have invested are more likely to volunteer or to become loyal customers. This can reduce costs and increase turnover. As member-investors, who support the community purpose of the enterprise, they may be prepared to accept lower financial returns, which will further strengthen the competitive advantage.

Multiple forms of member engagement also help the longer-term sustainability of the enterprise, by offering many reasons other than just investment for people to become members in the future. This helps maintain the liquidity of withdrawable share capital, as explained in Section One. Inviting new customers to become members and investors consolidates their relationship with the society.

The remainder of this section examines how societies can maintain high levels of member engagement. Some of these activities are determined by the legal requirements governing societies and are covered in more detail in Section Three.

Members' rights

All members of societies have rights, enshrined in co-operative and community benefit society legislation. These include the following rights:

- To be invited to, and attend, general meetings of the society, including the annual general meeting, and any extraordinary general meetings that may be called;
- To participate in democratic decision making at general meetings;
- To determine the rules of the society, and to decide upon any changes to these rules;
- To appoint the directors of the society in accordance with the processes set out in the rules;
- To approve the recommendations of directors regarding interest and dividend payments;
- To receive a copy of the annual accounts and report;
- To inspect the register of members;
- To withdraw some or all of their share capital, subject to the conditions set out in the rules, and at the discretion of directors.

Co-operatives UK has a Corporate Governance Code of Best Practice for its member consumer co-operative societies, which goes well beyond these legal rights to include guidance in the following areas:

- Provision of member education and encouraging active members
- Monitoring and reporting on member participation
- Responsibilities of the board of directors
- Acquisition or disposal of significant assets
- Transfer of engagements to another society
- Remuneration of managers and directors
- Composition and diversity of boards and independence of directors
- Training, development and appraisal of directors
- Audit procedures, accountability and compliance.

Societies have a responsibility to protect and enhance their members' rights, and although this can be expensive, it also lies at the heart of community engagement and ensures the members remain committed as investors.

Encouraging activists

Activists are members who participate in the affairs of the enterprise. Ultimately, these active members might become the future directors of the society, but initially, activism is best encouraged by offering members quick and easy ways of getting involved. Too many societies adopt an all-or-nothing approach to activism, seizing upon anyone who shows the slightest interest, expecting them to contribute too much, too quickly. An annual general meeting should not be a recruiting ground for new directors. Candidates for the election of directors should be nurtured well in advance, guided by a series of stepping stones leading to greater involvement in the society.

Societies should always strive to make it easy for members to participate. Organising on-line election ballots is more demanding, but invariably results in much higher participation rates, and may also boost the number of members who turn up at annual general meetings. Meetings should not just be about the business of the society, but also address topics of interest to members that are closely connected to the community purpose of the enterprise.

Encouraging volunteers

An activist is one type of volunteer, but there may be plenty of other members who would prefer to volunteer for practical tasks. FC United has over 200 volunteers who contribute on a regular basis to the success of the club. The volunteer page on its website lists 24 different volunteering roles to choose from, everything from administration and bar staff through to web designers. It has its own radio station and TV channel that prides itself on posting edited highlights of home matches, with replays and interviews, on its website within four hours. One FC United video clip on YouTube has received over 900,000 hits.

The key to recruiting volunteers is to have lots of different volunteer options. As with activists, new volunteers should be offered one-off volunteering options to start with, so they can find out whether the task is something that suits them. Volunteer roles should be capable of expanding with the volunteer, providing the person with the scope to shape their volunteer input. It helps to have a volunteer co-ordinator. And it is important to celebrate the contribution of volunteers.

Recruiting directors

Competent, motivated and engaged boards of directors are central to the success of all societies. Contested elections for directorships are a sign of a healthy board. But if a society wants to have contested elections it must develop mechanisms that will encourage members to take on the responsibilities of becoming directors.

A good starting point for nurturing new directors is to find out about members' talents and experience. Members' forums that provide feedback on specialist topics of relevance to the enterprise are a good way of giving members an opportunity to exercise their talents without having to make a regular commitment. Other one-off activities that use their skills and abilities can give members a taste of what it would be like to become more involved in the society. These can include short campaigns, projects, events and other activities with a clear beginning, middle and end. As members become more involved it is useful to offer training in the roles and responsibilities of directors. Remember that unless the society is a registered charity, there is no impediment to paying directors. This could be more cost-effective than employing specialist advisers, consultants or managers.

Annual reports

The financial reporting and audit requirements for co-operative and community benefit societies are set out in legislation. Societies are required to submit their annual accounts to the FSA, along with an annual return, both of which are available to the public via the FSA's website. These statutory requirements are covered in greater detail in Section Three.

As well as containing the annual financial accounts, the annual report provides an opportunity to tell members, and the wider public, about the social performance of the society, and to make sure that the affairs of the society are fully transparent. Members, and prospective members, need information to make judgements about the returns they are getting on their investment, and the risks associated with continued investment. Annual reports should be consistent with offer documents, covering the same ground, so that members can determine whether the forecast financial and social returns have been achieved.

In addition to the annual accounts members need information about their share capital. Most established societies operate member share accounts, which are credited with any interest or dividend payments due. If the society is making an open offer (see Section Four) members will be free to invest or withdraw capital from their accounts. In such instances, it is good practice to issue the member with an annual statement of their share account, which they can also use for tax purposes. Interest and dividend payments to members are paid gross of income tax and it is the responsibility of members to declare this income to HMRC.

Members also need information about the performance and liquidity of the capital invested in the society. This information should include:

- The number of members joining and leaving during the year
- The amount of share capital invested and withdrawn during the year
- Changes to the level of reserves
- Changes to the level of long-term (more than one year) borrowing
- Interest rate payable (compared with any forecast and historical record)
- Dividend rate payable (compared with any forecast and historical record).

How a society reports its social performance will depend on its community and social purpose, and the resources available to identify and measure its social impact. It is very important that offer documents only promote social returns that can be measured and described in the annual report, so having a social performance measurement plan is essential before the offer document is prepared. Social auditing practices, including Social Return On Investment (SROI), have well-established principles that should be used to determine appropriate targets. These principles should also be used to decide how to monitor the social performance, and to assess the social impact of the society, both positive and negative.

Social return on investment

The Community Shares programme worked with the Social Return On Investment Network to investigate how SROI could be applied to community investment. SROI is a framework for measuring and accounting for the value created by an organisation's activities. It is an analysis of how activities lead to changes to people and organisations, measuring the outcomes arising from an activity, and using monetary values to represent these outcomes.

Social return refers to the benefits or costs expected to accrue to a community as a result of activity that has, in part or wholly, been financed by money raised through the community share offer. Although the language used often refers to benefits and returns, it is also possible to describe these as outcomes or changes experienced by stakeholders.

Although this appears simple enough, a structured approach is required to account for this return; and to be clear about the benefit, how it can be measured and how to be reasonably certain that it occurs as a result of the investment. Within this structure there will be times when the return is clear and relatively easy to describe and other times when it is more complex. Some offers will generate a wide range of different returns, others only one. SROI provides a structured approach to understanding the returns by asking a number of questions. In essence these are set in relation to a particular activity, and are:

- Who will benefit (or lose)?
- How will they benefit (or lose)?
- How will we know how much benefit (or loss) they experience?
- How valuable are the benefits (or losses)?
- Have we focused on the important benefits (or losses)?
- What benefits would have happened without the activity?

The process of recognising who will benefit or lose out and what outcomes they will experience will help to identify:

- Groups that you will want to engage as members (the audience)
- Ways in which they can be engaged (the supporters)
- Opportunities for increasing membership (the members).

Further information is available in a separate guide on SROI and community shares.

Annual general meetings

The annual general meeting is an opportunity to celebrate the purpose and achievements of the society. Although there are a number of legal requirements that need to be addressed, this can be done in a way that is interesting to members, if handled correctly. It should be an occasion to revisit the fundamental purpose of the society, and to tell members about the social and community achievements of the past year. The focus should be on the practical work of the society; it can be used as an opportunity to find out what members think about the society's products and services, and to get feedback on plans and proposals for new developments. There should be plenty of scope for members to interact, not only over food and refreshments, but also in the context of the society's business.

There is a formal business agenda that must be covered. This will be set out in the society's rules, and usually includes the following items:

- Annual reports (financial and social)
- Election of directors
- Rule revisions (if any)
- Appointment of auditors
- Approval of interest and dividend rate recommendations
- Minutes and records of previous AGM.

It should be possible to present this formal business in interesting ways if the focus is kept on the purpose of the society.

Section Three: Governance

Governing documents

Governance is the act of governing or directing an organisation according to the principles set out in its legal constitution, the governing document. The governing documents of co-operative and community benefit societies are known as the rules. Any organisation seeking to become a co-operative or a community benefit society must register its rules with the Financial Services Authority (FSA). This registration function of the FSA is distinct from its role as regulator of the financial services industry in the UK.

Making sure the society's rules are fit for purpose is a continuing responsibility of the board of directors. The governance needs of a society will develop over time, and the governing document needs to be regularly amended to reflect these changes and to enable the society to function effectively within the law.

This section looks at what is involved in selecting and developing a governing document fit for the purpose of offering community shares.

The basics

Before commissioning expert legal advice on the preparation of a governing document, there are five basic questions that need to be addressed:

- What is the starting point?
- What type of legal advice is required?
- Why not use some other legal format?
- When to register?
- Who are the founders?

What is the starting point? The existing constitutional arrangements of an organisation will have a major bearing on how it should proceed. Pre-start and start-up groups that do not have a written constitution and are not already incorporated should be aware that any agreements already entered into need to be transferred to the new legal entity. Established enterprises that are already registered as charities or incorporated as companies, need to investigate two options: converting into a society, or creating a new independent society. Community buy-outs of existing enterprises need to be mindful of the practical arrangements for transferring the undertakings of the purchased business.

What type of legal advice is required? Setting up a co-operative society or community benefit society is a relatively specialised activity and not all solicitors or legal practices will be familiar with this legal form. Societies are registered by the Mutuals Team at the FSA and it will consider applications from organisations that have devised their own rules in accordance with the legislation. The alternative is to use a set of model rules offered by sponsoring bodies, a process explained later in this section.

Why not use some other legal format? This guide advocates the use of co-operative and community benefit society legislation as the most appropriate form for smaller enterprises that want to engage their communities as members and investors. There are other options, based around the company form that may be more appropriate for some larger initiatives requiring share capital in excess of £5m to £10m, or where the financial incentive to invest is stronger than the social incentive. This matter is addressed in more detail later in this section.

When to register? Determining the right moment to register a new society is subject to a number of considerations. Early registration can give an initiative some momentum, provide it with a legal identity, and limit the personal liability of the promoters. It also enables a society to begin the work of community engagement, allowing people to become members of the society. A consideration against early registration is the cost involved, pre-start groups may simply not have the resources to cover the cost of registration; and there is also a danger of adopting rules that will not be fit for the eventual purpose of the society.

Who are the founders? Any application to become a society must be signed by a minimum of three founder members. New societies must also appoint a secretary. Most governing documents empower the founders to appoint the first management committee or board of directors, who will govern the society until the first Annual General Meeting of the society is convened. It is easy to underestimate the significance of being a founder member, especially for pre-start and start-up groups that are entering a new phase of commitments and responsibilities. This can place a strain on relationships as new and additional demands are placed on the founders' time.

Choosing between co-operatives and community benefit societies

There are two types of society, a co-operative society and a community benefit society. Both types of society can issue withdrawable share capital, and pay interest on that share capital subject to the limitation placed on it by the FSA that interest rates should be no more than what is sufficient to attract and retain the investment. Although the FSA application form says that it is "unusual" for a community benefit society to issue more than nominal share capital (typically one £1 share per member), this does not mean that it is not allowed. A community benefit society can issue shares up to the legal maximum permissible to each individual member, currently £20,000.

