

**CECOP Position on the European Commission Staff Working Paper
“THE SOCIAL BUSINESS INITIATIVE: PROMOTING SOCIAL INVESTMENT FUNDS”**

Brussels, September 2011

CECOP – CICOPA Europe (European Confederation of Worker Cooperatives, Social Cooperatives and Social and Participative Enterprises) is a European confederation grouping national organisations in 16 countries which in turn affiliate over 50.000 cooperative and participative enterprises in industry and services, the vast majority being SMEs, and employing 1.4 million workers across Europe. Among the main sectors of activity, we find industries, construction and public work, social services, transport, environmental activities, education and culture, media-related activities, etc. Most of them are characterised by the fact that the employees in their majority are members-owners, while some of them are second degree enterprises for SMEs. Furthermore, around 4.000 of those enterprises are specialised in the reintegration of disadvantaged and marginalised workers (disabled, long-term unemployed, ex prisoners, addicts, etc).

General remarks

CECOP would like to thank the European Commission for giving the opportunity to share its members' concerns about the initiative on Social Investment Funds. For CECOP members, social business is not something new, in fact since their origin, cooperative enterprises were created in order to achieve social objectives - for their members or for the society - while pursuing an economic activity.

A first general observation concerning this consultation has to do with the procedure. In our view, it is not acceptable to launch a consultation within such a short period of time. Starting an 8 week consultation in mid-July, in the middle of summer holidays does not allow a proper collection and coordinated analysis of the answers to the questions. This inevitably lowers the legitimacy of such an important consultation.

Defining social business

Cooperatives fall totally under the definition of “social businesses” sketched out in the consultation document. In fact, they:

- **“focus as a primary corporate objective on the achievement of social outcomes”¹**

No matter their activity, cooperatives achieve social outcomes because they are designed to respond to the needs of key stakeholders (workers, producers, consumers, users of services, inhabitants, members of a community, disadvantaged citizens etc) who are also their members-owners. The social dimension of cooperatives has been recognized by Italian and Portuguese constitutions. Beyond this fundamental characteristic, cooperatives also contribute to the sustainable development of their communities through policies approved by their members (7th

¹ Quote from the consultation document

cooperatives principle²). This dimension is even reinforced when cooperatives have as primary corporate objective the achievement of specific social needs for their members and/or the community like the provision of social services of general interest or work integration for vulnerable groups (eg. social cooperatives³). In case of worker cooperatives⁴, the creation and preservation of workplaces is the first social outcome for the workers/members of the cooperative.

- **“reinvest profits so as to maximise their ability to deliver on their primary objective, and therefore have no or limited profit redistribution for investors or stakeholders”**

As stipulated by the 3rd cooperative principle, cooperative members contribute equitably to the capital of their cooperative. At least part of that capital is usually the common property of the cooperative and, therefore, members allocate a substantial part of the surpluses towards developing their cooperative by setting up and developing reserves, which, in part of the EU countries, are legally indivisible even after the dissolution of the enterprise. Another part of the surplus is used to benefit members, though not as a dividend, but in proportion to their transactions with the cooperative (e.g., in the case of worker and social cooperatives, as a supplement of remuneration according to the work carried out). Part of the annual surplus can also be used to support other activities approved by the membership, to the common benefit of the latter, or to the benefit of the local community or of the cooperative movement. Another key characteristic is that members usually receive limited compensation, if any, on the capital to which they subscribe in order to become cooperative members.

- **“follow specific governance arrangements”**

Membership of a cooperative is open to all persons willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination. Cooperatives are democratically controlled by their members, who actively participate in setting their policies and making decisions. Cooperatives members have equal voting rights (one member, one vote) and cooperatives at other levels are also organised in a democratic manner (1st and 2nd cooperative principle).

As mentioned above, cooperatives remunerate capital in a very limited way and are not controlled by external shareholders. The other forms of social economy enterprises (mutuals, associations, foundations, as well as nationally regulated “social enterprises” namely enterprises whose specific, prevalent and direct mission is to focus on the delivery of goods or services of general interest⁵) generally have the same financial redistribution structure. The main reason for this is to ensure their social mission over the long term.

² The cooperative principles are guidelines by which cooperatives put their values into practice. All cooperative principles are listed here: www.cecop.coop/What-is-a-cooperative

³ Social cooperatives are commonly called social enterprises

⁴ Cooperatives where workers hold the majority of the shares, at least 51%

⁵ See Roelants (ed) *Cooperatives and Social Enterprises – Governance and Legal Frameworks*; Brussels: CECOP Publications, 2009

The funding challenge

Although we consider that adequate financial instruments are very important for the development of social businesses they should not be considered as the unique tool. An adequate regulatory framework at national level remains as the essential condition for their development and growth.

The type of social businesses represented by cooperatives face funding challenges that are clearly different to those faced by other kinds of business.

