National Reconstruction Fund Consultation Paper

Submission to the Department of Industry, Science and Resources

February 2023

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Business Council of Co-operatives and Mutuals

Introduction

The Business Council of Co-operatives and Mutuals (BCCM) thanks the Department of Industry, Science and Resources for the opportunity to respond to the National Reconstruction Fund (NRF) Consultation Paper.

Our members are active across many of the priority areas for the NRF including agriculture and fisheries (e.g. Norco), advanced manufacturing and circular economy (Master Butchers Co-op), renewable energy (Hepburn Energy), transport and mobility (The NRMA) and defence (HunterNet).

The NRF represents an important opportunity to boost Australian manufacturing and supply chain resilience across these sectors and to move to a serious partnership model between purpose-led businesses, government and workers.

As a longstanding for-purpose business movement, co-ops and mutuals are an ideal partner for government. The overarching purpose of co-ops and mutuals is to generate economic and social value for the eight in 10 Australians and more than 160,000 businesses that are members, and the communities where those members live. Co-ops and mutuals:

- Are **long-term investors in domestic manufacturing** because their members are local
- **Increase the resilience of Australia's SMEs** in a range of industries by helping them reduce input costs, access markets and share in profits from value-adding activities such as manufacturing
- Are **domestically-owned and pay taxes domestically**
- **Earn vital export income for Australia**
- **Generate quality employment** across regional and metropolitan Australia
- **Enhance the function of markets** by being the consumer and small business focused challengers
- **Promote democratic values and practices** through member ownership and collaboration

Public investment in co-operatives and mutuals will maximise these outcomes and will also act to accelerate the maturation of markets for member, community and private investment in co-operatives and mutuals, addressing historical constraints on the growth of co-ops and mutuals.

The BCCM welcomed Labor's election commitment to ensure the NRF will be able to invest in co-ops and mutuals, including through Co-operative Capital Units and Mutual Capital Instruments. Our submission is focused on providing feedback on how the NRF can be designed to be inclusive of investment in co-ops and mutuals and providing context on the broader policy barriers and opportunities in relation to such investment. Our response consists of an overview of co-operative and mutual legal structures and investment instruments in Australia, and responses to specific consultation questions.

The BCCM would be pleased to provide any further information to assist the Department.

Summary of recommendations

The following recommendations are collected from our responses to the consultation questions:

- That the National Reconstruction Fund Corporation Bill is amended to include a minimum 50% Australian ownership requirement. In the alternative, this should be included in the rules, guidelines or investment mandate.
- That co-operatively and mutually-owned projects should be expressly recognised in the Investment Mandate as a focus for the NRF.
- That transformation should be defined as including transformation to more Australian ownership and production in supply chains across all the priority areas.
- That diversification should be defined to include diversification of forms of ownership in Australian supply chains across all the priority areas. Co-operative and mutual ownership should be recognised as one of the distinct forms of ownership in the measurement of diversification.
- That, in collaboration with the BCCM, a focused program of industry, government and market stakeholder education and capacity building is delivered so that the NRF is meaningfully inclusive of co-operatives and mutuals.
- That the National Reconstruction Fund Corporation Bill is amended to expressly include Co-operative Capital Units structured as equity in the definition of equity. In the alternative, the NRF rules must specify that the NRF can invest in Co-operative Capital Units that are structured as equity.
- That the Department of Industry, Science and Resources seek tax and legal advice on fund design to ensure the NRF has capacity to provide s120(1)(c) loans to co-operatives.