> **A co-operative** is run for the mutual benefit of members who use its services. This is based upon the common economic, social and cultural needs or interests of the members. Typically, the common need or interest will define their relationship with the co-operative as a service user, customer, employee or supplier. A co-operative has open membership; there should be no artificial restrictions on membership, and membership should be open to anyone who meets the criteria. Recent guidance[1] from the FSA says that a co-operative can have investor-members who are not otherwise users of the society's services. A co-operative can pay interest on member share capital and a share of the surplus, or dividend, based on the level of transactions (customer-purchases, supplier-sales or employee-wages) with the society.
>
> **A community benefit society** is run primarily for the benefit of the community at large, rather than just for members of the society. This means that it must have an overarching community purpose that reaches beyond its membership. An applicant enterprise must also have a special reason for being a community benefit society rather than a company, such as wanting to have democratic decision-making built into its structure. Although a community benefit society has the power to pay interest on members' share capital, it cannot distribute surpluses to members in the form of dividends. A community benefit society can opt to have a statutory asset lock, which has the same strength as the asset lock for a charity and for a community interest company. This type of asset lock is not currently available for co-operatives.

There are pros and cons associated with both types of society. Co-operatives have the scope to pay members a dividend (See Section One), which can stimulate member loyalty and strengthen the business model. Community benefit societies, with a statutory asset lock, may provide greater reassurance to public funders and grant-giving bodies that none of their money can end up in private hands. Co-operatives might have greater appeal to members who are attracted by the benefits of mutuality and community; community benefit societies might be more appealing to members who put wider community benefit before their mutual interests.

Choosing between a co-operative or community benefit society structure is important because, while it

1 Investor membership of co-operatives registered under the Industrial and Provident Societies Act, 1965. Policy note by Michael Cook and Ramona Taylor. 2007

is possible to convert a co-operative into a community benefit society, it is not possible to convert a community benefit society into a co-operative.

To register a community benefit society, the FSA requires the applicant to give 'special reasons' for not registering as a company. Generally speaking, the FSA will accept any reason associated with the unique attributes of a community benefit society, ranging from member democracy to the statutory asset lock. The FSA wants to know what groups or categories of people will benefit from the creation of a community benefit society, and whether any limits have been placed on the amount of withdrawable share capital held by members. It also wants to know whether the society has charitable objects, and although it does not require societies to register as charities, societies that do have charitable objects may be required to register as charities by the Charity Commission.

Of the ten organisations participating in the Community Shares programme, four are community benefit societies (Brixton Green, FC United, Hurst Green and Sheffield Renewables) and three are co-operative societies (Slaithwaite, Oxford Cycle and Cybermoor Networks). Two more, Hastings Pier and Tutbury EcoPower plan to form community benefit societies. After much investigation, Ashington Minors decided not to proceed with a community share offer for the reasons explained later in this section. The choice between the co-operative and community benefit form was relatively straightforward for all nine organisations. Those that opted for the community benefit form are those that are more reliant on securing public funding, whereas those that chose the co-operative form are wholly reliant on trade with their customers and prospective members.

Other legal formats

The Introduction to this guide explained why co-operative and community benefit societies are the preferred legal formats for organisations offering community shares. The principal reason is that withdrawable share capital, which can only be offered by societies, has a range of unique attributes that makes it ideally suited to community investment. Chief among these attributes is the withdrawable nature of the shares. This provides investors with an established method for cashing-in their shares, without having to find a third-party buyer or rely on the society being listed on a stock market.

Withdrawability provides liquidity for investors in small enterprises. Larger enterprises can turn to stock markets to provide liquidity to their share capital. But, typically, even the smallest listed companies issue £5m to £10m in share capital, and are much larger than most community enterprises. Community and social enterprises with interest or dividend caps and asset locks would not be financially attractive to investors trading on a stock market. For the past three years work has been conducted on plans to establish a Social Stock Exchange, although the details of exactly what type of enterprise this market would cater for have yet to emerge.

There are alternative ways of providing liquidity. Three social enterprises, CafeDirect, the Ethical Property Company and Traidcraft, have successfully used the public limited company (plc) structure to raise capital from the public, and provide liquidity to their shareholders through a matched bargain market operated by stockbrokers Brewin Dolphin. A matched bargain market is where an intermediary matches sellers to buyers of shares in a given enterprise, at a price acceptable to both parties.

Company law does not provide for withdrawable share capital, and although it is theoretically possible to draw up a company share agreement that allows for withdrawability, it would not be as robust as the provision under society law.

Community Interest Company (CIC) legislation, introduced in 2005, provided a new regulatory framework governing the three main forms of company: a company limited by shares, a company limited by guarantee, and a public limited company. CICs were introduced after current financial promotions legislation was drawn up and hence there are no exemptions for CICs similar to those that exist for co-operative and community benefit societies.

Like any other company limited by guarantee, a CIC company limited by guarantee cannot issue shares, although it can promote the sale of bonds and offer membership as a separate consideration. There is provision for the creation of a CIC public limited company, but none have yet been established.

The government invested a lot of energy into enabling CICs to adopt a company limited by shares structure, which allows equity investment by individuals and at the same time protects the interests of communities. This was achieved through the following specific provisions:

- **An asset lock** preventing any residual assets in a CIC being distributed to members if a CIC is sold, dissolved or amalgamated;
- **A double dividend cap** which prevents a CIC from distributing more than 35% of its profits to shareholders in any one year, and limits dividends to a maximum of 20% of the paid-up value of the share. Unused dividend allowances can be rolled forward to future years but the 35% cap on distributions in any one year cannot be exceeded.

There is also a range of other regulatory requirements CICs must meet, which include passing a community interest test and producing an annual community interest report.

In common with other private or public companies, CICs limited by shares can issue shares that are transferable or redeemable, but unlike IPSs, they cannot issue withdrawable shares. There is no upper limit to how much an individual or entity can invest in a CIC. And there is no provision for democratic membership rights in CICs limited by shares. The voting principle behind all companies limited by shares is one-share-one-vote, so it is possible for one large shareholder to own the majority of shares in a CIC and therefore have majority control.

Since the introduction of CIC regulations in 2005, over 5,000 CICs have been established, but only a handful have used the form to raise community investment and there have been no examples of public limited company CICs. There may be a number of reasons why CICs are not used much for community investment purposes. Problems with the liquidity of transferable shares and the lack of exemption from financial promotions regulations are major factors. Other factors may include the rigid controls on shareholder dividends, and concerns that a minority of shareholders could have majority control.

Charity regulation offers very limited scope for community investment. Charities can and do issue bonds, but they cannot normally issue company share capital. Charities issuing bonds and other forms of debt, are usually exempt from regulation, although legal advice should be sought to check the specific circumstances of an offer.

Before embarking on raising capital through bonds, charities should consider the impact this type of financial promotion may have on their voluntary fundraising activities. Encouraging donors to become investors might have a lasting impact on their relationship with the charity. The problem with bonds, and all other forms of debt, is that eventually the capital has to be repaid. This means that the charity has to behave like a business and generate sufficient profit to repay capital. The only alternative is for the charity to find donors willing to pay off its debts to bondholders. In this sense, bond finance can only ever be a temporary solution to the funding needs of charities.

Determining the most appropriate legal form for an organisation will largely depend on its underlying purpose and objectives. For organisations pursuing charitable objects, and which are not overly reliant upon trade, then a charitable form is probably most appropriate, even though it will only be able to raise community investment in the form of bonds. For organisations that get most or all of their income through trade, and which also have clear community or social objectives, then either a society or CIC form will be most appropriate. Both these forms can be used to issue shares or bonds.

The choice between the society and CIC forms depends on the relative merits of their special features to the organisation concerned. Societies have four unique attributes: member democracy, withdrawable share capital, a limit on individual shareholdings, and a flexible limit on the interest paid on share capital. None of these features are available to CICs. However, all types of CIC have an asset lock, whereas only community benefit societies have the scope to adopt this feature. CICs are generally cheaper to register and maintain as a legal form than societies. However, unlike societies, CICs are not exempt from regulation when offering shares or bonds to the public, adding significantly to the cost of raising capital this way.

Converting from one legal form to another

For organisations that are already incorporated but have adopted a form which is not the most appropriate for community investment purposes, there are two options to consider: either to convert the organisation into a different form, or to establish a new legal entity. The second option is considered in the next sub-section.

It is possible to convert most legal forms, from one form to another. Companies can be converted into co-operatives or community benefit societies. Both types of society can be converted into CICs, or into private companies, although a special resolution is required, and community benefit societies must not be asset locked. Private companies can be converted into CICs, but a company limited by guarantee cannot be converted into a company limited by shares, even if it becomes a CIC. This is because there are no provisions in company law to allow such a conversion to take place.

Charities can also be registered as companies limited by guarantee or as community benefit societies, but not as companies limited by shares, except under special circumstances. Most charitable community benefit societies opt for exempt charity status with HMRC rather than registering with the Charity Commission. The rules governing exempt charity status are set to change in the near future. Further information on societies and charitable status in the context of community investment is provided in Section One.

Charities can be converted into CICs with the permission of the Charity Commission. However, if the charity is also a company limited by guarantee, it will have to retain this guarantee format as a CIC. A CIC can be converted into a community benefit society, but not into a co-operative society, because co-operatives do not have statutory asset locks.

More complex structures

If an existing enterprise is either unable or unwilling to convert into a society form, then establishing a new independent society is always an option. This may have its advantages. It reduces the risks for the parent organisation, and allows the new organisation the scope to develop its own reputation and brand. The parent organisation can still be involved as a shareholder and part-owner of the new organisation. But a potential drawback is that the parent organisation will not benefit from the consolidation of its current assets with the new investment. Also, potential investors might be more reluctant to invest in a new organisation, without a proven track record or any other financial reserves to draw on. The parent organisation might also be reluctant to share control of the new entity with community investors.

A number of societies participating in the Community Shares programme considered developing more complex structures for their share offers. FC United was initially encouraged to establish a separate society to finance and own its stadium, the argument being that it would protect the football club from the potential liabilities of the new stadium. However, in the end it was decided that the club should own the stadium and that there should be just one legal entity. As one member put it "What use is a stadium if there is no club, and what is a club without a home?"

Hastings Pier has taken a different view, planning that the pier itself should be owned by Hastings Pier and White Rock Trust, a charitable entity, and a separate operating enterprise, structured as a community benefit society, should invest in the infrastructure and management of the pier. Acquiring and renovating the pier will be dependent on securing public funds, which is why ownership of the pier should be vested in a charity. The society will rent the pier from the trust.

In contrast, Brixton Green, a community benefit society, hopes to acquire the freehold of the development site it has designs on. It will form partnerships with other entities, which will lease land from Brixton Green, with the other entities responsible for financing, developing and owning the long-term leaseholds of the buildings.

Ashington Minors joined the Community Shares programme hoping to sort out its ownership structure. Ashington Minors is a private limited company by shares. The nursery was purchased by Ashington Community Development Trust in 2007 from its founders, jointly financed by the Trust, two of the nursery employees, and a local business person. However, the parties involved failed to reach agreement about the ownership structure, and eventually the business person's interest was bought by the nursery itself, using a loan from the Trust to finance the deal. The families of children currently using the nursery were consulted about the option of community investment, and although they were not averse to the idea, most of them felt they simply could not afford to invest in the nursery. Ashington Minors are now considering converting the company into a CIC, to allay the concerns of Ashington Learning Partnership, the freeholders of the nursery building, about only charging a peppercorn rent to a private company.

Oxford Cycle Workshop Training (OCWT) was established as a community co-operative society in 2008 by Oxford Cycle Workshop, a workers' co-operative. The aim of OCWT is to encourage greater bike use by making it easier for people to maintain their bikes. Engaging the community by developing their cycle maintenance skills and providing workshop facilities is seen as the best way of achieving this aim. Creating a new society that would work alongside the existing workers' co-operative was seen as a good way of engaging customers while maintaining the autonomy of the workers' co-operative. But now it is looking to merge the two societies, along with a Cycling Club it established, recognising the shared interests of all the stakeholders.

Cybermoor is a community co-operative society, registered in 2002. The co-operative provides wireless broadband services to the local community. A subsidiary company, Cybermoor Services, provides consultancy services to other community broadband initiatives. Cybermoor is now seeking to raise additional capital from the local community to finance the next generation of local broadband connections, utilising a fibre cable it installed last year. It has opted to establish a new co-operative, Cybermoor Networks, to raise the necessary capital and to own the network assets. The rationale for creating a new society is to ensure that both societies are independent of each other, even though Cybermoor will be a major customer of Cybermoor Networks, and therefore heavily dependent on its trade.

