Defining Mutuality

What are co-operative and mutual enterprises (CMEs)?

BUSINESS COUNCIL OF CO-OPERATIVES AND MUTUALS

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Published July 2020 by the Business Council of Co-operatives and Mutuals (BCCM)|
GPO Box 5166, Wynyard, Sydney 2001 | www.bccm.coop

BCCM thanks Mutuo for assistance with preparation of this note.

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Overview

This note seeks to provide guidance on how different co-operative and mutual enterprises (CMEs) are defined in Australia, how they fit into the corporate landscape, the different legal structures used, and the governance systems operated. It does so under the following headings:

Comparing corporate business purpose

- The purpose of a shareholder owned company is to reward owners who make risk investments, through profits and capital gain
- The purpose of a CME is to provide goods and services to its members, on an equitable basis
- The purpose of a charity and not-for-profit is to deliver 'public benefits' to a defined community

Defining a CME

- Every CME has a business purpose that seeks to achieve equitable outcomes for its members
- A basic principle is that no member can benefit more than is fair - so benefits are either universal, or tied proportionately to business transactions
- CMEs constitute themselves in ways that ensure this outcome

Legal Structures

- In some parts of the world, particular CMEs have bespoke legal structures that only they can use. In Australia, this only applies to state and territory registered co-operatives
- There is no single legal structure for a CME, though federally registered mutuals are now able to identify as a 'Mutual Entity' under the Corporations Act
- Australian CMEs utilise a range of incorporated (co-operative, company, incorporated, Aboriginal Corporation and unincorporated (trust) structures, but always with a mutual style constitution

Mutual Governance

- In order to maintain equity, all CMEs choose a constitution that operates on the on the basis of one member, one vote (OMOV) governance or a system close to it
- Governance can either be direct, with all economic participants qualifying as members, or indirect, with proxy representation of stakeholder interests
- The level of active engagement by members will depend on the type of CME and the level of engagement required

Appendices

- Identifying a co-operative or mutual enterprise
- A comparison of CMEs: producer-owned, mutual and customer-owned
- The spectrum of mutual governance

Comparing corporate business purpose

a) The purpose of a shareholder owned company is to reward owners who make risk investments, through profits and capital gain

Private purpose relies on creating shareholder value and is effective at delivering it. It dominates the commercial world today. It creates jobs, provides goods and services and generates tax revenue. It encourages constant innovation, improvement and progress and has driven many great advances.

Rewards for this success belong to the owner shareholders, for the whom the company exists. Directors have a legal duty to serve the interests of shareholders, above all other stakeholders.

b) The purpose of a CME is to provide goods and services to its members on an equitable basis

A mutual venture is one where people come together to achieve something for themselves and for each other. They have a shared need that none of them can meet on their own, but by pooling that shared need through a willingness to do something collaboratively, they provide a mechanism to meet the needs of all.

CMEs can operate at lower cost to customers/members, other things being equal, because they are not required to reward investors. They can choose to share this advantage with members through higher service levels, lower pricing or rebates.

CMEs are equitable because they reward membership in relation to its engagement with the CME, rather than in proportion to investor shareholding.

c) The purpose of a charity is to deliver 'public benefits' to a defined community

Charities are a form of custodian ownership where individuals are precluded from obtaining any private benefit, and where the organisation exists for one or more 'public benefit' charitable purposes. They are established by private individuals or organisations and generally seek their funding from private individuals, businesses and other benefactors.

Often those who benefit from charities will be limited to a specified group of people living with a particular disadvantage. In many jurisdictions, charities are treated favourably for fiscal purposes, to reflect their public purpose.

Defining a CME

a) Every CME has a business purpose that seeks to achieve equitable outcomes for its members

CMEs emerge where there is a 'market failure', where traditional forms of business do not meet people's needs. Mutuality consists of people making a commitment to each other through the mutual organisation they have set up.

The venture is only sustainable if people commit to bringing their trade to the organisation, and if their needs change, then by changing what the organisation does to meet those changing needs. As members, people are able to do this in a CME because they own and control the organisation.

b) A basic principle is that no member can benefit more than is fair - so benefits are either universal, or tied proportionately to transactions

CMEs are a form of ownership which will only work and retain people's commitment if they are fair to everyone, and equitable.

This is achieved through members sharing equal power in the organisation, rebates from surpluses only distributed in proportion to economic contribution, underlying assets not being used to reward anybody and nobody gaining more than anyone else, except through the trade they have contributed to the CME.

c) CMEs constitute themselves in ways that ensure this outcome

Mutuality is a form of collective or shared ownership between individual members on the basis of a mutual commitment.

