CO-OPERATIVE CAPITAL UNITS:

A MULTI-PURPOSE TOOL FOR CO-OPERATIVES AND MUTUALS OPERATING WITHIN AND OUTSIDE THE CO-OPERATIVE ACTS

RESEARCH FINDINGS SUMMARY FOR THE 2014 BCCM LEADERS' SUMMIT

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A CCU is defined as "an interest issued by a co-operative conferring an interest in the capital, but not the share capital, of the co-operative" (Cooperatives Act 2009 (WA), Division 2, p. 152). It can be structured as a debt or equity instrument, be issued to members and non-members and there are a number of other terms in relation to the issue and redemption of such instruments under co-operatives law. The key characteristic is that whilst conferring an interest in the capital of the co-operative, CCUs do not carry the rights of co-operative membership (no voting rights at members' meeting).

The Co-operative Enterprise Research Unit at UWA conducted an assessment of Co-operative Capital Units (CCUs) as tools for raising debt or equity by member-owned enterprises, without compromising the member-controlled nature of these businesses. This study was part of an Australian Linkage Grant Research Project co-funded by Co-operative Bulk Handling Ltd, Capricorn Society Ltd and Ravensdown Fertiliser Co-operative Ltd. The research commenced in 2010 and took place in three phases, including the formation of a Delphi Panel of experts that assessed the likely attractiveness of different terms of issue, a conjoint model that revealed trade-offs between various levels of the key attributes of instrument design, and an industry workshop that allowed for integration of feedback from the sector's CEO's, CFO's, board directors, legal and accounting advisors.

Some of the key findings are that:

- *CCUs are likely to be of most value as an equity (rather than debt) instrument*
- *CCU structure (ownership, governance, market facilitation and profit distribution options) is highly dependent upon the purpose that a CCU is designed to serve*
- *CCUs can be of value to member owned businesses operating within and outside the Australian Co-operatives legal frameworks*

Figure 1 illustrates suggested combinations of CCU terms of issue that could result in an attractive proposition for the investor, the enterprise and its members for each one of three key purposes:

- *Reward patronage and retain capital*
- *Reward patronage and unlock member value*
- *Raise investment capital*

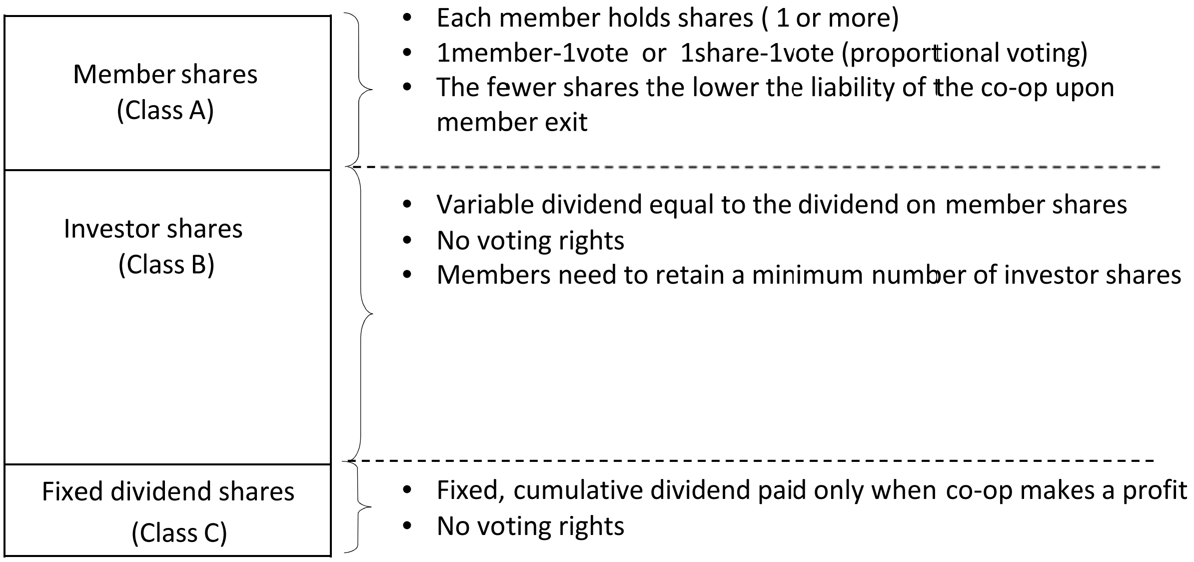
Figure 1: A framework to guide CCU structure *(adjusted from: Mamouni Limnios et al. 2012b)*