Complex organisational structures can make it more difficult for members of the public to understand the risks associated with an investment proposition. A society should only raise capital for its own business purposes, and should not raise capital to invest in other legal entities that it does not own or control.

Society registration requirements

Societies are currently registered by the Financial Services Authority. The FSA website has a section devoted to the registration of new co-operative and community benefit societies, which provides all the necessary forms. The application form states that it takes 15 working days to examine each application. At the time of writing, the cost of registration ranges from £40 if the applicant is using model rules (although the sponsoring body may charge an additional fee), up to £950 if the applicant is not using model rules.

Applicants are required to submit a set of rules that must cover 14 matters required by the FSA. (See Box One.) Rules can cover additional matters as long as these matters do not conflict with legislation and are acceptable to the FSA. Once approved, a society is obliged to follow its rules, so it is important that it is committed to implementing all the rules it adopts, including those that are supplementary to the rules required by the FSA. Rules can be added, amended or rescinded, but only with the support of a general meeting of members and the permission of the FSA.

The application form also requires applicants to state whether they are registering a co-operative society or a community benefit society, and to provide additional details if they are registering the latter. The difference between these two types of society is explained later in this section.

Applications can be made to register new societies, or to convert an existing company, including a CIC into a society, subject to certain conditions. Organisations that are registered charities can only become one type of society, a community benefit society, as long as this is approved by the Charity Commission. Similarly, a CIC can only convert into a community benefit society, and must have a statutory asset lock.

Sponsoring bodies and model rules

Sponsoring bodies publish model rules that have been pre-approved by the FSA. The FSA publishes a list of sponsors on its website. Currently, it lists 22 sponsoring bodies, although there are only four sponsors that produce rules that are suitable for community investment and are marketed as such by the sponsoring body. These bodies are:

- Co-operatives UK
- Plunkett Foundation
- Somerset Co-operative Services
- Wessex Community Assets.

Energy4All also sponsors a set of model rules that are available only to the projects it works with as a developer.

These sponsoring bodies offer a full registration service, which includes offering advice on amendments to their model rules, and will submit applications to the FSA on behalf of their clients. Details of their charges are outlined later in this section.

The alternative to using model rules is to employ the services of a legal professional with knowledge and experience of formulating co-operative and community benefit society rules, or to write rules without professional support. The FSA does not require applications to be made by a professional person, although, as noted above, it does charge more for examining applications that are not based on model rules, and these fees are non-refundable, even if the application is rejected.

Most organisations choose to use model rules offered by sponsoring bodies, amended to suit their own particular circumstances. Co-operatives UK offers two sets of model rules, the Community Co-operative Rules and the Community Finance Rules, the latter being for community benefit societies. Wessex Community Assets (WCA) has developed model rules for community benefit societies called the Community Assets Rules. It also offers an amended version of these rules, called the Enterprise Investment Rules, which have been approved by HM Revenue and Customs as satisfying the requirements for Enterprise Investment Scheme (EIS) tax relief. Somerset Co-operative Services (SCS) has designed model rules for a multi-stakeholder co-operative, the Somerset Rules. It describes these rules as a template for the design of different types of multi-stakeholder co-operative ranging from a community land trust to a workers' co-operative. Finally, the Plunkett Foundation launched a new set of model rules for community ownership in November 2010, based on the community benefit society format. These model rules include an option to adopt rules that enable the society to raise substantial amounts of capital.

Seven of the organisations participating in the Community Shares programme are registered as societies. Cybermoor Networks, Oxford Cycle Workshop Training and Slaithwaite Co-operative used the Community Co-operative Rules. Sheffield Renewables and Hurst Green Community Shop and Centre used the Community Finance Rules. Brixton Green used the Wessex Rules. FC United of Manchester was registered in 2005 as a community benefit society, using model rules sponsored by Supporters Direct. FC United's rules were revised in 2010 to make them suitable for community investment.

What follows is an analysis of how these five sets of model rules deal with each of the 14 matters (A-N) that the FSA requires all co-operative and community benefit societies rules to address.

A. Name

Choosing a name for a society is usually a straightforward task. It has to be unique and distinct, it must not be misleading or offensive, or use terms that are classed as sensitive. The FSA website contains a guide to naming a co-operative or community benefit society, which goes into more details about all these matters. Getting the name right is very important when it comes to promoting a community share offer – it is the opportunity to encapsulate the whole project in a few memorable words.

B. Objects

Objects describe the purpose of an enterprise and the scope of its operations. The general advice when writing the objects clauses of any organisation's governing document is to ensure that they are broad and flexible enough to enable the enterprise to fully engage in trade. The sponsoring bodies all adopt a broad-brush approach to the rules on objects, although, in addition, the Somerset Rules invite applicants to state the mission of the society and commits the organisation to the ICA Statement on Co-operative Identity. The Plunkett Rules uses the term commitments to refer to objects, and also contains a statement explaining why the Society exists. It should be noted that to register as a co-operative society, it is an FSA requirement that the society should be carrying on "an industry, business or trade, whether retail or wholesale". This excludes co-operatives that are set up just as investment vehicles in order to invest in the activities of other societies or companies. This is reinforced by another requirement that "a society may not be a bona fide co-operative if it carries on business with the object of making profits mainly for paying interest, dividends or bonuses on money invested with or lent to it, or to any other person".

All the models, with the exception of the Somerset Rules, contain additional rules setting out the powers of the society.

Box One: FSA rules requirements

The FSA requires all applicants to submit a set of rules for the proposed society, together with information covering a range of other matters, including:

- Proposed date for the financial year end
- Type of society (co-operative or community benefit)
- Close links with other societies or companies (e.g. subsidiaries, groups, and/or holding companies)
- Use of model rules issued by a sponsoring body.

The rules must cover the following 14 matters:

Statutory matters	Details
A. Name	The name of the society.
B. Objects	The objects of the society.
C. Address	The registered office of the society to which all communications and notices to the society may be addressed.
D. Admission of members	The terms of admission of the members, including any society or company investing funds in the society under the provision of the 1965 Act.
E. Conduct of meetings	The mode of holding meetings, the scale and right of voting, and the mode of making, altering or rescinding rules.
F. Board members	The appointment and removal of a Committee of Management, and of managers or other officers, and their respective powers and remuneration.
G. Shareholdings	The maximum amount of interest in the shares of the society which may be held by any member otherwise than by virtue of the relevant legislation.
H. Loans and deposits	Whether the society may contract loans or receive money on deposit subject to the provisions of the said Act from members or others; and, if so, under what conditions, under what security, and to what limits of amount.
I. Terms and conditions for share capital	Whether the shares or any of them shall be transferable, the form of transfer and registration of the shares, and the consent of the committee thereto; whether the shares or any of them shall be withdrawable, and the mode of withdrawal, and the payment of the balance due thereon on withdrawing from the society.
J. Audits and auditors	The audit of accounts by one or more auditors appointed by the society in accordance with the requirements of the Co-operative and Community Benefit Societies and Credit Unions Act 1968. (Also covers audit exemption provisions.)
K. Terminating membership	Whether and, if so, how members may withdraw from the society, and provision for the claims of the representatives of deceased members or the trustees of the property of bankrupt members, or, in Scotland, members whose estate has been sequestrated, and for the payment of nominees.
L. Use of profits	The mode of application of profits.
M. Official documents	If the society is to have a common seal, provision for its custody and use.
N. Investments	Whether and, if so, by what authority, and in what manner, any part of the society's funds may be invested.

C. Address

This is the registered address of the named society. All the model rules make provision for this to be included.

D. Admission of members

These rules determine who can (and cannot) be a member. Under society legislation the minimum age of a member is currently 16, although this age restriction is set to be removed later in 2011.

Traditionally, co-operative societies and community benefit societies had different approaches to membership. Co-operatives tended to restrict membership to a single user group such as customers, suppliers or workers, but also practised open membership within that group, encouraging people who qualified for membership to join. Until recently, membership was not offered to people whose only relationship with the co-operative was that of investor. In 2006 the FSA published a policy note that supported the introduction of non-user investor-members to co-operatives. It considered practices elsewhere in Europe that restricted the voting powers of non-user members, but made no specific recommendations in this area, although it is considered to be good practice to limit the influence of non-user investor-members.

In contrast, community benefit society rules tend not to qualify the basis of membership. No distinction is made between users and non-users; instead, membership is aimed at people who support the objects of the society. Traditionally, community benefit societies did not practice open membership, but this is now changing with the growth in community investment, which relies on open membership.

This is reflected in all the community benefit society model rules. The Community Finance Rules and Plunkett Rules offer membership to anyone who supports the objects of the society. The Wessex Rules do not state any qualifying criteria for membership other than the purchase of a share.

The Community Co-operative Rules restrict membership to people "living, working or active within the community", but as the rules do not define community it is open to interpretation as to whether the community is geographic or a community of interest. It should be noted that the Community Co-operative Rules currently make no provision for paying members a dividend based on transactions, although this is likely to be amended in the near future.

The Somerset Rules propose a multi-stakeholder approach to membership, providing applicants with the scope to define multiple categories of membership, distinguishing between stakeholder roles, especially the difference between user and non-user roles. Users are beneficiaries and include customers, workers, suppliers and producers: essentially anyone who has a transactional relationship with the enterprise. Non-users are those whose role is primarily that of investor. This categorisation of membership enables two things to happen: it provides a basis for restricting the voting powers of non-user investor members (See: E. Conduct of meetings), and it permits different dividend rates to be paid to user members.

The Plunkett Rules also allow societies to adopt a multi-stakeholder approach to membership, dividing members into constituencies based on geography, the nature of their interest in the society, or any other relevant factor. This can be used to ensure that each constituency can elect at least one representative from among their number to the management committee.

The Wessex Rules and Community Co-operative Rules contain rules that allow members to opt for electronic communications with the society.

An interesting feature of both the Community Finance Rules and Plunkett Rules is the provision to introduce an annual subscription fee as a condition of membership. Annual subscriptions are a useful way of covering the cost of providing membership services and can assist the society in maintaining an up-to-date membership list, if members are required to pay the annual fee. This matter is addressed in more detail in Section Four (see: Membership Offers). The Plunkett Rules contain another innovative feature, requiring the society to develop, maintain and report on its membership strategy, which may be a way of reinforcing the importance of community engagement for the society.

The Wessex Rules contain additional rules that allow for nominee shareholdings. They allow the board to approve up to five nominees, who can hold shares on behalf of their clients, and exercise proxy votes at general meetings, subject to restrictions. Nominees will normally be independent financial advisers or the managers of investment funds. While such arrangements may make it possible to attract more investment from wider sources, they could weaken the community-building aspects of community shares. An amendment enabling nominee shareholdings is available for the Somerset Rules.

E. Conduct of meetings

Members' meetings lie at the heart of community engagement. All societies are required by law to hold general meetings of their members on at least an annual basis to oversee the affairs of the society. Section Two described what must be addressed at annual general meetings, and how they can be used to encourage community engagement. The rules of a society set out how these meetings should be conducted.

All five sets of model rules include rules that provide for annual general meetings, where the annual report and accounts are considered, auditors are appointed, directors are elected, and decisions are taken on the use of profits and any resolutions to change the rules of the society.

All five models also set a quorum for general meetings, in most cases, 10% of the membership. This could be high for organisations with memberships that run into the thousands. Consideration should be given to ensuring that the quorum is realistic and achievable. Both the Wessex Rules and the Somerset Rules allow members to nominate a proxy, which in the case of the Wessex Rules can count towards the quorum. The Wessex Rules also contain provisions for postal ballots, at the discretion of the board of directors.

All the model rules describe how votes must be conducted in meetings, and the arrangements for a simple show of hands, compared with a secret ballot. These rules also set the majority required to amend, rescind or add new rules, ranging from a two-thirds majority in the Community Finance Rules and Plunkett Rules, to a three-quarters majority in the Community Co-operative Rules and the Wessex Rules. The Wessex Rules contain an additional rule that allows 10% of the members present to block a resolution to wind-up the society.