Like a shareholder owned company, CMEs are legal entities distinct from their member-owners, but their business purpose is different, and this is reflected in the way they are constituted.

There are many different legal forms used by CMEs - but rather than a particular legal form, they instead share a common approach in their constitutions.

Legal Structures

a) In some parts of the world, particular CMEs have bespoke legal structures that only they can use. In Australia, this only applies to State registered co-operatives

Before the Corporations Act 2001, separate legislation existed in Australia for credit unions, building societies and friendly societies. Other types of CMEs were already registered as companies.

Today, all federally registered CMEs are now under the Corporations Act as companies, with the sector's only exception in corporate structure being State registered cooperatives, and occasionally, incorporated associations.

Other bespoke corporate structures remain overseas, with specific co-operative and mutual forms maintained in a number of jurisdictions. Indeed, in the European Union for example, new and additional structures for co-operatives and mutuals have been developed in recent years.

b) There is no single legal structure for a CME, though federally registered mutuals are now able to identify as a 'Mutual Entity' under the Corporations Act

Mutuality is a way of doing business, with a different business purpose from shareholder owned firms. As indicated above, it is the constitutional arrangements that define a CME, rather than any single legal structure.

The Treasury Laws Amendment (Mutual Reforms) Act 2019 permits federally registered companies with a mutual constitution to use the definition of a 'Mutual Entity'. A company is a mutual entity if: (a) the company is registered under the Corporations Act; and (b) the company's constitution provides that a person has no more than one vote at a general meeting of the company for each capacity in which the person is a member of the company.

c) Australian CMEs utilise a range of incorporated and unincorporated structures, but always with a mutual style constitution

Federally registered CMEs all adopt one of the types of company structure and add a mutual style constitution that reflects their needs as best can be established under the Corporations Act.

Australian CMEs may be companies limited by shares, by guarantee, or by shares and guarantee. The additional qualification of 'mutual entity' was introduced in 2019, though as explained above, this is an assertion of mutuality that is parallel to the existing legal and taxation corporate status of a CME.

Though a major step forward, this remains sub-optimal, as the Corporations Act fails to cater for the necessary character of mutual business. Additional reforms will be needed to remedy this.

Mutual Governance

a) In order to maintain equity, all CMEs choose a constitution that operates on the basis of one member one vote (OMOV) governance or a system close to it

It is a fundamental principle of CMEs that members share power in the organisation.

CMEs almost universally adopt constitutions that are based on the foundation of one member one vote. This contrasts with shareholder owned companies, where voting is proportional, in relation to investments.

When the Mutual Reforms Act 2019 was drafted, it was this feature that was selected as the essential characteristic for the definition of a 'mutual entity.'

b) Governance can either be direct, with all economic participants qualifying as members, or indirect, with proxy representation of stakeholder interests

Constitutions in CMEs will reflect the character, history and membership base of the business.

In most CMEs, membership is broad, with membership rights for all customers in consumer mutuals, or all producers in the case of those types.

Occasionally, member representation is on a proxy or delegate basis, with membership rights held by a smaller representative group on behalf of the wider stakeholders. In either case, OMOV is operated.

Occasionally, proportional voting is on the basis of economic contribution or investment. In these cases, an upper limit is placed on the voting power of any individual member.

c) The level of active engagement by members will depend on the type of CME and the level of engagement required

