CECOP answer to the European Commission consultation on the Green Paper "Long-term financing of the European economy"

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CECOP – CICOPA Europe is a European confederation, grouping national organisations in 17 countries, which in turn affiliate over 50.000 cooperative and participative enterprises active in industry and services. The vast majority are SMEs and they employ 1.4 million workers across Europe. Among the main sectors of activity, we find metal and mechanical industries, construction and public work, social services, environmental activities, white goods, transport, education and culture, etc. Most of them are characterised by the fact that the employees in their majority are member-owners. More than a thousand worker cooperatives in the CECOP network were created as business transfers to employees of conventional enterprises in crisis or without heirs.

CECOP welcomes the European Commission's Green Paper and consultation on long-term financing of the European economy. Cooperative enterprises from our network naturally contribute to the long-term development and wealth generation perspective, and thus require long-term financing instruments, in line with their inherent characteristics.

The formation of long-lived capital by cooperative enterprises

According to the 3rd cooperative principle[1], the members of a cooperative contribute equitably to the capital of the enterprise, through financial participation, which can be either symbolic or more substantial, but always confers an equal participation in ownership without indenting the second cooperative principle, namely democratic member control. The fact that each member holds a portion of the share capital of the cooperative makes each member responsible for the future of his/her own enterprise and therefore members are more prone to assume risks for the growth and recovery of the enterprise. Another aspect of this 3rd cooperative principle is that a limited part of the annual surplus is redistributed to members, not as a dividend based on their contribution in share capital but as a year-end adjustment of the price of the transactions between the cooperative and its members, which, in the case of cooperatives among workers, is an adjustment of the worker-members' remunerations. Another part of the annual surplus is usually earmarked for a **reserve fund**, which is the common property of cooperatives.

The 3rd cooperative principle also states that "members allocate surpluses for (…) developing their cooperative, possibly by setting up reserves, part of which at least would be indivisible": reserves are a general practice in all cooperatives in the world, regardless of their different purposes and activities. These reserves are an essential measure to ensure the financial sustainability of the enterprise: they compensate for the structural

[1] International Cooperative Alliance, Statement on the Cooperative Identity, available on www.ica.coop, and incorporated in ILO Recommendation I93 on the Promotion of Cooperatives, available on www.ilo.org

limitation of share capital in cooperatives, and protect them against debt and market volatility. There are cooperatives which, having experienced a strong growth over years, have built amounts in reserves that are much higher than their share capital. The above principle mentions indivisible reserves: in some EU countries (such as France, Italy, Spain, Portugal, and the UK relating to a specific type of enterprise[2]), the indivisibility of reserves is legally mandatory, even after the liquidation of the enterprise. In such countries, in the case in which the cooperative is closed down, the reserves are transferred to an institution promoting cooperatives, such as a cooperative development fund.

Indivisible reserves are a key way to express that cooperatives are **cross-generational enterprises**, which, in turn, partly explain their sustainability and the sustainability of jobs within them. Furthermore, they can act as a deterrent against take-overs by external acquirers, who cannot claim control over such funds.

The strong cooperative trend towards **capital accumulation** contributes to their longevity and can reveal its usefulness in times of crisis. The reserves allow cooperatives to go beyond the short-term emergency measures when the crisis comes (such as temporary wage reductions etc), and to adopt measures oriented towards the long-term, such as investment in innovation, technology or other structural changes in the production process. This has undeniably contributed to the resilience cooperatives active and industry and services have demonstrated (in term of enterprise closure and job losses compared to conventional enterprises of similar size, active in same sectors and from the same territory) since 2008.[3]

Cooperatives and long term financing

When it comes to the barriers to long-term financing, cooperatives in industry and services, especially small and medium sized ones, testify very often facing unfavourable attitudes from banking institutions and very high requirements and access conditions when applying for credits and loans. Their difficulties to access venture capital are mainly related to:

- their profit distribution system which gives priority, in the allocation of the profits, 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 to the indivisible reserve funds
- their control system, which accord very limited power, if any, to external shareholders (only some national legislations 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)

Cooperative enterprises also suffer from the lack of financial actors willing to contribute to long-term investment and not directly in the enterprise but trough non-banking financial instruments acting as **intermediaries**.

Those difficulties have encouraged worker cooperatives and their federations to put in place specific **financial instruments** for their development and long-term investment needs. Some of them are entirely dedicated to cooperative enterprises, such as **CFI-Cooperazione Finanza Impresa, Coopfond** and **Fondosviluppo** in Italy, **SOCODEN** in France or even other social economy actors, such as **ESFIN-IDES** in France, **Soficatra** and **CoopEst** at the European level. They use different financial instruments, such as subordinated loans, capital, participatory bonds, or guarantees. More importantly perhaps, none of them are only "financial" organisations: they all have a critical follow up and

[2] Called Community Interest Company (CIC)

[3] See the report "The resilience of the cooperative model. How worker cooperatives, social cooperatives and other worker-owned enterprises respond to the crisis and its consequences" published by CECOP in 2012 and available on www.cecop.coop

advisory role: in this sense, they are full-fledged **development organisations**.

It is essential for economic actors to create and develop among themselves **non-banking funds providing risk capital and loan capital and mutual guarantee schemes** that can boost long-term capital, and for the member states and the EU to develop corresponding **public policies**. The cooperative system, in particular in some countries where it has had the time to develop adequately and has benefitted from relevant public policies, provides models of self-financing and leveraging on bank loans, like the ones mentioned above, which are worth studying and promoting for SMEs at large.