The Somerset Rules have far more complex arrangements for the conduct of meetings to accommodate this model's multi-stakeholder philosophy. These arrangements are designed to prevent non-user investor members ever having more than 25% of the total vote on any matter. Furthermore, non-user members are prevented from voting on resolutions to wind-up the society or convert it into a company. Voting is weighted in favour of user-members, who have 75% of the voting power, spread proportionately between the different categories of user-members. The different categories of members can either cast their vote as a block vote (decided at a separate meeting before the general meeting) or as individual votes at general meetings, weighted according to their category. The Somerset Rules also contain provisions to allow a minority one-third vote to pass resolutions calling on the board to draw up and publish policies in specified areas.

In addition to all this, the Somerset Rules include further rules designed to protect the interests of a broader range of stakeholder than just members. Provision is made for the convening of a Commonwealth Council, to provide "oversight" on "key decisions" made by general meetings. The Commonwealth Council is composed of a wide range of people, including non-members, in order to encompass all possible stakeholder interests. The rules specify a list of key decisions, and if a Commonwealth Council has been convened, it has the powers to veto these decisions until agreement can be reached with the board.

F. Board members

The good governance of a society depends on having an active board of directors, elected by the members, to oversee the affairs of the society. In electing a board, members are delegating their sovereign powers to directors. The directors are accountable to the membership, and are responsible for supervising the managers and executive staff who run the business. Non-charitable societies can elect employees as board members. However, this raises a separate matter about the composition of boards, and the utility of non-executive directors. A non-executive board can be a highly effective support mechanism for executive staff. Non-executive board members can be paid for their services.

The FSA requires all co-operative and community benefit societies' rules to state how members of the "committee of management" will be appointed and removed, and similarly for the officers of this committee, and the arrangements, if any, for remuneration. Under society legislation the minimum age for board members is 18.

The model rules vary in their approach to these requirements. The Community Co-operative Rules require a minimum of three and maximum of 15 board members, with powers to co-opt up to a third of the board. The Community Finance Rules have the same minimum, but a lower maximum of 12 board members; they also provide for co-option and for the appointment of two professional external directors. The Plunkett Rules require a minimum of four and a maximum of 12 board members, a quarter of whom may be co-opted persons. The Wessex Rules require at least two directors, but do not specify a maximum number, nor do they require directors to be members. The Somerset Rules specify the same minimum and maximum number of directors as the Community Finance Rules.

All five models require the board to be elected by members, with four of them specifying that at least a third of directors must stand down each year; the Community Co-operative Rules require all directors to stand down each year, although as with the other model rules, they may seek re-election. All the model rules, except the Plunkett Rules, allow board members to be paid for their services to the society, although the Plunkett Rules do allow the board to receive expenses and for the secretary to be paid.

All the models make provision for removing directors from office, although there are some differences in provision. All except the Wessex Rules, allow directors to be removed by a majority vote at a general meeting of members; the Plunkett Rules and Wessex Rules give this power to the board itself. All five models enable directors to be removed if they are declared bankrupt, and all except the Plunkett Rules allow directors to be removed if they miss three consecutive board meetings, or are deemed medically incapable of carrying out their duties as directors.

The model rules also vary slightly on the appointment of officers. All co-operative and community benefit societies are obliged by law to appoint a secretary. This is the only officer post specified in the Wessex Rules. All the others specify a secretary and treasurer, and both sets of model rules produced by Co-operatives UK also specify the appointment of a chairperson. The Plunkett Rules go one further, specifying four officer posts, secretary, treasurer, chair and vice-chair.

Even though it is not required by the FSA, all five models provide rules about proceedings at board meetings, focusing mainly on quora and the role of the chair. The Community Finance Rules make specific provision for meetings to be held by phone or by means of other forms of electronic communication. These Rules and the Plunkett Rules and Wessex Rules also allow for board resolutions to be passed by signed consent, rather than at meetings.

The Plunkett Rules go even further in terms of governing the behaviour of board members. The Rules require the board to adopt a code of conduct for members of the management committee, setting out their duties and the standards of behaviour to which they are expected to adhere.

The Wessex Rules contain two additional rules that are not required by the FSA. The first requires directors to obtain legal advice when issuing any form of financial promotion. The second places a requirement on the society to indemnify its directors, officers and auditors against any liability they may incur in the performance of their duties. The Somerset Rules also require the board to obtain "expert, independent advice before making any issue of shares".

G. Shareholdings

All co-operative and community benefit societies must have rules that stipulate the minimum and maximum shareholding a member may have. All community share offers must be within these limits. The minimum shareholding in many societies is £1. It is set this low to ensure there are not financial barriers to membership. However, many societies will set much higher minimum investment levels when making a community share offer in order to reach their targets.

Most societies set their maximum shareholding at the maximum permitted by law, currently £20,000. This maximum does not apply to corporate members that are registered co-operative societies or community benefit societies, where no upper limit applies. All five sets of model rules refer to an upper limit based on the maximum permitted by law, although the Somerset Rules specify a maximum of £50,000, which limits shareholding by other co-operative and community benefit societies in the new organisation, and another part of the same rule prevents any member from owning more than 25% of the total share capital. The Community Co-operative Rules contain a similar rule, preventing any one member from owning more than 20% of the total share capital if the society has more than ten members.

The Plunkett Rules allow societies to choose between two versions of its rules regarding share capital. One version (A) provides for shares that carry no right to interest. There is a fixed price per share coupled to a provision that if the member holds not more than ten of these shares, the shares are forfeited and cancelled on cessation of membership. The other version (B) of the rules allows for interest to be paid on shares and provides for a public share offer.

All the models also include rules on the minimum shareholdings of members. They all allow the boards to determine a minimum shareholding and make provision for members to purchase shares in instalments. The Somerset Rules also allow the board to determine the minimum shareholding, although the rules specify that this minimum must not exceed £50 for user-members.

Unless a society is only concerned with building its membership rather than raising share capital, a minimum investment significantly more than £1 is advisable. In practice, societies making community share offers have set minimum shareholdings ranging from £50 to £1,000. FC United set its minimum at £200.

Given that the annual cost of servicing a member can range from £10 to £20, this can add significantly to the cost of share capital. The Community Finance Rules and Plunkett Rules allow societies to charge members an annual subscription to cover the costs of membership, in which case a lower minimum investment may be practical, but otherwise societies should be mindful of the costs of servicing and maintaining a large membership.

H. Loans and deposits

Co-operative societies and community benefit societies rules must say whether they will allow members or others to hold deposits or make loans to the society and, if so, under what terms and conditions. All the models have rules which expressly forbid deposit taking, but allow the society to borrow up to £10m (but only £0.25m in the Plunkett Rules), including from members as well as other sources such as banks or commercial lenders. Three of the models specify an upper limit to the interest paid on loans of base rate plus 3%, while the Wessex Rules refer to a rate not higher than that needed to attract the loan. The Plunkett Rules do not address this matter. These provisions mean that societies adopting any of these models can issue bonds as well as withdrawable share capital. This may be an important way of attracting additional capital, especially from members who already have the maximum permitted shareholdings.

The distinction between loans and deposits is crucial. Deposit-taking is a regulated activity, whereas accepting loans for the purposes of the business is not regulated on that basis. Non-transferable debt securities are exempt from prospectus requirements, and a society is allowed to make non-real-time communications about its own debt securities without complying with the financial promotion rules, which would otherwise require an authorised person to approve the material communicated.

I. Terms and conditions for share capital

Co-operative and community benefit societies can issue share capital that is transferable and/or withdrawable, or neither, and the rules must state what type of share capital the society intends to issue, and the terms and conditions applying to these shares.

Very few societies issue transferable shares. Transferable share capital may be less attractive to investors because they have to find a buyer when they want to sell their shares. There are no established secondary markets for transferable share capital issued by societies, nor any stockbrokers with experience of operating matched bargain services in this type of share. Societies can operate their own matched bargain service, by maintaining lists of people who want to buy and sell their shares, but this can be a very slow way of providing liquidity. Also, transferable share capital may, under some circumstances, be subject to regulation: any society intending to issue or trade in transferable share capital is advised to obtain legal advice on how it can be promoted. However, Energy4All has successfully helped a number of co-operatives make regulated offers of community shares that are transferable and withdrawable. In certain circumstances transferable shares may be more appropriate, especially if the society wants to raise larger amounts of capital (above £1m) or where an extended period of non-withdrawal of capital would improve cash flow.

Only the Somerset Rules make any provision for transferable share capital. These rules allow transferable share capital to be issued to non-user members, and, as is common for societies, for the board to have the right to refuse the transfer of shares to a person of whom they do not approve. The Somerset Rules also provide for withdrawable share capital, which can be issued to any category of member.

Withdrawable share capital is the norm for societies, although there are major differences in the terms and conditions adopted by societies for this type of capital, which in turn affect the liquidity of the shares and the capital flows of the society. These terms and conditions also have a bearing on how withdrawable share capital is treated in the accounts of the society.

All the model rules give the board the discretion to suspend the right of withdrawal. This rule is necessary for withdrawable share capital to be treated as equity, not debt, on the balance sheet of the society. It also has major implications for investors, who must be informed of this fact when they are invited to invest in the society.

Another reason for having rules that allow for the suspension of withdrawals is the length of time it may take for a new investment to generate sufficient profits to be able to cope with withdrawals. Societies need to plan for the liquidity of their share capital, and reflect these plans in the terms and conditions of their shares. Societies planning to apply for Enterprise Investment Scheme (EIS) tax relief also need to make it clear that withdrawals are suspended for at least the first three years of trading. Wessex Community Assets offers a specially adapted set of its model rules that meet the relevant criteria for EIS.

The rules should also state what period of notice a member must give when they ask to withdraw some or all of their share capital. Each of the four model rules has a slightly different approach to this. The Community Co-operative Rules set a minimum period of notice of 13 weeks, whereas the Community Finance Rules set it at three months, and the Wessex Rules at 180 days minimum. The Somerset Rules do not state a minimum period of notice, which means that the board can decide how long they take to respond to a request for withdrawal, unless the offer document through which the shares were sold states a minimum notice period for withdrawals.

Version B of the Plunkett Rules restricts withdrawals for an initial minimum period of five years, and then requires members to give at least three months notice of withdrawal, with further limitations on the total amount of share capital that can be withdrawn in a financial year.

Another common condition applied to withdrawable share capital is the right of the board to reduce the value of shares. This right is usually linked to an auditor's assessment that the net asset value of the enterprise can no longer support the full value of the share capital, therefore justifying a temporary or permanent reduction in share value. The Plunkett Rules are the only model not to contain this provision.

Uniquely, the Wessex Rules allow a new class of withdrawable share to be issued for a "special purpose". These special-purpose shares can have different risks and rights attached to them, at the discretion of the board, including a different rate of interest. These special-purpose shares can be reduced in value according to the performance of the special-purpose fund. The Community Finance Rules and Plunkett Rules also contain a provision that allows the society to charge administrative costs for the withdrawal of share capital.

The terms and conditions applied to withdrawable share capital have a big impact on the liquidity of share capital and therefore its attractiveness to potential investors. It is very important to ensure that the rules address all the terms and conditions a society will want to present in its offer document. Enterprises should carefully consider what amendments to the terms and conditions applicable to share capital would be beneficial before adopting any set of model rules.

J. Audits and auditors

All co-operative and community benefit societies are required to have a rule specifying their obligation to appoint an auditor in accordance with the relevant Act. Societies can, if their rules permit it, pass a resolution at their AGM exempting them from a full professional audit, if their turnover and assets are below a prescribed level.

This is covered by all the model rules, which allow societies to apply for the relevant exemptions. Some of the models also have additional rules stating the statutory obligation to make annual returns to the FSA.

K. Terminating membership

Rules governing the termination of membership have important long-term consequences for societies that promote community investment. They enable a society to manage their membership and make sure members remain in touch with the enterprise, and do not become an unnecessary burden as dormant or untraceable members.

