Financial participation by employees in co-operatives in Britain

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Introductory

Overview of UK co-operatives

Britain is well-known internationally as the home of the first modern co-operative, the grocery store opened in the northern town of Rochdale in 1844. Today the increasingly diverse co-operative sector in Britain continues to be dominated by retail co-op (consumer co-op) societies in terms of assets, turnover, membership and employees.

Together, these consumer societies run about 6,750 shops and retail outlets, including supermarkets, convenience stores, pharmacies, travel agencies, funeral services, garages, and much else. There is a major insurer (Co-operative Insurance Services) and a retail bank (Co-operative Bank), both owned by the largest society. The total turnover of these societies is approximately £12 bn (about €18 bn) a year.

Previously organised on a local or regional basis, the number of retail societies has declined considerably in recent years, primarily as a result of amalgamations and of take-overs of smaller societies. Compared with 1960, when there were about 860 consumer co-op societies, there are currently 41 co-op societies who together use the ‘Co-op’ brand.

Of the 41 societies, four contribute over 85% of the total turnover, and of these four one is pre-eminent in terms of size. The Co-operative Group, created as the result of a recent major merger, has turnover of over £8 bn (about €12 bn) and represents about 65% of the retail co-op sector. It runs 1700 stores, owns the bank and insurance company (jointly run as Cooperative Financial Services), is Britain’s largest funeral director and is also the country’s biggest farmer. There are three sizeable regionally-based co-operatives, United, Midlands, and Oxford Swindon & Gloucester. The other 37 societies operate locally or regionally.

The workers’ co-operative (producer co-operative) sector in Britain, whilst it can also trace its historical roots back to the pioneering days of the nineteenth century, is today much smaller than the retail side. Almost without exception workers’ co-ops are SMEs (in some cases microenterprises with fewer than ten employees), usually established relatively recently. Nevertheless, workers’ co-ops tend to have a strong commitment to co-operative values, and some play an active and important role in the national co-operative movement. There are also a small number of larger businesses in Britain, which – whilst not considering themselves workers' co-operatives – are to a significant extent employee-owned and controlled; these include a well-known chain of national department stores, the John Lewis Partnership which also runs the Waitrose supermarket chain.

Britain has a number of agricultural marketing co-operatives (including those for farmers and fishermen), and a small housing co-operative sector, providing social housing. There is an active, if relatively small, credit union movement.

There are also a growing number of 'community co-operatives', with membership open not just to employees or customers, but more generally to those people in a particular locality who support the aims of the enterprise. In some cases, community co-operatives have been encouraged by public policy measures designed to support economic regeneration and social inclusion. Recent ventures include community broadband telephone connectivity and wind energy generation. In a number of towns, co-operatively structured Football Supporter Trusts have been developed, allowing football supporters to have a direct stake in the business side of their team. A small number of teams in lower divisions of the English Football League are now under the majority ownership and control of their Football Supporters Trust.

At present, there is considerable interest in the possibilities that co-operatives could be used to develop public services, such as local leisure facilities and elderly care. This interest comes at the time when the current government is increasingly looking to the commercial private sector for the delivery of public services.

Recent developments in the UK co-operative movement

The last few years have seen a welcome, and much needed, start made towards strengthening and rebuilding the co-operative movement in Britain.

For much of the second half of the twentieth century, the story – at least for retail co-operatives – was one of decline. Co-ops, which had once dominated the food market, saw their market share fall, from 22% in 1957 to 15% in 1967, 8% in 1987 and about 6% today. In some cases, capital assets such as land and property were effectively cashed in, to make up for poor trading performance. A number of smaller societies which would otherwise have ceased trading were rescued by larger societies through transfers of engagements. This loss of trading performance was mirrored by a decline in membership and in member engagement.

At the same time, the national climate in Britain was increasingly antithetical to the idea of mutuality. From the early 1980s onwards, the Thatcher government privatised large areas of enterprise formerly publicly owned, whilst at the same time encouraging private individuals to become shareholders. The way in which privatisations were structured generally meant very quick capital gains for investors.

A trend towards demutualisation in the building society sector, which began in the late 1980s but which reached its peak in the late 1990s, saw almost all the major societies in Britain convert to (or be taken over by) plcs. Of the top ten building societies in 1988 only two remain mutual today. A number of formerly mutual insurers have also recently demutualised, as have other member-owned ventures (such as the major car breakdown organisation, the AA).