Thus, CECOP suggest the **development and creation of European instruments that operates in a similar way as the cooperative ones mentioned above**: long time and patient investments even over 10 years, consultancy and advisory services, limited shareholders capital remuneration, etc.

The Italian model of cooperative development funds - financed with endogenous resources and mandatory – should be adapted at the European level. It is an effective way to set up a well-capitalized financial asset with traditional private equity characteristics (annual returns and capital gains) which intervenes especially in venture capital, without acquiring the majority and with prospects for output to be generated gradually over the medium term, and with a careful and constant monitoring. Such a European fund could facilitate the internationalization of enterprises and the creation of networks of European business.

The supply of long-term financing and characteristics of long-term investment

The diminishing share of banking in the financial market since the crisis started and before, is indeed taking place and is being further deepened by Basle III, but banks are deemed to continue having a much larger role in EU than, e.g., in the United States. Cooperative banks, one of the main types of banks active in the real economy at the local level, provide middle to long term loans, make up around 20% of the banking market in the EU and, in France and the Netherlands, over 40%. Cooperative banks should be distinguished from ordinary commercial banks, and should be considered in a differentiated manner in the reform of the structure of the EU banking sector.

The Green paper focuses strongly and is conditioned by the pure credit vision, meaning enterprise being financed by medium and long-term loans. According to CECOP, a **stronger attention should be paid to the intervention in venture capital** - even as investor members and with the limitations on remuneration and way-out.

European enterprises including cooperatives, and in particular SMEs, are financed through banks or by self-financing although the current state of the banking system and the new rules laid down are decreasing bank financing of enterprises. This does not mean that the available capital is decreasing. There is a set of non-banking financial intermediaries having substantial and growing capital seeking to develop sustainable enterprises and sustainable employment, such as insurance companies, pension funds and investment funds in general. Those funds, investing in long-term programs for enterprises, come through the subscription of securities issued by the enterprises themselves. However in the present context, it is very difficult and expensive for small and even medium enterprises to issue bonds or similar securities. This maintains their dependency toward banks.

The EU should stimulate member states to simplify and make less expensive the issuance of bonds by SMEs but also to create funds (open or closed) signing bonds issued by SMEs and sold by non-bank financial intermediaries. This would channel funds for SMEs. In this sense, tax benefits should be enforced for SME development funds and for intermediaries buying shares of these funds. Charges related to the allocation of adequate ratings both to enterprises and to the funds should also be simplified and made less expensive.

Public resources

Public resources can play a key role in financing long-term investments, but public resources in the form of grants or loans, used to support private-sector long-term investment, should not be considered as an alternative to market failures which "lead to sub-optimal levels of private funding and/or investment".

Public intervention should not only be provided in the form of guarantees, but also grants corresponding to a very small share of the investment and should intervene in the capital of the enterprise through **financial intermediaries**. Public intervention is crucial because of its anti-cyclical nature as private investment can shrink in times of crisis.

Several studies have revealed that public authorities generally recoup resources allocated to cooperatives trough taxation or decreased unemployment and social protection benefits.

Enhancing the long-term financing of the European economy

Some private equity funds require profitability rates which go beyond what is sustainable in the real economy and can destroy enterprises through such financial pressure. In addition, their time frame is 3 to 5 years, during which they can purchase and sell an enterprise, whereas enterprises in the real economy need to have a much longer strategic vision in order to maintain their economic sustainability. Policies aimed at **limiting the intervention capacity of equity funds investing into the short term should be strictly controlled in the EU**, if any EU policy on long term financing is to have any effect.

Cross-cutting factors enabling long-term financing

Tax incentives

CECOP agrees with the European Commission that tax incentives can encourage certain types of investment. In this sense we consider **essential to preserve the possibility given for Members States to apply reduced VAT rates**, as it is foreseen by the Directive 2006/112/EC Annex III. The European Commission recognizes in the latter that "supply of goods and services by organisations recognised as being devoted to social wellbeing by Member States and engaged in welfare or social security work" are taxed where they are delivered and thus do not cause any distortion within the Single Market. Moreover, we consider fundamental to maintain the possibility for Member States to apply "super-reduced" VAT rates (lower than 5% on the categories of Annex III). For example in Italy a 4% VAT rate is applied to social cooperatives and social enterprises providing health, social and educational services. This has been crucial for the enterprises development: it encourages investment and enterprise growth and therefore the sustainability of the activity. In fact, investing in welfare from one's own resources increases the enterprise's business volume, and thence more VAT is being paid. The Italian experience is very interesting in this respect, as it has contributed to the development over the last years of numerous social cooperatives providing health, social and educational services to citizens including the most vulnerable ones, with sound economic performance and recognised dimension of sustainable social inclusion.

Accounting principles, information and reporting

Fair value has already demonstrated its deleterious effect as one of the elements accelerating the advent of the 2008 financial crisis. Since then the US, Canada, Japan and South Korea, among others, have clearly scoped out the International Financial Reporting Standards (IFRS) for SMEs (in which fair value accounting is a constituent part), and several EU member states such as Germany and France, as well as SME and cooperative representative organisations, have also outspokenly stated that this project should not be pursued in the EU.

Again, **IFRS are not needed for SMEs nor cooperatives** as they are not supposed to be targets of the global financial market. Long term financing can be promoted in the absence of IFRS, and existing accounting systems (national GAAPs) and other existing financial information methods are appropriate in order to ensure the financial information. The non-financial information is key in this respect, as it can increase the real-economy investors' understanding of the real-economy information on the enterprises. The experience within the cooperative system is that dedicated financial instruments, led by other objectives than solely the financial ones, constantly need non-financial information because their role is also follow up of the entrepreneurial project and development, not only their financing.