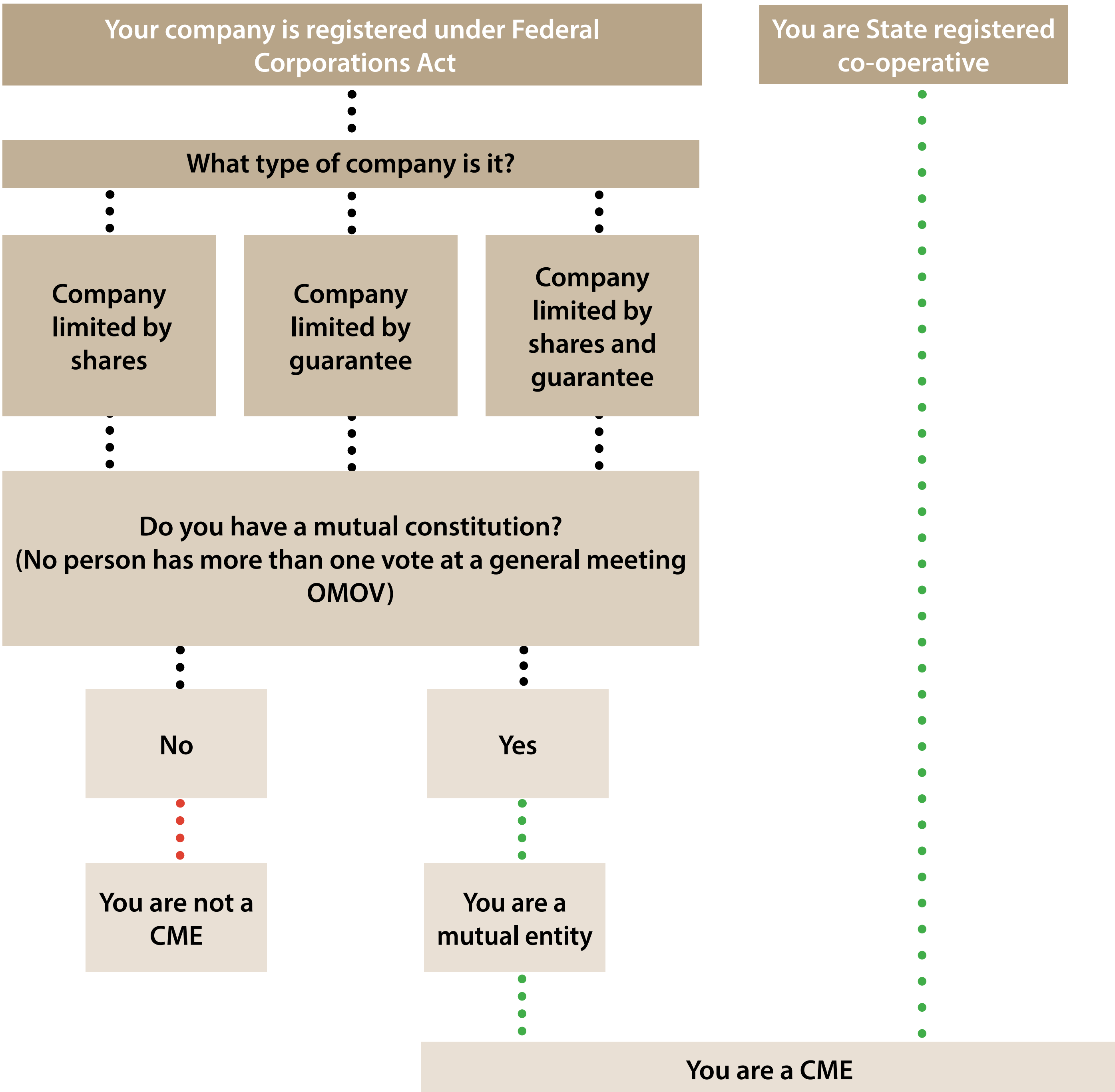
Mutual constitutions vary according to their particular circumstances of a business. The level of engagement between individual members and the governance structure also varies.

As a general rule, the greater the financial relationship between the CME and the member, the higher the level of engagement that is experienced in the governance structure.

Appendices

Identifying a co-operative or mutual enterprise

In most cases[1], it is a simple process to identify a CME.



[1] There are some exceptions, for example mutuals that are incorporated associations like RAC WA.

A comparison of CMEs: Producer-owned, mutual and customer-owned

For purpose of this comparison, we have selected a number of leading Australian CMEs.

Producer owned, e.g. Norco, CBH Group

Features

- Business purpose is to provide value to its enterprise members
- Membership consists of individual enterprises
- Strong financial relationship between members and the CME
    - Members contribute capital
    - Members benefit from rebates and services

Mutuals, e.g. HCF, CareSuper, Australian Unity

Features

- Business purpose is to provide value to its customers (or policy holders)
- Membership consists of individual customers or their proxy representitives
- Members do not contribute capital
- Members benefit from price and service

Customer owned, e.g. CUA, Bank Australia, RACWA

Features

- Business purpose is to provide value to its customers
- Membership consists of individual customers
- Members do not contribute capital
- Members benefit from price and service

The spectrum of Mutual Governance

Less active member governance relationship	Proxy member governance relationship	More active member governance relationship

The varying manner in which CMEs adopt mutual governance structures is a good illustration why legal form and governance alone is not the best indicator of the way a business will operate its mutuality. It is always best to refer first to the business purpose.

As suggested above, the level of engagement that members will have with the governance mechanics of a CME will tend to increase, the more financial stake they have. Hence members in producer-owned CMEs are usually more engaged in director elections, AGMs and other member activities

Where the member relationship is more as a customer, this reduces the level of the active engagement, in the normal life of a mutual. An exception to this is in the case of proxy members, usually a small number representing the wider customer base, who will be more engaged up to and sometimes including Board level.

For more information contact BCCM: info@bccm.coop

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