These demutualisations, by distributing accumulated reserves to individuals, frequently brought sizeable cash windfalls to former members. For a time there was a frenzy of media speculation about which would be the next enterprise to demutualise.

The largest co-operative society in Britain was subject to an attempted forced demutualisation, financed by City of London funding, in 1997, a bid which was defeated but which revealed the weakness of the movement and the need for renewal. One response was the decision to merge the two largest co-operative societies, to create the powerful Co-operative Group. This merger necessitated a major overhaul of previous management and Board structures.

The establishment of a high level Co-operative Commission, set up in 2000 with the Prime Minister's active support and chaired by the General Secretary of the Trades Union Congress, was another very significant initiative. The Commission in its final report, issued in Spring 2001, made 60 recommendations in a call for a renaissance of the movement. The aim, it said, should be "to challenge conventional UK enterprise by building a commercially successful family of businesses that offers a clear co-operative advantage"[1].

The three years since the Co-operative Commission reported have seen a number of developments take place designed to help achieve this aim. The national bodies for the retail co-operative and workers' co-operative sector have come together to create a new national federal body, Co-operatives UK, which held its inaugural conference in 2003. Co-operative Action, funded by a number of societies, was established in 2002, to act as a charitable foundation to promote the development of co-operative and mutual initiatives. Moves have also been made to explore ways in which co-operatives can develop into new areas of business trading.

[1] The Co-operative Advantage, report of the Co-operative Commission, January 2001

Legal frameworks

Whilst private limited companies and public limited companies (plcs) are incorporated under the Companies Act, co-operatives in Britain have traditionally registered under the *Industrial and Provident Societies (I&PS) Act.*

This legislation has its origins in the nineteenth century, in the early days of the co-operative and friendly society movements. Unlike the Companies Act, which has been extensively revised and modernised over the years, the I&PS Act has (at least until very recent times) received little attention from legislators. Co-ops have had to make do with a legislative framework, therefore, which in some areas has lacked flexibility. Even the name of the Act is archaic (though the law is gradually moving towards the alternative name 'Co-operatives and Community Benefit Societies Act').

The I&PS Act confers corporate (legal) status on a society, and also gives its members limited liability. Members join by purchasing a share which costs £1 in most co-operatives, and can also hold further shares up to the maximum permitted by law, currently set at £20,000 (about €30,000). Regardless of the shareholding size, the co-operative principle of 'one member, one vote' applies. (In secondary co-ops, such as federal bodies, other I&PS Act societies are not limited by the £20,000 rule).

Co-op shares occupy something of a grey area in relation to traditional types of business finance. Unlike equity shares in conventional companies, they never vary in value: a share is always worth its original £1. Shares are withdrawable and can normally be cashed in at any time, on application to the co-operative society. For these reasons, there is no secondary market in the shares. Limited dividends (more correctly, 'share interest') can be paid to members from profits. (As interest is normally added to shares rather than distributed, this means somewhat curiously that fractions of shares can be held). In a number of respects, therefore, co-op shareholdings resemble building society or bank savings accounts much more than they do traditional company shares.

Both because of the nature of co-op society shares and because of the current £20,000 maximum individual holding, traditionally co-ops have been unable to use equity-style capital for development. Business growth has been financed through retained profit (and, historically, also profit distributed to members but retained by them in their share accounts) or through forms of interest-paying borrowings.

Partly because of the perceived limitations of the I&PS Act, a number of co-operatives (mainly workers' co-operatives and community co-operatives) have chosen to register using the Companies Act. In general, they have incorporated as *companies limited by guarantee, without share capital,* a legal model also used extensively by charities and other non-profit voluntary organisations. Using this route, 'membership' of the venture is effectively given to those individuals who choose to pay £1 (this is also the limit of their legal liability, in the event of insolvency). A number of model rules enabling co-ops to register under the Companies Act have been devised; for workers' co-ops, these rules restrict membership to those who are employed by the enterprise.

This route offers some flexibility not available under the I&PS Act, but still deprives co-operative businesses of access to equity capital. However, a number of workers' co-operatives have also explored ways in which it may be possible to set up co-operatively run *companies limited by share capital* under the Companies Act. This is the route taken both by private and public limited companies. A number of quite complex composite legal structures have been proposed and in some instances tried out, as a way of attempting to combine elements of co-op member control with investor input. This potentially controversial issue is considered later in this report in relation to the former co-operative Poptel.