Overview of co-operative and mutual legal structures and investment instruments

General background and legal framework

Co-operatives and mutuals are corporations that are registered and regulated under Australian law. The two most common legal forms that co-operatives and mutuals take are:

- A co-operative registered under the harmonised Co-operatives National Law/Co-operatives Act 2009 (WA) in its home state or territory
- An unlisted public company that meets the definition of a mutual entity under s51M of the Corporations Act

The co-operative and mutual model is distinguished by its ownership structure and the business purpose. Co-ops and mutuals are businesses that are owned and controlled by their members. Members form and participate in co-operatives and mutuals to meet common economic, social and cultural needs. Members are typically:

- Consumers (e.g. in a mutual bank or insurer)
- Producers (e.g. in an agricultural co-op or an independent retailers' buying group)
- Workers (e.g. in a employee-owned services business)
- Community (e.g. in an energy generator owned by local residents)

Co-operatives and mutuals are guided by seven internationally-agreed principles for delivering value to members and their communities over the long-term:

1. Voluntary and open membership
2. Democratic member control
3. Member economic participation
4. Autonomy and independence
5. Education, training, and information
6. Co-operation among co-operatives
7. Concern for community[1]

[1] These principles are incorporated into ss10-11 of the Co-operatives National Law

There are approximately 2,000 co-ops and mutuals in Australia. They have a combined turnover of more than $35 billion (National Mutual Economy Report 2022).

Policy context: barriers to equal participation in markets and access to capital

Traditionally, co-operatives and mutuals have relied on retained earnings and, depending on structure, member shares, to raise capital. The report of the 2016 Senate Economics References Committee inquiry into co-operatives, mutuals and member-owned firms, noted lack of access to capital as one of the key barriers for co-operatives and mutuals that has hindered growth, or in some cases, has led to demutualisation.

In line with the recommendations of that report, co-operative and mutual legislation has been reformed in recent years. Since 2019, co-operative and mutual companies registered under the Corporations Act have been able to Issue Mutual Capital Instruments. And in 2020 the harmonisation of state and territory co-operatives legislation was completed, providing all state and territory-registered co-operatives with the ability to issue Co-operative Capital Units.

While more than $350 million in new investment has already been facilitated by these reforms there remains low awareness among markets, government and other stakeholders about the potential for innovative forms of co-op and mutual investment.

The Senate Economics References Committee recognised this challenge, and as a result also recommended that the Commonwealth deliver increased education to inform all relevant stakeholders about co-operatives and mutuals and provide information and advice on new forms of capital raising in co-operatives and mutuals.

Our response to the consultation question 'what are the gaps in or barriers to private sector investment in each of the priority areas?' provides more detail on how the NRF can respond to this challenge through the collaborative development of an Australian Centre for Co-operative Business Growth under a co-investment plan.

Investment mechanisms for co-operative and mutual companies registered under the Corporations Act

Co-operatives and mutuals that are formed as unlisted companies will generally have a one-member one-vote governance system. This means while they have many of the same financing mechanisms available to other companies, they cannot issue ordinary shares that give one vote per share while retaining their mutual governance structure.

In 2019, the Corporations Act was amended to introduce Mutual Capital Instruments as a unique instrument for co-operative and mutual companies.

The BCCM led the industry advocacy campaign for legislative change. The BCCM has developed significant resources on Mutual Capital Instruments as part of our Capital Partners program.

Mutual Capital Instruments case study: Australian Unity

180-year old wellbeing mutual Australian Unity has issued two tranches of MCIs that are listed on the ASX. The first tranche, issued at the start of 2021, raised more than $120 million and included a placement from mutual superannuation fund HESTA. Issuing MCIs is enabling Australian Unity to pursue growth and acquisition opportunities while retaining its mutual ownership structure and purpose.

Investment mechanisms for co-operatives registered under Co-operatives National Law/Co-operatives Act 2009 (WA)

As corporations, co-operatives generally have the same ability to raise funds or seek financial accommodation as companies. The Co-operatives National Law provides a framework for co-operatives to issue member shares, debentures and Co-operative Capital Units (CCUs).

The BCCM provides detailed Information on these instruments and the regulatory framework for them in the Capital Builder tool and the Community Investment Handbook.