Beyond the fact that the banking or near-banking sector is reluctant to grant credits to cooperatives, their difficulties to access venture capital are also related to:

- their ownership system that accords limited rights to its members regarding the availability of the value of the company
- their profit distribution system which gives priority to the granting of returns to members (calculated on the basis of the type of relation between the members and the cooperative, not on the remuneration of capital) and the allocation of the profits to the indivisible funds⁶
- their control system, which accord very limited power, if any, to external shareholders (only some national legislation give the possibility of conventional external investors having an aggregate power of maximum 33%, provided the general assembly of the cooperative approves such structure, which is seldom the case).

Those difficulties have stimulated worker cooperatives and their federations to put in place specific financial instruments for their development. Some of them are entirely dedicated to the cooperative sector (such as CFI, Coopfond and Fondosviluppo in Italy or SOCODEN in France) or even other social economy sectors (such as ESFIN-IDES in France, Soficatra and Coop Est at the European level). They intervene according to different modalities, such as the cooperativisation of enterprises in crisis, enterprise start-ups, enterprise development and modernisation. They use different financial instruments, such as subordinated loans, risk capital, participative certificate, or guarantee funds. None of them are purely 'financial' organisations: they all have a critical follow up and advisory role: in this sense, they are full-fledged development organisations, in full support of the employment creation and social inclusion mission of worker and social cooperatives and other types of worker-owned enterprises.

European institutions could contribute to tackle barriers to access to finances for social businesses by adopting the following measures⁷:

1. Promote EU level financial mechanisms. The European Investment Bank and the European Investment Fund should be involved in the creation and strengthening of non-banking financial institutions for the development of cooperatives and other social businesses. Those institutions should:

- act as intermediaries between these networks of enterprises on the one hand and the financial markets, the banks and institutional investors on the other, with the issuing of

⁶ ZANOTTI Antonio in ZEVI A., ZANOTTI A., SOULAGE F., ZELAIA A., (2011), "Beyond the Crisis: Cooperatives, Work, Finance. Generating Wealth for the Long Term", CECOP Publications, Brussels, p.79. The book is the final result of a study carried out with the support of the European Commission (under the "Restructuring, well being at work and employees' financial participation" budget line of DG Employment). For more information about this book www.cecop.coop/Beyond-the-Crisis-Cooperatives

⁷ The specific policy recommendations in this section are drawn from a set of policy recommendations addressed to the EU institutions and at the national level in order to facilitate the development and the anticipation of change for industrial and service cooperatives and other employee-owned enterprises (some of these recommendations concerning the wider enterprise world) can be read in ZEVI A., ZANOTTI A., SOULAGE F., ZELAIA A., (2011), "Beyond the Crisis: Cooperatives, Work, Finance. Generating Wealth for the Long Term", CECOP Publications, Brussels.

non-voting financial instruments, both redeemable ones (such as classical bonds) and non-redeemable ones (such as participative certificates that can remain as equity for an indefinite period in enterprises, and can thence increase the capacity of the enterprises to obtain bank loans for productive purposes, especially under Basle 3). In addition, the policy environment should promote interaction with banks and institutional investors with the aim to encourage the subscription of these new financial instruments. These mechanisms should respect the governance system of joint control by the members-stakeholders over their enterprise and by the latter over their common financial institutions, as decades-long experience has shown that this was the safest way to maintain the specific strengths of these enterprises and ensure the long-term effect of the investments carried out in them. The experience since the crisis that flared up in 2008 confirms this fact.

- favour joint guarantee mechanisms
- manage common funds among enterprises

2. The European Commission could launch of a **specific Open Method of Coordination** to favour the national-level policies aimed at supporting capital accumulation:

- Employee participation to enterprise capital
 - Considering that their financial shares are, in most cases, not immediately redeemable, worker-members in industrial and service cooperatives should be granted complete de-taxation on their financial participation in their enterprises, and they should be able to borrow with limited guarantee mechanisms for this purpose.
 - In particular, direct financial mechanisms aimed at helping employees to invest in enterprises in crisis or without successor in order to engineer business transfers to employees, in particular under the cooperative form, are strongly urged.
 - Similar policies encouraging employees to take part in the capital and results of their enterprises should be encouraged through concrete fiscal mechanisms in other forms of enterprise as well, and with the necessary legal protection and corresponding ratio of participation in the governance, oversight, decision-making and responsibility in the enterprise.

- Promotion of enterprises reserves

If better financing of cooperative enterprises is to be encouraged, complete de-taxation of indivisible reserves (namely reserves that are not divisible even in case of liquidation, and which are then used to promote cooperative enterprises in general) should be envisaged.

- Legal provisions instituting fully de-taxed indivisible reserves (namely reserves with asset lock) in cooperatives in all EU member states where indivisible reserves are not already enshrined in legislation are strongly urged. In countries where indivisible reserves are already enshrined in legislation, total de-taxation of these reserves is advocated. Indeed, reserves that are indivisible even at liquidation have proven to be a powerful instrument for the long-term permanence and development of enterprises in the territories where they are located, and the jobs therein. They are also a major component of the intergenerational solidarity systems.
- Other accompanying mechanisms in industrial and service cooperatives and other employee-owned enterprises such as the non- (or not immediate) distribution of cooperative returns, the revaluation of members' shares (according to mechanisms

to be defined and independent from the stock market) should be encouraged and protected by law.