Before leaving this overview of legislative frameworks, mention must also be made of current government proposals to create a completely new legislative framework for so-called *Community Interest Companies* (CICs). This move is designed in particular to support economic regeneration through social enterprises and community-based trading ventures. For example, it is proposed that CICs (whilst able to raise share capital and pay dividends) would include an 'asset lock' to prevent consolidated reserves being distributable.

If CICs do become introduced into British law, the legislative options potentially available to co-operatives could become even more complex, therefore. It should be noted, however, that CICs stress public benefit rather than member control.

Financial participation by employees in retail (consumer) co-operatives

The Co-operative Commission drew attention to the need for improvement in the relationship between retail co-operative societies and their employees. As the report pointed out:

> Management of any business, and particularly of Co-operative businesses, should be based on partnership with the staff of the organisation… Encouraging employees to become members and making that membership meaningful should become an important focus of management and of Societies' policy.[2]

Whilst some employees of retail societies choose to become members of their society (often investing just the minimum £1 necessary for membership), this is by no means always the case. There is, in fact, some evidence that co-operative societies have in the past not done as much as they could to make their staff feel partners and stakeholders in their businesses. (On the other hand, many consumer co-operatives have been better at recruiting staff into membership than customers.) As Pauline Green, chief executive of Co-operatives UK, pointed out in 2001, co-ops have traditionally suffered a higher rate of staff turnover than competitor retailers[3].

In this respect, the experience of *Oxford, Swindon and Gloucester Co-operative Society* is interesting. OSG is committed to encouraging its employees to become members (without at the same time threatening the principle of voluntary and open membership) and has recently introduced a new initiative to achieve this. Its strategy has been to identify individual employees who know about membership and who can approach other staff to invite them to join. (The OSG found that the biggest reason why staff were not co-op members was simply that no-one had ever asked them). OSG began a pilot scheme with 12 of these 'staff member representatives', and has since increased this to 80. In the short time since the scheme launch, the proportion of employees who are members has risen from 28% to 43%.

As well as improving employee loyalty, the initiative has produced an interesting financial side effect. Although it was not an original objective to raise capital from staff, one major benefit has been that more employees are choosing to save directly from their pay into their Member's Share Account (that is, to increase the number of shares they hold), by automatic payroll deduction. The OSG has worked to make this process simpler, and in just over a year has seen the number of employees saving in this way increase from a very low base to nearly 250. On average, each member of staff saves £28 (€42) a month with the co-operative.

A number of other co-operative societies are trying to address this same issue by making use of tax-efficient employee share option plans. Until 2000, co-op employees were denied the opportunity to benefit from tax concessions made available by the government to employees of plcs who held shares in their companies through Employee share ownership plans (Esops). Strong pressure was exerted by the co-operative movement on an initially reluctant Treasury (UK finance

[2] ibid
[3] Comments made at the launch seminar for an Aesop co-operative model, 10 January 2001

ministry) to extend the scheme to co-ops. This was achieved in July 2000, at the time when the tax rules for Esops were more generally undergoing change, as part of the government's introduction of a broader scheme for All Employee share option plans (Aesops).

Under the Aesop rules, individual employees who acquire shares in their company or co-operative society can benefit from relief from certain tax and national insurance (social protection) payments they would otherwise have made, provided they hold the shares for a minimum period. The tax rules are similar for both types of business. However, because co-operative shares are always valued at par (£1), co-op employees do not have the potential benefit of share price appreciation which their counterparts in plcs may enjoy.

The Aesop rules allow for three types of share acquisition. An employee can choose voluntarily to use some of their pay to acquire shares, up to a maximum of £125 (about €190) a month or 10% of salary. The share purchase is made from gross pay (prior to tax and NI deductions), either on a one-off basis or through the pay roll on a regular basis. The shares can be cashed in at any time, but normally have to held for five years to avoid a tax and NI liability becoming due. This arrangement is known under Aesop rules as 'Partnership shares'.

Secondly, companies and co-op societies can choose to reward employees who acquire Partnership shares by giving them additional free 'Matching shares'. This need not be on a 1:1 basis (though there is a maximum permitted of two Matching shares for each Partnership share).

Thirdly, companies and co-op societies can also choose to provide 'Free shares' to staff, as a form of employee incentive or to reward performance, up to a maximum of £3000 (about €4500) a year. The rules are complex, but the tax and NI relief is normally available only if shares are held for five years. Furthermore, for both Matching and Free shares, companies and co-op societies can insist that the shares are forfeited if staff leave employment for another job before the five year period is up. In other words, this scheme can be used as a tool to aid staff retention.