Co-operatives registered under Co-operatives National Law also may have a share capital. However, co-operative shares are not ordinary shares. Some notable features of a co-operative share are as follows:

- May only be issued to and held by a member of the co-operative
- Are repayable by the co-operative when a member resigns or otherwise leaves the co-operative. As such, they are classified as debt, not equity, for accounting purposes.
- Maximum holding of 20% of the share capital per member.
- Are subject to a regulatory restriction on dividends set out at cl3.19 of the Co-operatives National Regulations. Noting there Is no restriction in a co-operative on rebates or issues of bonus shares.

A co-operative could take investment from the NRF by way of shares. However, this would require the NRF to be eligible to be a member of the co-operative and for the terms of issue of the shares to comply with co-operative principles.

Co-operative shares case study: Sweeter Banana Co-operative

Sweeter Banana Co-operative is registered under the Co-operatives Act 2009 (WA). This means Sweeter Banana has the ability to issue CCUs as well as shares or debentures.

Under the rules of Sweeter Banana, the WA Department of Agriculture is eligible to become a member of the co-operative alongside the main membership base of private banana producers. A special membership test is set for the Department, but the minimum shareholding obligations and member rights are the same.

Co-operative Capital Units are defined as an interest In the capital (but not the share capital) of a co-operative (s345 CNL). CCUs provide co-operatives with significantly enhanced flexibility to develop their capital stack beyond retained earnings and member shares. Significant differences from member shares are that CCUs can be structured as debt or equity, can be offered to non-members as well as members, and do not have a regulatory limit on dividends or other distributions.

Co-operative Capital Unit case study: Haystacks Solar Garden Co-operative

Haystacks is Australia's first solar garden. Based in the Riverina, it issued CCUs to members that will fund construction of the solar garden. Members who participate in the CCU offer will be entitled to a rebate on their power bill that will save them an estimated $505 per year. This model provides renters and others previously locked out of rooftop solar to enjoy the economic benefits of the renewable energy transition.

Co-operatives can also issue debentures. Under this framework, the debentures may actually be referred to as notes or a similar name if unsecured.

Tax and co-operative and mutual investment

Co-operatives and mutuals may be not-for-profit or for-profit and they may have charitable registration.

There is longstanding tax legislation that provides a mechanism for certain 'co-operative companies' (as defined for tax purposes) to invest in plant and equipment. Under ss117-121 of the Income Tax Assessment Act 1936, an eligible co-operative may make deductions on repayments of interest and principal on a loan received from the Commonwealth or a State.

Currently only New South Wales, South Australia and Western Australia provide loan schemes for co-operatives for this purpose. In other states and territories, co-operatives do not have the same ability to fund expansion projects. The NRF can resolve this policy gap by providing an eligible type of loan to a co-operative operating anywhere in Australia.

The BCCM hosts information on government loans to co-operatives on our website.

Government loans to co-operatives case study: Western Australian Meat Marketing Co-operative (WAMMCO)

WAMMCO is owned by lamb producers who supply its abattoir in Katanning. It is the largest employer in the town. In 2019, the co-op received a $5 million loan from the Western Australian Government to upgrade its mutton boning room. As a supply-based producer-owned processor, the co-operative qualifies under s120(1)(c) of the ITAA 1936 to make deductions on repayments of both principal and interest on the loan from the government. Historically this has been an important mechanism for regionally-based farmer-owned processing and marketing co-ops to invest in new plant and equipment.

Response to consultation questions

What types of projects or investments should the Government direct the NRF to focus on, or not invest in, within each of the seven priority areas to achieve the NRF's purpose?

There should be a willingness to support enabling projects relating to workforce, energy, transport, warehousing and distribution, marketing or other projects where this facilitates manufacturing activity in Australia.

The BCCM believes that domestically owned projects should be prioritised by the NRF as they are likely to create more social and economic value in Australia. The BCCM recommends the National Reconstruction Fund Corporation Bill is amended to include a minimum 50% Australian ownership requirement. In the alternative, this should be included in the rules, guidelines or investment mandate.