Purpose	Ownership	Governance	Market facilitation	Distribution
Reward patronage & retain capital	**Inside** • Rewarded based on patronage • The buyer must be either a qualified member of the co-op (past members and their beneficiaries can retain their holdings) or the co-op itself	**No control** • CCU holders have no representation on the Board of the co-op	**Co-op facilitated** • Sold in a market facilitated by the co-op **Private market** • CCUs to be sold privately at a price agreed by the seller and buyer **Redemption by Co-op** • Redeemed by the co-op at Board discretion	**Variable** • Variable dividend as determined annually by the Board
Reward patronage & unlock member value	**Outside** • Rewarded based on patronage • Subsequent to their issue (and build-up of critical mass) transferrable between members and non-members	**Some control** • CCU holders nominate a predetermined number of independent directors to the Board of the co-op (to be approved by members) **No control** • CCU holders have no representation on the Board of the co-op (for co-ops with good historical performance)	**Third Party facilitated market** • Sold on a secondary market operated by a third party **Co-op facilitated market** • Sold in a market facilitated by the co-op	**Combined Fixed and Variable** • Dividend with a fixed component (fixed or referable to market rates) and a variable component (at Board discretion or performance related) **Variable** • Variable dividend as determined annually by the Board (for highly performing co-ops with history of attractive dividend payments)
Raise investment capital	**Outside** • CCU ownership open to members and non-members, with members possibly offered a first right of refusal	**Some control** • CCU holders to elect a predetermined number of independent directors to the Board of the co-op • CCU holders nominate a predetermined number of independent directors to the Board of the co-op (to be approved by members)	**Third Party facilitated market** • Sold on a secondary market operated by a third party **Co-op facilitated market** • Sold in a market facilitated by the co-op (for smaller CCU issues and co-ops that cannot justify third party facilitation costs)	**Combined Fixed and Variable** • Dividend with a fixed component (fixed referable to market rates) and a variable component (at Board discretion or performance related)

Notes:
1) The above options are suggested as the most likely combination of terms that could result in an attractive proposition for the investor, the co-op and co-op members.
2) When multiple suggestions are provided for Governance, Market Facilitation or Distribution, these are listed from more to less preferable for investors (top to bottom).

The key challenge is to design a *CCU that would attract a variable dividend at board discretion, while remaining an attractive investor proposition*. A requirement for a minimum CCU holding per member share could achieve this objective, by providing some assurance to investors that members' interests are aligned to their own. The dual function of co-op members as patrons and investors is acknowledged in the literature and can generate tensions that can impact on the management of the co-operative. The proposed variable dividend equity structure (Figure 2) provides a mechanism that enables the co-op to function in any spectrum from a traditional co-op (investor share (CCU) and member share dividend is low) to a co-op that is more investor oriented (high requirement of investor shares per member share, high dividends paid).

Figure 2: A proposed equity structure (*adjusted from: Mamouni Limnios et al. 2012c)*



In this structure investor shares (CCUs) would increase transferability and liquidity of member equity and could attract external capital investment in the co-op without compromising member control. In the case of an existing co-op (e.g. a traditional co-op) that wishes to attract external capital, investor shares can initially be rewarded to members (e.g. based on history of patronage) in order to build up a critical mass to cover the minimum holding per member share and thus increase the investor interest of member-patrons. Subsequently, investor share issues can attract additional member investment and external capital, while maintaining the existing structure of co-op control.

For more information refer to the following published reports, conference papers, book chapter and journal article, or email elena.limnios@uwa.edu.au. We would like to acknowledge the contribution of our colleagues and co-authors, John Watson and Geoff Soutar to this research project and published outcomes.

Mamouni Limnios E., Watson, J., Mazzarol, T., Soutar, G.N. (2014) Financial instruments and equity structures for raising capital in co-operatives. Journal of Accounting and Organizational Change (accepted, forthcoming).

Mamouni Limnios, E., Watson, J., Mazzarol, T., and Soutar, G.N. (2012a) "Co-operative Capital Units: Attractive Equity Instruments?", in T.W. Mazzarol and E. Mamouni Limnios (Eds), Cooperatives in the Fourth Sector: The Role of Member Owned Businesses in the Global Economy, Tilde University Press, Prahran Vic., pp. 56-65. (ISBN: 978-0-7346-1170-3).

Mamouni Limnios, E., Watson, J., Mazzarol, T., Soutar, G. (2012b) "Structuring Co-operative Capital Units - Symposium Findings". Industry Research Report. Centre for Entrepreneurial Management and Innovation.

Mamouni Limnios, E.A., Watson, J., Mazzarol, T. (2012c) "Co-operative Capital Units as a Solution to Co-operative Financing". Centre for Entrepreneurial Management and Innovation discussion paper series, ISSN: 1448-2541.

Mamouni Limnios, E., Watson, J., Mazzarol, T., Soutar, G.N. (2012d) "Debt or Equity in the Financing of Co-operative Enterprises". New Zealand Association for the Study of Cooperatives and Mutuals (NZASCM) Annual Conference, 21-23 June, Wellington, New Zealand.