Companies and co-operatives can choose whether they wish to introduce an Aesop scheme. To aid co-operative societies considering taking part, the Co-operative Union (now Co-operatives UK) worked with consultants KPMG and with a firm of solicitors to prepare a comprehensive set of Aesop model rules, trust deeds and briefing papers, and these were launched at an event held early in 2001. The Co-operative Union nevertheless pointed out that each society would wish to tailor its own Aesop to its own circumstances.

Up to now, only a minority of the 41 retail societies have chosen to implement Aesops. Some – such as *West Midlands Co-operative Society* and *Southern Co-operative Ltd* – have investigated the scheme and decided as a consequence not to proceed. The *Co-operative Group* is currently exploring ways of increasing employee participation and this could in due course be linked to a tax-efficient mechanism such as an Aesop scheme.

Elsewhere, *Lincolnshire Co-operative Society* is in the final stages of agreeing an Aesop scheme with the Inland Revenue, and is planning to roll it out to employees from May 2004[4]. The Lincolnshire has chosen to proceed initially just on the basis of a Partnership share scheme, and this is the most popular route chosen by those societies which have already launched Aesops. The *Ilkeston Co-operative Society*, for example, has offered Partnership shares for about two years, having launched the scheme to its staff through a series of staff road shows and a marketing leaflet. About forty employees, out of a total workforce of about 1300, have joined to date. Ilkeston's head of human resources Paul Smith admits that this is a lower take-up rate than the society initially hoped. He identifies the five year minimum retention period for tax relief as the main obstacle to greater participation[5].

The *Anglia Regional Co-operative Society* also feels that the take-up for its Partnership shares has been lower than it had anticipated. It launched its Aesop scheme in April 2002, and attracted 220 employees (out of a workforce at that time of 3266). The number participating has now fallen to 206, mainly as a result of staff leaving. Of these, 24 are higher-rate taxpayers (out of Anglia's 70 employees who pay higher-rate tax).

One issue sometimes raised in relation to Aesops is that the tax savings are too small, and the five-year wait too long, to make the scheme sufficiently attractive, at least to standard-rate (22%) taxpayers. Higher-rate (40%) taxpayers appear to have more to gain, though they do not have the full national insurance savings available to most standard-rate taxpayers, worth about 10%. For higher rate taxpayers, a single £1 Partnership share, held for five years, effectively costs them about 59p. For most standard-rate taxpayers, the cost is around 67p. (The co-operative society also benefits itself from saving the employer's national insurance contribution, currently levied at 12.8% on pay above £89 a week).

Both Ilkeston and Anglia are now considering extending the scheme to include a Free shares scheme. For the Anglia, this would be a way of returning to the idea of an employee bonus scheme, paid for a time in the mid-1990s but withdrawn when the society encountered trading difficulties. The idea of introducing Free shares has

[4] Information from Kevin Cooke, Chief Executive, December 2003
[5] Information from Paul Smith, December 2003

been debated by the society's Executive in recent months, and may be introduced for the trading year beginning October 2004.[6]

This is indeed the path which *United Co-operatives* has chosen to follow. United is now in the third year of its Free Share initiative, a reward scheme for all staff based not on salaries or individual performance, but simply on the number of hours worked. The Free share scheme is linked to the society's overall level of trading success, and for the first two years has resulted in an award of £500 in shares to all full-time staff with at least a year's employment service with the society. Part-time staff receive a pro rata award, whilst newer members of staff who have worked for at least 6 months receive a half allowance. Shares have to be held for three years (except in the case of retirement, redundancy or death), and for a further two years to attract the government's tax and national insurance concession. Shares benefit from interest, currently 3.75% pa.

Martyn Wates, Chief Financial Officer at United Co-operatives, says that the society has specifically chosen to operate the scheme by focusing on hours worked rather than salary levels, in order to maximise the benefits for lower-paid staff. The scheme complements a more traditional bonus scheme for managers, linked to performance.

Since its introduction, staff retention rates have improved among employees who have at least a year's service, which suggests that the scheme may be having some success. The society is now in the process of planning the introduction of a Partnership share scheme.[7]

Scottish Midland Co-operative Society (*ScotMid*), the independent Scottish co-operative society based in Edinburgh, is believed to be the only society currently to offer its employees access to all three types of Aesop share. ScotMid has made Partnership shares available since the Spring of 2002, when about 200 employees (out of its workforce at that time of about 3300) joined the scheme. Shares are purchased each month through the pay packet, from £2 a week to £125 a month (the maximum permitted by Aesop rules).