Provision must be made for the different circumstances under which membership of the society may be terminated, and the arrangements for handling terminations. All the model rules allow for members to cancel their membership, or for membership to be terminated if the member no longer satisfies the criteria for admission. All the models, with the exception of the Wessex Rules, also allow the board to expel members under certain conditions. The Community Finance Rules allow membership to be terminated if a member fails to pay the annual subscription fee. The Somerset Rules allow a society to cancel membership of any person failing to respond to communications over a period of two years. The Plunkett Rules allow a society to remove as members any person it has lost contact with, having followed agreed procedures.

The models differ in the precise arrangements they make for handling the termination of membership. The Community Co-operative Rules enable the society to convert withdrawable share capital into loans repayable within three years, if the right to withdraw share capital has been suspended. The Somerset Rules contain a similar provision, except that the loan is repayable over two years rather than three, whereas the Plunkett Rules do not state the term of the loan under such circumstances. Version (A) of the Plunkett Rules states that members with no more than ten shares will forfeit those shares if they cease to be a member, with the capital transferring to the general reserves of the society.

L. Use of profits

The rules regarding the use of profits differ for co-operative societies and community benefit societies. Co-operatives are designed for the mutual benefit of members, and may therefore decide to use some of their surpluses to pay a dividend to members, based on their level of transactions with the co-operatives. The Somerset Rules allow up to 20% of profits to be distributed to user-members based on their contribution to the co-operative, and because this model allows for different categories of user-member, there is scope to offer different dividend rates to these categories. The same model rules also allow up to 80% of profits to be used to pay interest on non-user share capital, while limiting the interest paid on user-member share capital to base rate plus 3%. It should be remembered that the FSA states that interest rates on share capital should never be more than is sufficient to attract and retain the investment.

The Community Co-operative Rules also allow profits to be used to pay dividends based on transactions, and to pay interest on share capital not exceeding 5% per annum or 2% above the Co-operative Bank base rate.

The FSA requires co-operative societies to use profits equitably, but also says co-operatives should not be run primarily to make profits for distribution. This stops short of the ICA Statement on Co-operative Identity, which requires co-operatives to use at least some of their profits to create "indivisible reserves".

Both sets of model rules for co-operatives embody the principle of indivisible reserves to some extent. The Community Co-operative Rules mention the statutory possibility of dissolution by three-quarters of the members signing an instrument of dissolution and expressly forbid any residual assets being distributed to members, requiring instead that they are transferred to some other non-profit body subject to the same restrictions. Solvent dissolution is also possible by members voluntarily winding up under the Insolvency Act 1986. The Somerset Rules require at least 20% of residual assets to be transferred to a common ownership or asset locked body, but do allow the distribution of the remaining residual assets, reserving up to 20% for user members with the remainder going to non-user members.

The FSA requirements for community benefit societies are much clearer: "the society's rules must not allow either profits or the society's assets to be distributed to the members". This is reflected in all the model rules for community benefit societies, which make it clear that members cannot benefit financially if the society is wound up or converted into a company. However, the Wessex Rules and Plunkett Rules go one step further by providing a statutory asset lock, as determined by the Community Benefit Societies (Restriction on

Use of Assets) Regulations 2006. This statutory asset lock can be introduced as an amendment to the Community Finance Rules.

While community benefit societies cannot pay dividends to members, they are allowed to use their profits to pay limited interest on share capital. The Plunkett Rules set a maximum interest rate of no more than 2% above the base rate of the Co-operative Bank. The Community Finance Rules are more flexible in that they say interest rates cannot exceed the minimum rate necessary to obtain and retain the capital. The Wessex Rules do not specify any principles determining interest rates.

M. Official documents

The FSA requires the rules to state whether the society intends to have a 'common seal', a device for stamping official documents such as share certificates, and if it does have a common seal, to state how it will be used. All the model rules except the Somerset Rules make provisions for a common seal or its equivalent. The Community Co-operative Rules, the Community Finance Rules and the Wessex Rules allow societies to decide whether they will opt for a common seal.

The law does not require societies to have a common seal or to issue share certificates, although if a society decides against issuing share certificates it should make alternative provisions so that members know how much share capital they hold.

There is a strong case for societies that intend to pay interest and/or dividends, or that plan to charge members an annual subscription fee, to introduce individual share accounts for members. Instead of sending out cheques for interest and/or dividend payments, or share certificates worth the same amount, the society could send members an annual statement of their share account, listing all receipts, withdrawals and charges. This would have the added advantage of automatically re-investing all interest and dividend payments, as well as enabling societies to charge an annual subscription fee without having to get members to make an annual payment. In order to manage share accounts this way, a society would need to have a 'lien on shares', which is the right to offset a member's debt against their share capital. All the models, except the Plunkett Rules, contain this rule.

N. Investments

Section 31 of the Co-operative and Community Benefit Societies and Credit Unions Act 1965 allows societies to invest funds in other corporate bodies and local authorities. The model rules produced by Co-operatives UK and Plunkett make specific reference to these powers in their rules, while the Wessex Rules provide these powers in a more general rule about the powers of the society. The Somerset Rules, while allowing the society to invest funds, require that individual investments of more than £10,000 must be based on a social investment policy drawn up by the board. This model also classes some investments as 'key decisions', which are subject to special rules (See E. Conduct of meetings).

Additional rules

All the models contain additional rules over and above the requirement for registration with the FSA. Below is a summary of these additional rules, together with an explanation of how these rules may assist community investment, where this is the case.

Secondary rules: Both sets of Co-operatives UK model rules contain provisions for societies to develop secondary rules, as long as these rules are consistent with co-operative and community benefit societies legislation. The Somerset Rules make similar provisions, referred to as standing orders. A society does not require the approval of the FSA to amend, rescind or add to its secondary rules. However, it is a matter of good practice to have secondary rule changes approved by general meetings.

Rules to support on-lending activities: The Wessex Rules contain provisions for a society that intends to raise capital for the purposes of on-lending. On-lending can be construed as a regulated activity, and any society planning to use this provision should seek legal advice on its regulatory position.

Somerset Rules: The Somerset Rules has additional rules designed to assist in the governance of a multi-stakeholder co-operative, and to embed co-operative values and principles. They include provisions for member education, the recognition of key decision areas affecting the mission and purpose of the co-operative, the creation of a

Commonwealth Council, relationships with the wider co-operative movement and the adoption of social accounting practices.

Registration costs

Registering a society is generally more expensive than registering other forms of corporate entity, although, arguably, the cost of registration is higher because it also includes the cost of legal advice to develop a governing document that is fit for purpose.

For organisations that develop their own rules and apply directly to the FSA, there is a non-refundable fee of £950 charged by the FSA to examine the application and rules, and to register the society if the application is satisfactory.

Co-operatives UK currently provides a free service for organisations registering with their Community Co-operative Rules, although it does pass on the FSA charges for registering with model rules, which are £40 if there are no amendments, £120 for up to six amendments, £350 for between seven and ten amendments, and £950 for more than ten amendments. The fee for registering using the Community Finance Rules are £660+VAT if there are no amendments, £790+VAT for up to six amendments, £1,070+VAT for between seven and ten amendments, and £2,000+VAT for more than ten amendments. These fees include legal advice on amendments and the drafting of amended rules.

The Plunkett Foundation charges £475+VAT for registration and passes on the FSA charges, outlined in the above paragraph, for amendments to its model.

Wessex Community Assets charges a basic fee of £500+VAT to register using the Wessex Rules. Amendments cost an additional £100+VAT for up to six rule changes. An extra fee is payable if more than six rule changes are required. These fees cover the cost of all advice and support on amendments and changes to the rules, but not the FSA fees.

Somerset Co-operative Services charges a basic fee of £190 (or £90 plus three instalments of £40 each) to register using the Somerset Rules. This fee includes an hour's free advice; any advice beyond the first hour is charged at an hourly rate of £50. A number of standard amendments are available free of charge; bespoke amendments cost £70 per rule.

Obligations of registration

Once registered, a society must keep proper accounts, submit an annual return to the FSA, and let the FSA know of any change relating to its registered office. It must also apply to the FSA to amend any of its rules or to change its name. Amendments are not valid until they are registered and approved by the FSA. Societies are legally obliged to be run strictly in accordance with their registered rules, and to inform the FSA if they no longer wish to be registered.

Annual returns

Registered co-operative and community benefit societies are required to make annual returns to the FSA. There is a standard form that should be completed by the society's secretary, and returned to the FSA within seven months of the society's financial year end. The form must be accompanied by a set of accounts. If the turnover of the society exceeds £5.6m (or £250,000 if the society has charitable objects), or its assets exceed £2.8m, these accounts must be subjected to a full professional audit. This also applies to any society that is a subsidiary, any society that has subsidiaries, or any society engaged in deposit-taking activities.

Societies with a turnover not exceeding £5.6m, or assets not exceeding £2.8m, can, if their rules permit it, and a resolution has been passed at their AGM, get exemption from a full professional audit, and instead submit an accountant's report verifying the accounts. Unaudited accounts, verified by the board, can be submitted if the turnover does not exceed £90,000. If the society's turnover and assets are below £5,000, and it has fewer than 500 members, then it can resolve to submit a lay audit, verified by someone who is not a director or officer of the society.

All registered societies also have to pay an annual fee to the FSA, known as a periodic fee. This fee is on a sliding scale, currently ranging from £55 for organisations with total assets not exceeding £50,000, up to £425 for societies with total assets exceeding £1m.

Section Four: The offer document

Financial promotions

Inviting members of the public to invest in an enterprise is a regulated activity, covered by the Financial Services and Markets Act 2000. Statutory regulation normally provides some protection for investors; they have the right to complain to the Financial Ombudsman, and they may be eligible for compensation from the Financial Services Compensation Scheme. But some types of financial promotion, including most of those described in this guide, are exempt from regulation, or fall outside the scope of the Act.

Even in the absence of statutory regulation, there can still be a legal liability to investors. Those communicating information about an investment opportunity or advising people about an offer, will have to pay damages, and may have the investment contract set aside, if the torts of deceit or negligent misrepresentation have been committed, if a contract term is broken, or if the Misrepresentation Act 1967 applies. This may well be the case if losses were incurred by an investor who relied on the document, information, or advice in deciding to enter the investment contract and if the loss was due to a false or misleading statement of fact or any negligent statement. It is therefore vital that all information provided in documentation, on videos or websites, at public meetings, and in any other communications with potential investors is accurate, is not misleading, and is the result of careful consideration. The lack of statutory regulation, and consequently more limited protection for investors, underlines the importance of developing robust standards of voluntary regulation and good practice.

The Introduction to this guide mentioned a proposal by Co-operatives UK to establish a Community Shares Unit. One of the proposed functions of this Unit would be to act as a co-regulatory body for community share offers, working with government, experts, professionals and practitioners to establish high standards of practice for community share offers. This section is a preliminary attempt to articulate these standards, and to provide guidance to practitioners about what is expected of them when they are making an offer.

The basics

Before starting work on developing any form of community share offer, there are five basic questions that need to be addressed:

- What is the offer for?
- What is being offered?
- Is now the right time?
- Are the targets realistic?
- Are the risks known and understood?

What is the offer for? Before making any form of community share offer it is very important to be clear about how much capital is required, what the money is wanted for, and how the capital raised will be used. Clarity is the key, as are unambiguous goals and targets. Most offers fail because the promoters are unclear about how much money they are trying to raise, what they will do with the money when they get it, and the timescales to which they are operating.