Co-operatives and mutuals are one form of business that is almost always domestically owned by members in the areas of Australia in which they operate. The member-owned structure of co-ops and mutuals means that they:

- Are long-term investors in domestic manufacturing because their members are local
- Increase the resilience of Australia's SMEs in a range of industries by helping them reduce input costs, access markets and share in profits from value-adding activities such as manufacturing
- Are domestically-owned and pay taxes domestically
- Earn vital export income for Australia
- Generate quality employment across regional and metropolitan Australia
- Enhance the function of markets by being the consumer and small business focused challengers
- Promote democratic values and practices through member ownership and collaboration

The BCCM recommends that co-operatively and mutually-owned projects should be expressly recognised in the investment mandate as a focus for the NRF.

How should industry 'transformation' and 'diversification' be defined and measured for each of the seven priority areas?

The BCCM recommends that transformation should be defined as including transformation to more Australian ownership and production in supply chains across all the priority areas.

The BCCM recommends that diversification should be defined to include diversification of forms of ownership in Australian supply chains across all the priority areas. Co-operative and mutual ownership should be recognised as one of the distinct forms of ownership in the measurement of diversification.

What are the opportunities for value-add, growth and diversification in each of the priority areas?

In the co-operative and mutual movement there are opportunities for investment in:

Renewables and low-emission technologies

- Product development and manufacturing of greener livestock feeds (e.g. Geraldton Fishermen's Co-op)
- Manufacturing, marketing and installation/retrofitting of green appliances and materials for household or industrial heating, cooling, hot water (e.g. Earthworker Co-operative)
- Innovative circular economy solutions reducing waste (e.g. Master Butchers Co-operative, Bega Valley Circular Co-op)

Value-add in the agriculture, forestry and fisheries sectors

- Expansion, diversification and innovation in established food processing co-operatives (e.g. Norco, The Casino Food Co-op)
- Investment in new and emerging food processing co-operatives reversing the long trend of offshoring of canning and other value-adding activities (e.g. Lockyer Valley Food Co-op)
- Collaboration between manufacturing co-operatives (and other aligned business) to meet common challenges such as input availability and cost, workforce, circular economy and marketing.

Defence capability and critical minerals

- Maximising domestic employment and SME capacity in relation to Defence industry and critical minerals (e.g. HunterNet Co-operative)

Enabling capabilities

- Co-operatives can facilitate group buying or shared services of any type for a group of likeminded businesses. The co-operative business model should be understood as an enabler for SME growth across all priority areas.
- Co-operatives can facilitate data sharing and new technology development and implementation across industries (e.g. SWIFT is an international co-operative of financial institutions)
- Co-operatives and mutuals can facilitate well governed group schemes to buy insurance or manage risk pools

What are the gaps in or barriers to private sector investment in each of the priority areas?

The report of the 2016 Senate Economics References Committee inquiry into co-operatives, mutuals and member-owned firms, noted access to capital as one of the key barriers for co-operatives and mutuals that has hindered growth, or in some cases, has led to demutualisation. These challenges apply to co-operatives and mutuals across the priority areas.

In line with the recommendations of that report, co-operative and mutual legislation has been reformed in recent years. Since 2019, co-operative and mutual companies have been able to Issue Mutual Capital Instruments. And in 2020 the harmonisation of state and territory co-operatives legislation (Co-operatives National Law) was completed, providing all co-operatives with the ability to issue Co-operative Capital Units.

Now the main barrier is stakeholder awareness and the development of markets for different forms of co-operative and mutual investment.

Government investment in these instruments would help accelerate market awareness and understanding of these relatively new forms of investment in co-operatives and mutuals (particularly Co-operative Capital Units) and encourage further investment by members, community investors and institutional investors.

The BCCM recommends that, in collaboration with the BCCM, a focused program of industry, government and market stakeholder education and capacity building is delivered so that the NRF is meaningfully inclusive of co-operatives and mutuals. The BCCM proposes a virtual Australian Centre for Co-operative Business Growth to provide expert business services to support industry, government and markets to be ready to use the NRF for investment in co-ops and mutuals and as a catalyst for further private investment.