The society adds to this investment by employees by donating Matching shares, at the rate of one Matching share to each ten Partnership shares held. This represents, in broad terms, the saving which the society is itself making in the national insurance contributions it would otherwise have made for these employees.

Thirdly, the society has for the past two years made Free shares available to all staff, as a way of providing a modest Christmas bonus. In 2002, £20 in Free shares were

[6] Information from Ron Douglas, Deputy Chief Executive, December 2003
[7] Information from Martyn Wates, January 2004

made available, in 2003 the award was £25. However, ScotMid is now going a stage further, and has committed itself to making up to £250 in Free shares available this year to its employees as part of a performance-related scheme. The Free share issue is tiered, so that the maximum £250 offer will be paid if performance collectively by the society's staff results in ScotMid outperforming its profit target for the year of £5.7m (€8.5m) by at least 14%. Below this level, smaller Free share offers will be made. As with United, the offer is identical for all staff.

The use of Aesops is unlikely by itself to act as a sufficiently powerful incentive to retain staff who are set on moving to other employers, as ScotMid's Depute CEO and Secretary John Brodie accepts. However, he points out that, as well as the tax breaks, staff are benefiting from the share interest paid by the society on its shares, currently a generous 4%.[8]

Whilst most people will welcome the opportunities offered by Aesops for increasing employees' commitment to the co-operatives which employ them, there does remain – at least potentially - an issue in relation to the democratic control of consumer co-op societies which should perhaps be mentioned. It is possible to argue that initiatives like these may have the effect of strengthening the role of employees – and in particular senior management – in the co-operative, at the expense of other members' interests. In particular, it could be argued that schemes which issue Free shares linked to profit levels could encourage co-op society managements to take business decisions which simply maximise profit, rather than those which most fit with co-operative values.

Financial participation by employee members in workers' co-operatives

Turning to the workers' co-operative sector, the question of financial participation by co-op members in their business raises rather different issues. We will distinguish between start-ups and conversions of existing businesses to co-operatives.

After many years of decline, the idea of worker co-operation encountered something of a renaissance in the 1970s and 1980s, associated with an upsurge of interest in alternative forms of collective working, often linked to business ventures with a strong philosophical or ideological commitment to social change. Co-operatives established during this time were frequently established on the basis of wage parity and (for smaller co-operatives) with collective as opposed to delegated management structures, though over time the majority of surviving co-ops have tended to move towards more conventional pay and management arrangements.

[8] Information from John Brodie, January 2004

In one respect, however, the philosophical commitment of these ventures to collectivity has been preserved in the legal structures adopted. The majority of workers' co-operatives established in recent years have chosen legal structures which establish common ownership (as opposed to co-ownership) of the business's assets. The idea is that employees in a common ownership co-op are to be rewarded through their pay for the work they undertake, but are to have no residual claim over the accumulated reserves of the venture. This form of 'asset lock' has the aim of reinforcing both the collective nature of the enterprise and of protecting the on-going life of the business from members who might be tempted to benefit personally by winding it up.

The concept of 'common ownership', whilst it emerged originally from a number of asset transfers by philanthropically minded owners of family businesses to their employees, fitted well with the rejection by many in the workers' co-op sector of the concept of a 'share-owning democracy', which was enthusiastically promoted by the Thatcher government (1979-1990). The centrality of common ownership to the recent history of worker co-operation in Britain is reflected by the fact that (until its recent merger into Co-operatives UK) the main national body representing workers' co-operatives was the Industrial Common Ownership Movement (ICOM) and that ICOM model legal rules were used by the vast majority of new co-operatives.

This emphasis on common ownership has tended to mean that the issue of financial participation by members in their co-operatives has not been a very live one in Britain. Most start-up workers' co-operatives do not require investment by employees in their businesses as a condition of participation. Business capital has tended instead to come from bank loans and from one of a number of specialist loan funds, including Industrial Common Ownership Finance, originally set up with the support of ICOM.

There has, however, been something of a debate within the workers' co-operative movement about the concept of 'sweat equity', in other words the contribution made by co-op members – particularly in the start-up phase of the business – towards ensuring the financial health of their enterprise by working long hours or by agreeing to take low wages. As has been pointed out, this effectively represents a form of unrecognised investment by members in their co-ops. One possible criticism of common ownership is that it fails to provide a mechanism for recognising the 'sweat equity' contributed by members.