What is being offered? Most people are totally unfamiliar with community shares, and are likely to base their picture of community shares on what little they know about shares in companies traded through stock markets. Explaining how community shares work and how they are different from conventional, speculative shares will help potential investors decide whether they want to join. Potential investors need to know that they could lose some or all of the money they invest (see below), that the only way of getting their money back is by selling their shares back to the society, that they have to give notice of their intention to withdraw share capital, and that directors have the right to refuse requests for withdrawal. They also need to know what the social and financial return on their investment will be, and the evidence for these forecasts. The Community Shares programme has produced a guide called Investing in Community Shares, aimed at the general public, which explains in non-financial terms the basic concepts and mechanisms of community shares, and is free to download and distribute. The Financial Services Authority also provides guidance on withdrawable share capital aimed at the general public, through its on-line Money Advice Service (www.moneyadviceservice.org.uk)

Is now the right time? There are two time factors to consider. Is now the right time to be raising capital for the society, or would it be better to postpone the offer until the society is clearer about its capital requirements, or better understands the risks it is facing? The success of community share offers often depends on lots of preparatory work in community engagement, making sure the community supports the purpose of the society, and is ready to invest. The second factor is whether the correct dates are chosen for inviting the public to invest. Are there any major holidays during the offer period, or any other factors that may affect how much the public can afford to invest at that time?

Are the targets realistic? Again, there are several factors to consider. Are the target amounts and timescales specific, realistic and achievable? Nothing undermines confidence in an offer more than the discovery that the targets were set too low and insufficient capital has been raised to enable the investment activity to proceed. Is the amount of capital required proportionate to the size of the community the offer is targeted at?

Are the risks known and understood? Even the most professional and expertly executed plans can go wrong, and this lack of certainty should always be made clear to potential investors. They need to know they risk losing some or all of the money they invest, without recourse to compensation. They should also be told that their shares will never go up in value but could go down, and that any forecast financial returns are not guaranteed. Investors may accept these risks if the community purpose and social returns are strong and clear.

Investment warnings

All community shares offer documents should make it absolutely clear that anyone buying community shares could lose some or all of the money they invest, without the protection of the government's Financial Services Compensation Scheme, and without recourse to the Financial Ombudsman Service. This warning should be prominently positioned in all offer documents and expressed in plain English.

In the past there has been a tendency to express such warnings in legal terms, with references to the relevant legislation and regulations that are difficult to understand and possibly intimidating for the general public. Some documents tend to bury such warnings in the small print.

It should always be remembered that an offer document, and all forms of media promoting a financial offer, including websites, public meetings, letters, emails, and social networking activities, constitute part of the contract between the society and the investor. The inclusion of statements urging the reader to seek expert legal or financial advice about the offer document does not absolve the society of its responsibilities.

Co-operatives UK has a Code of Practice for member societies issuing withdrawable share capital. This Code requires societies to warn investors of the risks associated with investment. A new Code is currently under review. It is proposed that all offers should include the following statement:

- "As a member and shareholder of [...] society you own the society. If the society is unable to meet its debts and other liabilities, you will lose the whole amount held in shares. This may make it inappropriate as a place to invest savings.
- The Financial Services Compensation Scheme, which applies to bank accounts, does not apply to your share account. The society, unlike banks

and building societies, is not subject to prudential supervision by the Financial Services Authority.

- Your investment in your share account is withdrawable without penalty at the discretion of the Board under the society's rules.
- Your investment in your share account receives interest but does not enjoy any capital growth. It is primarily for the purpose of supporting your society rather than making an investment. As a society, the maximum return offered to investors by way of income will always be limited.
- The Financial Ombudsman Service does not apply to your share account or your relationship with the society, but under the society rules any dispute may be the subject of arbitration by [insert as applicable]."

Additionally, community benefit societies with a statutory asset lock may wish to point out that their shares cannot increase in value, and in the event of the society being wound up, any residual assets will be transferred to another asset-locked body.

Four types of offer

The unique attributes of withdrawable share capital in co-operative and community benefit societies mean that the regulations and standards governing financial investment promotions in companies issuing transferable share capital are wholly inappropriate for societies. One of the major differences is that withdrawable shares can be issued for different purposes at different stages in the development of a society, resulting in the need for different types of offer document.

Community investment can be appropriate at any phase of development, ranging from pre-start proposals through to mature community enterprises that need new capital to consolidate their trading position. In developing this guidance it is recognised that different types of offer document are needed to address the different development needs of enterprises. Table One describes four different types of offer document, and shows how they relate to the key development phases experienced by many community enterprises. These phases are described more fully in Section One.

Not all invitations to join a co-operative or a community benefit society should be treated as invitations to invest. This is why the first type of offer document is called a membership offer. There is a long tradition of societies offering membership based on the purchase of a single share, usually priced at £1. Some of these societies also charge an annual subscription fee, which can be significantly more than £1, depending on the membership services on offer. It would be inappropriate to apply the same standards to an offer document where the public is being invited to part with £1, to another type of offer, where they may be invited to invest up to £20,000.

Three of the societies participating in the Community Shares programme started with membership offers. Oxford Cycle Workshop Training offers membership for an annual fee of £10. In return members get access to the workshop facilities and discounts on training courses. It currently has over 350 members. Brixton Green is aiming to recruit 5,000 members, one in ten of the local population, as part of its campaign for the regeneration of part of the centre of Brixton. Membership costs just £1, and is being promoted using an innovative membership scratch card, which can be purchased through local retailers. FC United of Manchester has over 3,400 members, each of whom pays a £12 annual membership fee.

Pioneer offers are appropriate for new ventures at the pre-start phase of development. They may also be appropriate for helping to finance the preparation work for acquisitions and transfers. Developing initiatives at these phases of development can be expensive and highly risky. While some groups are able to obtain small grants to cover some of their development costs, many other groups end up using their own resources, and often money donated by their keenest supporters, volunteers, activists and champions. Instead of supporters making donations in an ad-hoc fashion, a pioneer offer would allow them to invest in the enterprise and, if the venture is successful, be rewarded by the possibility of one day recouping their investment.

Sheffield Renewables and Hurst Green Community Shop have both experimented with pioneer offers. Sheffield Renewables raised £6,000 from 12 members, an amount that was matched by an investment in share capital from Key Fund. This risk capital has been used to meet some of the £50,000-plus development costs it has already incurred in endeavouring to become investment-

Table Three: Offer documents and development phases

Starting points	Community share offer types			
Pre-start		**Pioneer offer**: a high-risk offer aimed at known supporters, to raise funds to spend on getting investment ready.		
Start-up				
Acquisition and transfers	**Membership offer:** the purpose is to recruit members rather than raise investment capital.		**Time-bound offer:** subject to a target amount and deadline for completion of the offer. Investors refunded if the target is not met.	
Early-stage growth				**Open offer:** members can invest and withdraw shares at any time, subject to terms and conditions.
Later-stage growth and consolidation				

ready. Hurst Green has also raised £6,000 but from only three members, again matched by an investment from Key Fund.

Time-bound offers are offers that seek to raise a target amount of capital for a specific investment-ready project within a specified timescale. If the offer fails to achieve its targets, or any of its contingencies, then the money is returned to investors and the investment project does not proceed. The target audience for time-bound offers can be the community the enterprise will serve, and beyond. This places an even heavier duty on the promoters to ensure that the offer is accurate, transparent and achievable.

Two Community Shares societies have made time-bound offers. Slaithwaite Co-operative raised the £15,000 it needed in just two weeks to finance the community buy-out of the local greengrocery, now trading as Green Valley Grocers. FC United of Manchester is aiming to raise £1.5m through its time-bound offer, launched in September 2010. This is the largest unregulated offer ever to be made of withdrawable share capital. At the time of writing it had raised over £1.4m towards this target. Other Community Shares societies planning to launch time-bound offers in 2011 include Cybermoor Networks and Sheffield Renewables.

Open offers are only appropriate for established enterprises that have a track record to support their investment offer. There are a number of situations where open offers are appropriate. For instance, societies that trade with their community will want to invite new customers to become members, and by making an open offer they can attract new investment and provide liquidity for existing members. Open offers can also be an appropriate way of building up capital to fund the organic growth of the business, reducing dependency on debt. The financial return offered by the society is likely to have an impact on the flow of capital, so, maintaining competitive interest rates, within the limits appropriate to a society, might be an important factor in attracting and retaining sufficient capital.

The only Community Shares society currently making an open offer is Slaithwaite Co-operative. It has increased its membership from 120 when it first launched, to 163 members by the end of 2010. Share capital has more than doubled from £15,000 to over £32,000.

The first step in planning a share offer is to identify which of the four types of offer is most appropriate for the society at that time. This will change as the society develops, and in some cases it may be a good idea to prepare a phased campaign that leads from one type of offer to another. For instance, it is normal to follow up a pioneer offer, designed to raise risk capital to get investment-ready, with a time-bound offer, to implement the investment plan. A time-bound offer may be followed-up with an open offer, in order to generate liquidity for existing members. Some societies may start out with a membership offer, to engage the community in the enterprise and demonstrate the level of support they have to other funders.

The next step is to plan how the offer will be communicated to the target audience, and prepare a marketing and sales campaign. The best choice of marketing media and the focus of the campaign will be different for each type of offer. Practical administrative arrangements have to be put in place, covering how applications will be made, the processing of payments, and the recording and issuing of membership records.

The final step is to prepare the offer document, drawing on the guidance provided in this publication, and supplemented by expert guidance and support from elsewhere. Both the Wessex Rules and the Somerset Rules have this latter requirement written into the governing document. The Community Shares programme is actively working towards establishing shared standards of guidance and expertise among all the promotional and professional advice bodies with an interest in this area.

Conflicts of interest

Conflicts of interest can arise in a number of ways and are usually easily dealt with by always ensuring full transparency in any dealings, and by discouraging anyone with a personal financial interest in an investment offer other than their personal shareholding, from standing for election to the board.

For instance, it is not unusual with community buy-outs for the owner(s) of the business to be a member or even an activist and founder of the society leading the buy-out. If the owner is selling the business to the community, it is important to obtain an independent valuation of the business or put other arrangements in place to avoid the possibility that any personal interests are in conflict with community benefits. Business valuations are notoriously difficult; accountants and other relevant professionals are usually reluctant to commit themselves to a precise valuation because they know that, ultimately, the value of a business is whatever somebody is prepared to pay for it.

Another potential conflict of interest may arise when one of the founder members is paid to undertake development work on behalf of a start-up society. This is best dealt with by ensuring that they are not part of the board of directors. Remuneration for development work should be listed as an expense in pioneer offer documents, and itemised in the business plan supporting time-bound offers.

Membership offers

The primary purpose of a membership offer is to recruit members rather than to raise investment capital. Building up the membership can be an important starting point for many community enterprises, especially those hoping to attract significant amounts of public funding. Members can also contribute significantly to strengthening the business model of the organisation, not only by investing capital but also by contributing to the business as customers, volunteers, supporters, activists, and even suppliers or paid workers.

All membership offers need to address the following:

- The minimum investment required to become a member should be restricted to a nominal amount. Many societies set this as low as £1, although this can be costly for societies because of the expense of servicing members. More typically, the amount ranges from £5 to £25.
- Some societies charge an annual subscription fee to cover the cost of providing membership services. The society's rules need to allow for annual subscription fees, and should also allow membership to be terminated and share capital cancelled if the annual subscription is not renewed.
- The terms and conditions of membership should be clearly stated, as well as the rights of members and the role of members in the life of the society.

A membership offer document need only address the above matters, and can be relatively brief, typically no more than 500 words or a single side of A4. Membership should be open to anyone over 16 who is eligible, based on the society's membership rules. (See Section Three.) No other restrictions should apply to membership offers.

Societies that intend to charge annual membership subscriptions may want to consider what impact this could have on any future time-bound offer, where investors might be put off investing if they have to pay an annual subscription just to maintain their investment. This problem could be addressed by having two classes of share: a membership share, which bears an annual subscription; and an investor share, which carries no annual subscription. Both classes of share would have the same voting rights. An alternative would be to deduct the annual subscription from a member's share account, although this practice would have to be clearly explained in the offer document, and provided for in the society's rules.

Another approach has been taken by FC United of Manchester. It has issued two types of share: membership shares and capital funding shares. The latter type of shares are available through its time-bound offer, carry no voting rights, and can only be held by people who are members. Anyone who wants to invest must become and remain a member. Membership costs £12 per annum, including a £1 membership share. If a member who holds capital funding shares decides to stop being a member, the capital funding shares must be withdrawn. If share withdrawal is suspended then the shares will be converted into an unsecured loan with the society. This arrangement is designed to ensure that members' interests always come before investors' interests.