- Options for other forms of accumulation of non-redeemable capital helping enterprises to de-leverage and reduce their level of indebtedness while engaging in productive investment programmes aimed at anticipating change should be explored and encouraged in all forms of enterprises.

- Systemic financial mechanisms for productive capital accumulation

We advocate the establishment of legislation making it compulsory for all cooperatives to dedicate a percentage of their turnover or results to help establish new cooperatives, reinforce existing ones, and restructure enterprises threatened by closure into cooperatives (as is already the case in Italy with a national law making compulsory for all cooperatives to dedicate 3% of their results to solidarity funds for the development of cooperatives, see Italian chapter of this research). Those solidarity funds should be managed under the supervision of the cooperative organisations themselves for all cooperatives affiliated to such organisations. As a real instrument of economic policies, those solidarity funds should be used in order to invest in certain strategic sectors.

3. European Commission should launch further **European level research** on the following topics:

- the lever effect of various financial instruments being used onto external financial sources
- the impact of the structure and nature of enterprise reserves on enterprise longevity and long-term strategy
- the mechanisms that cause a higher or lower level of enterprise indebtedness

The role of investments funds

The creation of IDES⁸ in France is an interesting experience in term of financial support designed for the development of cooperatives and other social economy enterprises. IDES was established in order to provide equity capital to the enterprises of the social economy in the form of participation certificates⁹ or convertible bonds. IDES's specificity is that it brings together the main financial institutions of the social economy (cooperative banks and federations, mutual insurance companies and mutual health insurance organizations) in addition to the State. *"IDES thus forms part of a system of resource mutualisation, as its shareholders do not expect substantial returns from it but sound and balanced management that enables it to generate the resources needed to continue its activity in view of the characteristics of its products"*¹⁰. The State has, since IDES's creation, kept a percentage of around 26% with the remainder of the capital being held either by State agencies or by the social economy institutions with a financial mission (cooperative banks and mutual insurance companies).

Usually traditional venture companies seek above all to increase the value of the capital they are investing and that makes them reluctant to invest in social economy enterprises. IDES at the same

⁸ Institut de Développement de l'Economie Sociale

⁹ Titres participatifs in French

¹⁰ SOULAGE François in ZEVI A., ZANOTTI A., SOULAGE F., ZELAIA A., (2011), *"Beyond the Crisis: Cooperatives, Work, Finance. Generating Wealth for the Long Term"*, CECOP Publications, Brussels. p.173,174

time acts at high levels of equity in the social economy and of subscribing to participation certificates or convertible bonds.

IDES and other financial instruments are launched by cooperatives and are managed by the stakeholders directly concerned through joint control. Such as CFI¹¹ in Italy or the capital contribution without voting rights launched by the cooperatives Eroski and Fagor electrodomesticos, part of the Mondragon group, in Spain¹².

Generally speaking, the institutions of the cooperative movement that manage non-banking financial instruments are more than just financing agencies: they also act as developing and advisory agencies. The combination of those two elements is their best guarantee for effectiveness, and this is one of the reasons why it is important to maintain joint control by the cooperative stakeholders involved over these institutions: this, *inter alia*, guarantees the long term strategy and development of such institutions in delivering their social mission, as well as the pooling of necessary technical expertise in order to ensure the appropriate entrepreneurial follow-up.

The role of investors

Access to conventional financing has already been experienced by worker cooperatives. The main challenge for cooperatives has always been, and remains, adequate access to bank credits (for which purpose they also favoured institutions such as credit cooperatives). However, more recently, and in particular with the financial constraints stemming from the financial crisis, access to capital markets in order to attract net capital/asset resources has been put in place in some instances (eg IDES, Eroski and Fagor mentioned above) and is worth looking at.

Contribution of capital without voting rights is a guarantee that the control of the cooperative belongs exclusively to cooperative members and thus a guarantee for the pursuit of the cooperative primary social goal and mission. At the same time it is a very interesting source of financing. This experience could be extended to other enterprises practicing social business.

We are of the opinion that social investment funds should be opened to retail investors but with a system of none or limited voting rights. In the situation of limited voting rights, they should remain minority in order to guarantee the stakeholders' control dimension of the enterprise, like it is the case for the cooperatives.

A common EU label?

More than just clearly being defined, a possible EU brand or label for social investment funds would require a very strong level of monitoring. According to us, the contours of a possible framework for funds that invest in social business should be further defined and discussed with the concerned stakeholders before planning a new brand or label.

¹¹ *Cooperazione Finanza Impresa*

¹² *ZELAIA Adrian in op.cit.,p.147-153*