Within this overall context, it is interesting to compare the experiences of two very different co-operatives, both established during the 1970s and 1980s. *Suma*, a successful wholefood distribution business, celebrated 25 years of trading in 2002 and currently has turnover of about £14m (€21m). Suma has maintained many of the co-operative principles on which it was founded, and its 100+ staff are all paid the same basic wage, currently about £17,000 (€25,500) a year. Staff also benefit from generous maternity and partner leave and an ethical pension scheme.

Suma's expansion has been steady rather than spectacular, funded almost entirely from retained profits, and it is possible to argue that its inability to access equity capital has allowed non-cooperative competitors to exploit more quickly the growing wholefood market. Nevertheless, Suma argues that – in contrast to conventional businesses - it is aiming to build for a business which is sustainable over the long-term, rather than one which generates short-term profits for investors of risk capital.[9]

Poptel was set up a few years after Suma, in 1983, to provide on-line services primarily for international and national non-profit organisations, especially trade unions and charities. Its origins were as a small common ownership co-op with pay equity; however, it rapidly developed from this base and by the mid-1990s was competing with other internet service providers, whilst still focusing primarily on the not-for-profit sector. Given the high speed of change and the high level of investment needed in the IT sector, it became clear to the co-op's directors that the business was undercapitalised and at risk of failing. The co-op therefore chose to seek external risk capital, and in 1999 it negotiated a £1.5m (€2.25m) loan from a private equity investment company. As part of this change, the legal structure of the business was changed with the creation of a new conventional private limited company; the workers' co-op owned 75% of the shares in this company, with the investment company holding the remaining 25%.

At the same time, Poptel pondered whether to introduce a share option scheme, a familiar device in the IT sector, as a way of incentivising and rewarding its staff. This would have enabled employees to benefit from any growth in the business's market valuation.

Unfortunately, this discussion was overtaken by trading difficulties, which necessitated Poptel taking additional external capital and diluting the worker-owned element of the business down to just over 50%. Finally, when yet further capital was required, the business effectively passed into the ownership and control of the equity capital company. Poptel itself ceased to be a co-operative in 2003, although a small number of its staff went off to develop a spin-off co-operative business, Poptel Technology.[10]

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[9] Andrew Bibby, Virtues of the ideal business, Financial Times, 16 October 2002
[10] For an extended case study about Poptel, see www.andrewbibby.com/socialenterprise/poptel.html

Poptel's difficulties as a business with a co-operative legal structure in attracting the capital it needed, and in particular in attracting equity capital rather than loan capital, has encouraged the sector in recent months to look again at suitable finance mechanisms for co-ops. A research project, established under the auspices of Co-operative Action, is currently investigating capital sources for co-operatives requiring between £1m-£20m (€1.5m-€30m), a perceived area of difficulty at present. In particular, the project is looking at ways in which investors, as stakeholders, might be able to have their interests formally acknowledged and recognised within co-operative structures.

The project recognises, for example, that the significant amounts of ethical money now invested in the UK are almost entirely bypassing the co-operative sector. For example, about £3.5 bn (€5.25 bn) is currently invested in collective investment funds with ethical investment criteria, whilst one estimate suggests that – if all the investment funds including charities, insurance funds and pension funds and churches who use elements of ethical screening are included – the total in socially responsible investment in Britain reaches as high as £220 bn (€330bn).

The project will publish its findings during 2004. Whilst not specifically looking at the issue of financial participation by co-op members, the project's findings will certainly open a discussion on multi-stakeholder co-operative models. This in turn will be relevant for the debate on co-operative delivery mechanisms for public services, including leisure trusts, and the way in which they can be capitalised.

Employee financial participation in the case of 'rescue' co-operatives and conversions

Although financial participation by employee-members of workers' co-operatives is, as we have seen, not usual in Britain in the case of start-ups, the situation is somewhat different in the case of 'rescue' or 'phoenix' co-operatives (established to re-establish insolvent conventional businesses), and of conversions (where existing businesses are converted to co-operatives, for example when an existing owner-manager comes to retire).

The idea that workers can save their jobs by stepping in to take over failed businesses has received considerable attention over the past thirty years. The 1970s began with a highly influential work-in by employees at Upper Clyde Shipbuilders in Glasgow, and the subsequent 1974-79 Labour government was actively engaged in a number of attempts to save failing businesses by relaunching them as co-operatives. In the 1980s, when traditional manufacturing in Britain was severely damaged by central government policies, a network of co-operative support agencies was established to carry forward this process. A number of these agencies continue to operate today.