Maintaining a large membership can be expensive. Regularly updating members' contact details, notifying members of general meetings, making arrangements for members to participate in elections, and sending members copies of the annual report, can all mount up. If most members are also regular customers of the enterprise then these membership costs can be offset against marketing, but if most members are only investors then the cost of servicing them has to be considered against the benefits of having a large membership.

One way of recouping the cost of membership is to charge an annual subscription. Members could be asked to pay an annual subscription by direct debit, or they could have the annual subscription debited from their share account. This charge could be offset by the interest paid to members on their share capital. For instance, if a society charges an annual subscription of £10, and pays 4% interest on share capital, members with £250 in share capital will have their annual subscription offset by the interest paid to their account.

The other advantage of charging an annual subscription is that it enables the society to determine whether the person remains committed as a member. This helps to prevent the accumulation of a large number of members who are no longer interested in the society. An alternative would be to require members to engage in at least one form of interaction with the society each year, as evidence of being an active member.

Pioneer offers

The purpose of a pioneer offer is to raise finance to cover the cost of development work to get a new venture investment-ready. Before deciding to make such an offer, serious consideration should be given to the alternative of seeking donations to cover these costs. Donations may be a far better way of paying for development costs because they do not burden the new venture with long-term financial commitments. FC United asks members to donate to a Development Fund as well as invest in its community share offer. So far it has fundraised over £375,000 towards its £0.5m target for the Development Fund. The money is being used to cover the non-recoverable costs of developing the plans for a new stadium.

However, there is an upper limit to what most people can donate, which may be significantly lower than the amount they are prepared to invest. If the development costs are likely to be high, or are only likely to be financed by a relatively small group of supporters, then it may be fairer and more effective to raise the capital through a pioneer share offer.

Two societies, Hurst Green and Sheffield Renewables have made pioneer share offers. Both societies raised £6,000 from their existing members, matched by investments from Key Fund. This match-funding from Key Fund is designed to incentivise pioneer investment, and is a precedent for other financial intermediaries and funding bodies that want to promote community investment.

Pioneer offers are different from the other types of investment offer in that they are usually much higher risk propositions. The money raised will be spent on development costs that the society will be unable to recoup if the proposals turn out to be unfeasible, or the society subsequently fails to attract additional capital. It is important to note that, like a company, a society cannot enter into any contract until it has been registered. If the pioneer offer is issued before registration, appropriate contractual and trust mechanisms should be put in place to deal with the offer and its proceeds. This may involve personal liability for those planning to set up the society.

Before making a pioneer offer, the venture needs to prepare a development plan, identifying all the potential development costs that must be incurred to get investment-ready. The forecast for development costs should be kept in scale with initial estimates of the start-up costs of the venture. Development costs should not normally be more than 5% to 10% of the anticipated start-up costs. Because pioneer members are being asked to take far higher risks than subsequent investors, consideration should be given to making pioneer investment a separate class of shares with different terms and conditions, including the prospect of a higher rate of financial return or preferential rights to withdrawal.

Because of the high level of risk associated with pioneer offers, the following conditions should apply:

- Pioneer offers should only be made to known supporters or members who fully understand the risks associated with the offer. Pioneer offers should not be promoted to the wider community through websites or at public meetings.
- Pioneer offers must emphasise the high-risk nature of the investment, and should not promise any form of financial return. It should also be made clear that further investment will be needed before the venture can be launched.
- The offer should set a target for the amount to be raised, based on a fully-costed development process. It should explain the contingencies if the target is not met, and also what will be done with excess capital if the offer is over-subscribed.
- The document should set out the terms and conditions that apply to share capital, which should include the indefinite suspension of withdrawal rights until after the society is trading and profitable, when the suspension will be reviewed.

By targeting pioneer offers at known supporters only, there is less need to develop an expansive offer document. However, it remains vital that high standards of accuracy, transparency and care are applied in drafting the document because the promoters are still legally liable under contract and civil law. Pioneer offer documents need to address the following matters:

Purpose of the investment: Focusing on the need to raise money to pay for development costs and get investment-ready

Development costs: Outline of development costs, target amount to be raised, contingencies if less than the target amount is raised, what will be done with the surplus if more than the target amount is raised. A proposed timetable for the development process

Terms and conditions of the investment: The high levels of risk and the possibility of losing all the money invested. Indefinite suspension of withdrawal rights until the society is trading and profitable, when the suspension will be reviewed. Details of plans to call for further capital when the project is investment-ready, and details of any plans to have more than one class of share capital.

Time-bound offers

Time-bound offers are used to raise finance for investment-ready projects by either new or established enterprises. Time-bound offers are usually open to anyone who qualifies for membership, and because these documents are promoting an investment opportunity to the general public, it is crucial that they meet high standards of probity. This should include a commitment to proceed only if the fundraising targets are met; if the targets or contingencies are not met then investors should be refunded.

The commitment to refund investors if the targets are not met is a substantial one. It means that the society must make provisions to hold the investors' money in a suspense account until the investment project proceeds or is cancelled, and have contingency plans for making refunds. It is possible to make an administrative charge in the event of having to issue refunds, but this has to be clearly stated in the offer document.

All time-bound offer documents should be supported by a business plan, which should be made available to potential investors on request, as should the governing document of the enterprise. The business plan should contain the evidence that supports any key statements made in the offer document, especially any forecasts for financial returns and the future liquidity of share capital. A copy of the society's rules should also be made available to investors. It is important to check that the society's rules allow it to do all the things mentioned in the offer document. Particular attention should be paid to the rules covering the administrative arrangements, membership and investment criteria, and additional charges, including annual subscription fees.

There are seven main elements to all time-bound offer documents, which are described in detail below. Ideally, time-bound offer documents should be no longer than 2,500 words, and written in an accessible and engaging style. It is important to get the balance right between writing a marketing document that clearly communicates the investment proposition, and a non-technical document which nevertheless provides accurate financial and legal information.

1. The purpose of the investment

Time-bound offers are most effective when the purpose of the investment is clear, unambiguous and direct. The community and social purpose of the investment should be appealing and attractive to potential investors, enabling them to engage with this purpose in a simple and straightforward way through the act of investment. Potential investors will have two immediate concerns: Are they at risk of losing some or all of the money they invest? Will their investment result in the achievement of the desired community and social outcomes?

Investors will also want to know how the money raised will be used. Will be it be spent on tangible assets, which could be sold if the society underperforms and gets into financial difficulties? Or will it be used to provide working capital, covering initial losses, with the inherent danger that continued losses will erode the capital of the society?

There will also be longer-term concerns about the financial returns on the investment. However strong the social motivation may be, financial incentives will always assist the overall motivation to invest. But any offer of financial returns has to be plausible, based on evidence contained in the business plan.

2. Fundraising targets

The offer document should clearly state the amount of share capital to be raised, together with a summary of how this capital will be used, and any other sources of capital that will be drawn upon to finance the investment project. This should include a summary of any plans to take on commercial debt or any other type of borrowing.

The target for the amount of share capital to be raised should not be exceeded. When this target is met, the offer should be closed. Any applications for shares received after the offer has closed should be returned. Under some circumstances it is acceptable to have upper and lower fundraising targets. For instance, a society may have already negotiated an option to take on a loan or overdraft facility to fill any gap between the lower and upper target. This type of arrangement is called underwriting, and should be mentioned in the offer document. Potential investors will usually be prepared to invest more in offers that have been underwritten by reputable financial intermediaries. This is because it will be assumed by the investor that the financial intermediary has assessed the investment proposition and considered it to be sound.

Lower and upper targets may also be acceptable where there is clear evidence that the investment development activity can be phased without unduly affecting the viability of the enterprise or adversely affecting the social and financial returns on the investment. However, very large gaps between lower and upper targets are likely to undermine the credibility of the business plan.

If the offer fails to meet the lower fundraising target within the specified offer period, then the money should be returned to investors and the investment project should not proceed. This commitment should be made clear to investors in the opening summary statement of the offer document. Investments received during the offer period should be held in a suspense account until the offer is closed. The offer document should explain what will happen if the offer is unsuccessful, stating how long after the end of the offer period investors will have to wait to get their money back, and whether any administrative charge will be deducted from the investment.

3. The offer period

All time-bound offers should have an opening date, when the offer is launched, and a closing date after which no further investments can be accepted. There are a number of factors to consider when determining an offer period. The length of the period has to be sufficiently long for the publicity and marketing campaign to be successful, but not so long that early applicants have their money held in suspense for extended periods. Offer periods vary in length from six weeks to six months, with a norm of three months. Many people will tend to wait until towards the end of the offer period before investing, partly to ensure that their money is not held in suspense for too long, and partly to see how successful the offer is before committing their money. So there is a danger with long offer periods that potential investors do not respond to the initial publicity, delay their decision to invest, and then forget to make a decision before the deadline.

It is important to get the timing of the offer period correct. It is best to avoid major holiday periods, when people may not be thinking about investment, or may have other calls on their money. The tax treatment of savings and investments tends to mean that people are more likely to be thinking about what to do with their money in the months preceding and following the HMRC financial year-end in April.

There is anecdotal evidence that most offers experience an initial surge of investment at the beginning of the offer period, followed by a lull, and then a final surge in the last few days of the offer. A number of societies have found themselves reaching the end of their offer period, not having quite reached their minimum fundraising targets. If a society has raised more than 75% of the minimum target amount, it may be acceptable to extend the offer period. But if the offer period is extended, those who have already applied for shares should have the right to cancel their application. Ideally, this contingency arrangement should be outlined in the original offer document.

4. Minimum and maximum investments

Currently, the maximum amount an individual can invest in the withdrawable share capital of a society is £20,000. It is up to the society to determine what the minimum investment should be. The minimum investment required by time-bound offers in the last two years has ranged from £50 to £500. The arguments in favour of a low minimum investment are that it makes investment more affordable to people on low incomes, and will encourage more people to invest because the stakes are lower. The arguments in favour of a high minimum investment are that it will generate a higher total investment and reduce membership administration costs.

Higher minimum investment thresholds can be made more affordable by offering people the opportunity to invest by instalments. For instance, although a few people may have £1,000 of spare money to invest, many more may be prepared to invest amounts ranging from £10 to £100 per month, for periods of up to five years. Investment by instalments was commonplace in the nineteenth century and was how most of the early co-operative societies were financed. Today, investment by instalments could be incentivised by financial intermediaries offering bridging loans to allow the investment activity to proceed as soon as sufficient investors are identified.

5. Warnings and risk assessments

All offer documents should carry a prominent warning that investors could lose some or all of the money they invest, and that they have no right of complaint to the Financial Ombudsman Service or to compensation from the Financial Services Compensation Scheme.

In addition to these warnings, time-bound offers should summarise the risks the society faces in implementing the capital spending plan, focusing on risks that may result in members losing some or all of their investment, or not getting the financial and social returns outlined in the offer document. A fuller assessment of these risks should be included in the business plan, along with contingency plans for mitigating these risks.

6. Terms and conditions of investment

The offer document should clearly state the terms and conditions that apply to the investment. Given the lack of public awareness or understanding of co-operative and community benefit society legislation, this statement needs to be comprehensive, and should assume that the applicant has no prior knowledge of community shares. The offer document should include the following information:

- The minimum age of investors (currently 16)
- The nature of withdrawable share capital (explaining that investors can withdraw their shares, subject to terms and conditions, but they cannot sell their shares to a third party; and that shares cannot go up in value but can go down in value if the board has these powers)
- Any initial period during which withdrawal of share capital will be suspended

- The period of notice that must be given of the intention to withdraw shares
- Any limitations on the amount of share capital that can be withdrawn in any one financial year
- The right of the board to suspend or refuse withdrawals
- The voting and ownership rights attached to shares being issued
- The implications of the asset lock, if one exists
- Any requirement to pay an annual membership fee.