The centre would be a collaboration between industry and the NRF so that all parties can fully understand and leverage the opportunities for investment in co-operatives and mutuals in the priority areas. It would focus on:

- A permissive legal and market framework
- Business preparedness among co-operative and mutuals
- Market and NRF understanding and acceptance

A permissive legal and market framework	Business preparedness among co-ops and mutuals	Market understanding and acceptance
○ Preservation of legacy assets ○ Open public markets ○ A positive regulatory framework	○ Business vision ○ Legal qualification ○ Capital planning ○ Growth plans for CMEs ○ Certification of business impact	○ National Reconstruction Fund ○ Wholesale markets ○ Retail markets ○ Placement investments ○ Intra-mutual sector investment

The centre would require modest funding and would be located with and administered by the BCCM. The centre could be delivered as part of a NRF co-investment plan.

What factors drive or constrain co-investment (for example, by industry, financial sector or domestic or offshore investors) and how should these be taken into account?

See above responses.

What are the mechanisms and types of finance which will best attract co-investment from the private sector? How can the NRF best crowd-in investment?

See above responses.

Co-operative and mutual ownership models encourage co-investment, not rent seeking. They are well positioned to meet the ESG benchmarks to qualify for Impact Investing.

Co-operative loans that comply with s120(1)(c) of the Income Tax Assessment Act 1936 are an excellent example of how a modest tax incentive attached to financial accommodation on commercial terms from the NRF could attract significant ongoing reinvestment in domestic manufacturing through co-operatives.

What are the non-financial barriers preventing businesses from making the most of opportunities for value-add, growth and diversification in the priority areas?

See above responses.

Are there non-financial mechanisms that could support priority areas and the objectives of the NRF?

See above response to question 'what are the gaps in or barriers to private sector investment in each of the priority areas?'.

The NRF can partner with the BCCM to increase industry and market understanding of innovative forms of investment in co-operatives and mutuals that operate in the priority areas.

The BCCM has run a Capital Partners program to educate co-operatives and mutuals and the ecosystem of professional advisors and firms about these types of securities. The BCCM has a sustainability program preparing members for the Impact Investment market.

How could the NRF work alongside other complementary reforms to best deliver on the Government's policy priorities?

The NRF should leverage the legislative reforms to introduce Mutual Capital Instruments for mutual companies in 2019 and Co-operative Capital Units for co-operatives in 2020 to facilitate the co-investment with co-operatives and mutuals operating In the NRF's priority areas.

At a minimum, this requires that the NRF legislation, investment mandate, guidelines and rules are inclusive of these instruments. Under the current National Reconstruction Fund Corporation Bill, a Co-operative Capital Unit is not captured in one of the listed types of equity. The BCCM recommends that the National Reconstruction Fund Corporation Bill is amended to expressly include Co-operative Capital Units structured as equity in the definition of equity. In the alternative, the NRF rules must specify that the NRF can invest in Co-operative Capital Units that are structured as equity.

The BCCM also believes the NRF can deliver a valuable reform for co-operatives by being a provider of loans that meet the requirements of s120(1)(c) of the Income Tax Assessment Act 1936 with national coverage. This would address the lack of such loans in the majority of the states and territories. The BCCM recommends the Department of Industry, Science and Resources seek tax and legal advice on fund design to ensure the NRF has capacity to provide s120(1)(c) loans to co-operatives.

Including co-operative and mutual forms of investment will build the type of private investment/public benefit partnerships the Government seeks and ensure that value is reinvested in the Australian economy.

To what extent are other levers required to support the objectives of the NRF (for example, skills, trade, supply chains)?

Providing the NRF with some flexibility to invest in enabling investments in workforce or supply chains where this is the main block on businesses committing to local value-adding would be helpful.

How does the NRF, with other private and Government settings, drive the right ecosystems for sustainable industry growth?

The NRF and other Government settings should incentivise purpose-led businesses that share the objectives of the Government. In relation to co-operatives and mutuals, the BCCM's policy blueprint outlines the broader reforms that are needed to enable co-ops and mutuals to contribute even more to sustainable industry growth.

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