Employees who lose their jobs through redundancy or company failure are entitled to a statutory redundancy payment, and a common feature of many ‘rescue’ co-operatives has been that workers have contributed an element of their redundancy pay to help finance the new co-operative venture. It has to be said that the subsequent track record of these co-ops is a mixed one, with many ultimately not succeeding. This is perhaps hardly surprising, given that the new worker-appointed management teams have to turn around businesses which have already failed once.

There have been some notable success stories, however. One example from south Wales is that of the workers at *Tower Colliery* near Aberdare. Tower, the last deep-level pit in Wales, was closed during the privatisation of the former nationalised corporation British Coal in 1994 and offered for sale to the private sector. Over 300 miners faced the loss of their jobs.

The secretary of the National Union of Mineworkers, which had strongly opposed the mine closure, led the Tower Employees Buy Out (TEBO) bid to enable the workers to purchase the business and run it as a worker-owned venture. 239 miners each contributed £8000 of their own money. In most cases, this came from British Coal redundancy payments, though sixty individuals took out personal loans to fund their investment. TEBO also negotiated a significant bank loan. In October 1994 the government announced that TEBO had beaten off private sector bids for the pit, and production started again early in 1995. The NUM secretary who led TEBO has now become the Chairman of the worker-owned company, known as Goitre Tower Anthracite Ltd.

To enable Tower to continue to be owned by those who work for the business, employees who leave must sell their shares to the company. An Employee Benefit Trust has been created to provide a mechanism for this buy-back process.

Under its new employee-owned structure, Tower got off to a strong financial start and by 2001 the business had an annual turnover of £28m (€42m), on which its profit was £2.7m (€4m). Whilst there have also been some difficult trading years, Tower has expanded its work to include coal distribution and domestic retailing of heating products and is set to celebrate its tenth anniversary as Europe’s only worker-owned coal mine in 2004.[11] (There is talk now of turning the story of Tower into a feature film).

Another more recent example of an employee buy-out of a failed company is that of *UBH International*, based in Lancashire in northern England. The company, which produces tank containers for transporting liquids, was formed in 1999 when 91 former employees of Universal Bulk Handling, then in receivership, contributed £5000 (€7500) apiece to buy the assets and intellectual property rights of the old company. Since then, the new firm has had to survive a difficult trading environment, and it reported losses in its first two years of operation. It managed a small notional profit in 2002 and hopes to be profitable in 2003-4. Its turnover is currently around £8m.

UBH International, whilst it is an employee-owned business, is a conventional share capital company and is not legally structured as a co-operative. This is partly the result of the way it has been capitalised. Although the employees of UBH International together contributed approaching half a million pounds themselves, they were able to capitalise their business only through the assistance of a specialist employee-ownership investment fund, Baxi Partnership, which invested £1m (€1.5m). Baxi Partnership, which controls a total fund of £20m (€30m), has also supported a number of other employee buy-outs in recent years. It takes an equity stake of at least 50% in the companies in which it invests, but the terms of its establishing trust oblige it to operate specifically in the interests of employees in those companies.[12]

As well as these ‘rescue’ initiatives to try to save ailing businesses, there is increasing interest in Britain in the potential for conversion of existing successful businesses into co-operatives. Typically, this can be appropriate where existing owner-managers of small companies reach retirement, or simply wish to find an exit route from their business in order to pursue other interests.

Historically, a small number of employee-owned businesses in Britain were established through the philanthropy of their previous owners. One well-know example is that of *Scott Bader,* an international polymer company which operates in nine countries and has 650 staff. Scott Bader was founded in 1921 and built up by its original owner Ernest Bader. He believed that a world where capital employed labour was not sustainable, and in 1951 he and the other original shareholders gifted the company to its employees, present and future. The shares were placed in The Scott Bader Commonwealth, a charitable company which provides collective

[11] See for example www.employee-ownership.org.uk/eootower.htm, http://www1c.btwebworld.com/tower-coal/towerhistory.html
[12] Mark Nicholson, Evangelist for employees as owners, Financial Times, 21 November 2002; Andrew Bibby, The challenge when labour employs capital, Financial Times, 31 October 2002

ownership of the business. Scott Bader has a sophisticated internal democratic structure, with members in general meeting delegating powers both to trustees and to the Commonwealth Board of Management. Participation by members in Scott Bader is not linked to any investment requirements.