It is important that the board determines what terms and conditions will apply to the share offer well in advance, making sure these terms comply with any external criteria, such as eligibility for Enterprise Investment Scheme tax relief (see Section One). Any plan to suspend the right to withdraw shares for an initial period should be considered in the context of longer-term plans for the liquidity of share capital. An open offer to invest can only be made by societies whose shares are fully withdrawable, and are therefore not suspended, restricted, or subject to unduly long periods of notice. Initial periods of suspension longer than three years, and withdrawal notice periods longer than three months, could act as barriers to open offers.

The terms and conditions that apply to shares will affect how attractive the offer will be to potential investors. Overly onerous terms may be off-putting to investors, but overly generous terms may prove hard to honour. It should be remembered that the offer document forms part of a contract between the society and the investing member, and could be used in a court of law if there were to be a dispute between the two parties.

7. Track record

The track record of the society and its management team will usually have a significant bearing on the success of any fundraising campaign. Established societies making time-bound offers to finance growth or consolidation should emphasise the financial and social performance of the society to date, providing verifiable evidence to support the forecast returns that will be generated by the new investment. New societies seeking start-up capital will be more reliant on the credentials of the management team, the board and its advisers.

The offer document should summarise the track record of the society and its board. It should also identify any personal interests board members may have in the offer, and explain what actions have been taken to address any potential conflicts of interest.

Finally, it is important to remember that the board is liable under contract and civil law for the contents of any offer document, and must ensure that it does not mislead the public or misrepresent any facts about the society.

Open offers

There are two main reasons why a society may make an open offer of membership and investment. The first is to provide liquidity for its share capital, with new investment generating the funds to cover withdrawals. This is most appropriate where the society has a trading relationship with its members and it is normal to expect a turnover in membership and investment. The second reason for making an open offer is to stimulate and support the organic growth of the enterprise, so that membership and investment grow in line with the business.

Open offers are not time-bound or linked to a specific investment plan, and because of this are not subject to the same information requirements as time-bound offers. Instead, open offers should be restricted to societies that can demonstrate that their share capital is fully withdrawable, without any unreasonable restrictions or undue limitations. Any initial period when withdrawals were suspended should be over, and withdrawal notice periods should be no longer than three months. If there are any limitations on the proportion of total share capital that can be withdrawn this should be no larger than the anticipated inflow of share capital resulting from the open offer. Typically, this would be 10% of all share capital.

Societies planning to make an open offer need to consider the terms and conditions of the offer, and the impact it may have on existing member investment. As well as potentially improving the liquidity of share capital, new investment could possibly have a diluting effect on the ability of the society to maintain its current level of financial return. It may be necessary to limit the investment of new members to prevent dilution, while still allowing open membership, in which case a membership offer might be a better option.

All societies that plan to make open offers should be required to publish their investment policies, explaining the reasons why they are encouraging new investment, and how additional capital will be used. This should focus on the broader principles guiding investment by the society, rather than details of specific investment plans.

It is also important to publicise and promote the community benefits and social achievements of the society. Section Two described how Social Return On Investment (SROI) was used to measure and report on the social performance of some of the societies participating in the Community Shares programme.

In comparison with a time-bound offer document, an open offer document can focus on the track record of the society rather than predictions about its future. It is, as ever, vital that high standards of accuracy, transparency and care are applied in drafting the document, as the board remain legally liable under contract and civil law. Open offer documents should contain information about:

Purpose of investment: The reasons for making an open offer of investment. The investment policies of the society;

Terms and conditions of investment: Membership eligibility criteria. Minimum and maximum amounts that can be invested. Terms and conditions applying to share capital, including the board's right to suspend withdrawals or reduce the value of shares. Members' voting rights and responsibilities;

Returns on investment: Summary of the financial returns and social impact achieved by the society over the previous three to five years;

Turnover in investment: Analysis of turnover in membership and share capital investment levels covering the previous three years;

Supporting documents: Details of how to obtain copies of the annual accounts and social reports for the previous three years, plus an up-to-date copy of the society's rules.

Application forms and processes

All offer documents, of whatever type, should include an application form. Application forms can be very simple, requiring no more than the name and address of the applicant, and the amount of share capital they are purchasing. But most societies will ask for additional information, to provide themselves with greater legal protection, improve the membership administration processes or for some other reason.

Some societies use the application form as a marketing tool. For instance, it might contain a series of tick boxes to encourage applicants to invest more than the minimum amount, or it might contain sections that invite applicants to nominate a beneficiary in the event of their death or bankruptcy, hence encouraging the applicant to think of the offer as a long-term investment.

The form can also be used to encourage applicants to read the information provided, by asking them to sign a statement saying they have read the offer document and understood the terms and conditions of the offer. Legally, no-one under 16 years of age can become a member (although this is set to change in the near future), and the application form should make this clear. In addition to the age restriction, some societies restrict applications to people who live or work in a specific geographical area, or do not allow applications by people who live outside the UK. Such restrictions should normally be specified in the society's rules.

Societies should be aware of the potential for offers to be used for money laundering purposes. Withdrawable share capital is exempt from money laundering considerations, and there is no legal obligation on societies to carry out identity checks on applicants. However, societies planning to make on-line offers or to accept applications from people living outside the UK, may want to put secondary measures into place to check the identity of investors. This could include restrictions on the methods of payment that are allowed, and the currency of the transaction, for instance by restricting investment to applicants holding a UK bank account.

A few societies have developed on-line application and payment methods. Putting aside the set-up costs of establishing these systems, and concerns about the security arrangements of such methods, societies may find this a very efficient way of administering an offer, although it may exclude some potential investors who do not use the internet for these purposes. It might also affect the geographical spread of applications, with a consequent affect on the identity of the community.

Marketing and administering an offer

Preparing the offer document is only one part of the process of making an offer. The marketing campaign for an offer should start long before the offer is launched. Section Two explained how community engagement techniques can be used to build a community of supporters who will be the target for any investment offer. For time-bound offers these techniques can be used to prepare the ground, enabling the society to run with a much shorter offer period than would otherwise be required.

It is also important to have the administrative processes in place for handling an investment offer before the launch of the offer. Resources will be required to process applications, deal with investor queries, and sort out any administrative problems associated with applications. The demands on these resources will intensify during the closing stages of a time-bound offer, which is when most applications are likely to be made, and most enquiries from applicants are likely to be received. Applicants will want to know that their applications have been received, so having a speedy system for acknowledging the receipt of applications will reduce the volume of follow-up enquiries.

Any society making a time-bound offer needs to plan how it will process applications, ensuring that it has the administrative capacity to process all applications quickly during the offer period. This should include the use of some form of suspense account, possibly administered by an independent third party, with arrangements in place to refund investors if the targets are not met and the offer fails. The society also needs to have the administrative capacity to deal with any mechanisms it has put in place to cope with contingencies such as under-subscription or over-subscription.

Some societies have rules that allow members to invest in instalments, usually monthly payments over one or two years. Such arrangements may make it more attractive and more affordable to invest, especially if the society has a high minimum investment of £250 or more. It is fairly simple to enable members to invest by instalments: the application form should include a section to issue a bank mandate to set up a standing order or direct debit payment. As well as ensuring the society's rules allow investment by instalments, a society needs to think about the impact on cash flow, and make arrangements to cover any short-term gap in funding. It also needs to decide what it will do if a member cancels payment before completion; it would normally be considered reasonable to charge an administration and cancellation fee. These terms would need to be clearly set out in the offer document.

The rules of a society will determine whether it either has to issue a share certificate (a paper document bearing the common seal of the society – see Section Three, *M. Official Documents*) to members, or provide them with a regular statement of their share account. Share accounts are simpler to administer and provide greater flexibility for societies that pay interest and/or dividends or charge an annual subscription fee. Instead of issuing share certificates and interest and/or dividend cheques, societies can send members a statement of their account, showing their investment, withdrawals, payments and charges. If the society's rules provide for a 'lien on shares' and annual subscription fees, then these fees can be deducted from a member's share capital instead of requiring payment.

Some share offers may be eligible for tax relief through the Enterprise Investment Scheme. Societies that think their investors may be eligible for this scheme should seek to obtain advance assurance from HMRC that the offer will qualify. More details of this tax incentive are provided in Section One.

Publications

Community Shares programme
The Community Shares Programme:
One Year On, 2010
Investing in community shares, 2010
Community Investment: Using Industrial
and Provident Society Legislation, 2008
www.communityshares.org.uk

Co-operatives UK publications
Simply Legal, 2010
Simply Governance, 2011
Simply Finance, 2011
www.uk.coop

Locality publications
Community Share and Bond Issues:
The Sharpest Tool In The Box, 2007
Community Asset publications
www.locality.org.uk

Further information and guidance

The FSA is the registering authority for societies which register under the Industrial and Provident Societies Act 1965 (I&P Act 1965). This registration function is separate from our role as regulator of the financial services industry in the UK, as provided by the Financial Services and Markets Act 2000 (FSMA) and the statutory instruments made under FSMA.
www.fsa.gov.uk

Investor membership of co-operatives registered under the Industrial and Provident Societies Act, 1965. Policy note by Michael Cook and Ramona Taylor. 2007

Business support

Co-operatives UK works in partnership with organisations that help co-operatives to start up and grow their business. To contact a local support provider in your area visit
www.uk.coop/cdbs

The Co-operative Enterprise Hub works with regional and national groups of experts to bring you the very best advice, training and consultancy on how to set up, run and grow a sustainable co-operative business.
www.co-operative.coop/enterprisehub

Delivered by Locality in association with Community Matters, the Local Government Association, and funded by Communities and Local Government, the **Asset Transfer Unit (ATU)** helps to empower local people and organisations to transform land and buildings into vibrant community spaces whilst supporting the development of a thriving third sector.
http://atu.org.uk

The Community Shares Programme: Expert Reference Group

The Community Share programme was a two-year action-research programme promoting equity investment in community enterprise funded by the Office for Civil Society and the Department for Communities and Local Government working in partnership with Co-operatives UK and Locality. The programme was completed in March 2011.

During its lifetime, the programme benefited from advice and guidance from the the Expert Reference Group, a group of specialists within the Community investment sector:

Baker Brown Associates is a research, development and training consultancy serving the social economy.
www.bakerbrown.co.uk

Co-operative & Community Finance (C&CF) – the lender for social purpose – provides sympathetic loan finance to help people take control of their economic lives and create social benefit.
www.co-opandcommunityfinance.coop

Co-operative and Mutual Solutions Ltd (CMS) is a worker co-operative consultancy (Industrial and Provident Society) which specialises in business advice, consultancy and training to co-operatives and other forms of social enterprise.
www.cms.coop

Energy4All was formed in 2002 by Baywind Energy Co-op to help communities develop renewable energy schemes, normally through the launch of local share issues.
www.energy4all.co.uk

Key Fund Yorkshire is a social enterprise that provides investment support to other social enterprises working in disadvantaged communities across Yorkshire and the Humber.
www.keyfundyorks.org.uk

The Plunkett Foundation helps rural communities through community-ownership to take control of the issues affecting them.
www.plunkett.co.uk

Social Return on Investment (SROI) is a framework for measuring and accounting for a broader concept of value.
www.thesroinetwork.org

Water Power Enterprises (h2oPE) is a Community Interest Company limited by shares which develops 'low head' hydro sites.
www.h2ope.org.uk

Wessex Community Assets Ltd (WCA) is an Industrial and Provident Society which offers support to community led organisations to use community investment as a means of establishing locally owned assets and enterprises.
www.wessexca.co.uk

CO-OPERATIVES UK

www.uk.coop

www.locality.org.uk

The Practitioners' Guide to Community Shares is the culmination of a two-year action-research programme promoting equity investment in community enterprise. Based on the experiences of ten co-operatives and community enterprises across England, from Ashington Minors and Cybermoor in the north to Brixton Green and Hastings Pier in the south, the guide explains how to raise risk capital for ventures serving a community purpose.

The guide focuses on the use of withdrawable share capital, a type of risk capital unique to co-operative and community benefit societies, which provides a democratic form of community ownership. The guide offers advice to practitioners in four key areas for development; the business model, community engagement, governance, and the offer document.

The Community Shares programme was funded by the Office for Civil Society and the Department for Communities and Local Government working in partnership with Co-operatives UK and Locality. The programme was completed in March 2011.

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