The potential for employee buyouts of existing businesses is not limited to those relatively few occasions where owners are philanthropically minded or committed to principles of common ownership, however. The launch in February 2004 of *Succession London*, a new advisory service for business owners and their employees in London wanting to explore the potential of employee buyouts, follows similar initiatives undertaken elsewhere in Britain. In Wales, for example, a co-operative support agency has helped bring about a number of employee buyouts in recent years. One example is the mid-Wales company *E.O.M. Electrical Contractors,* established by twelve former employees of a family-run business in 1995. The twelve original members of E.O.M. each invested up to £5,000 (€7,500 apiece) in the new business.   The company has since quadrupled its turnover, to £2m, and increased its staff to 39.

The exact structure of an employee buyout varies between companies and can be complex. One model is to create an employee benefit trust which can hold the new company's shares, allocate them gradually to employees under an Aesop, and also buy them back when employees leave their jobs or come to retire. This has been the arrangement at E.O.M., where the company's founding team see the employee benefit trust as providing a further succession route for the firm when in due course they themselves reach retirement age and want to realise their investment.

The structuring of employee buyouts has, however, been handicapped by the removal in 2003 of a tax concession which allowed companies to make contributions to employee trusts from pre-tax profits. This government move, aimed at blocking tax evasion used by some conventional companies to benefit senior staff, may inadvertently hold back future growth in the number of employee buyouts.

Financial participation in community co-operatives

As mentioned above, recent years have also a growth in the number of community co-operatives in Britain, generally to run social enterprises of one kind or another.

One example is that of community initiatives undertaken to save village pubs. Pubs are a familiar part of the cultural life of Britain's towns and villages, but their continued existence is under threat, particularly in rural areas, from changes both in the brewing and drinks industry and in social habits.

When The Kings, the last pub in the Cambridgeshire village of Reach closed in 1998, for example, a local campaign *Reach for a Pint* was established to seek its reopening. The campaign found 48 people prepared together to chip in £160,000 (€240,000) to buy the pub's premises. It reopened in October 1999 with a new name, the Dykes End, and has since operated as a successful pub and restaurant. Similar initiatives have taken place in other villages.

Another interesting development in the UK co-operative movement is the establishment of *football supporters' trusts*. As already mentioned, these provide a collective way in which football supporters can together own shares in their favourite club on a mutual ownership basis, and can seek to make the football fans' voice heard at Board level.

Many lower-division football clubs are in extremely weak financial position, partly as the result of the collapse of a TV deal, and indeed several have already been pushed into bankruptcy or financial administration. Any successful long-term rescue plans clearly require new sources of capitalisation, and the development of football supporters trusts may well be one way to achieve this.

Initial legal work has already been undertaken towards devising a loan-note instrument, under which community investors could receive a combination of interest payments, at low rates of return, and non-financial benefits (such as use of club facilities or discounts on admission). Here would be one intriguing model, therefore, of a way in which members of co-operatively structured community ventures could invest their money in order to receive both social and financial returns[13].

Concluding comments

The issue of members' financial participation in their co-operatives is the subject of one of the international Co-operative Principles, as revised by the International Co-operative Alliance in 1995.   The text of the relevant clause is as follows:

[13] Christine Oughton et al, Back Home: returning football clubs to their communities, Mutuo, 2003; Christine Oughton, Football's Coming Home, New Sctor, June/July 2003

3rd principle: Member Economic Participation

Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership.

In many parts of the world, co-operative law and practice requires a minimum investment by members as a condition of membership – the idea being that self-financing is one way of ensuring that co-ops successfully preserve their independence from commercial take-over. As will have become clear from this report, this is not the usual practice in Britain today. In general, member financial participation – whether in retail or workers' co-operatives – has not been a major issue of discussion or debate.

However, this situation may change. The current climate of renaissance within the UK co-operative movement is leading to a reappraisal of many aspects of traditional co-operative practice. Following the publication of the Co-operative Commission report, the movement is looking much more closely at ways to diversify into new sectors, with childcare, the provision of care for the elderly, and sustainable energy generation being three of a number of areas under focus. At the same time, there is discussion of ways to develop co-op solutions to the delivery of public services.

It is too early to say how successful these various moves will be, or to what extent they will involve changes in the practice and legal basis on which co-operatives have traditionally operated. However, any discussion of new ventures inevitably raises questions of capitalisation and it must be assumed, therefore, that the question of appropriate financial mechanisms for co-operative businesses will receive greater attention than in the past. As part of this discussion, there may well be more discussion than in the past of the role of members' own financial participation in the development of their co-operatives.