Introduction

The following is the edited text and associated slides of a presentation by Peter Gates, Chief Executive of The Mercury Centre, to the Annual Conference of Monash University's Institute for Regional Studies in October 2006. The title of the conference was 'Owning Your Future: small towns and community assets'.

Presentation

Good morning everyone. This morning I will talk about Community Enterprise Ownership and give you some dimensions to it that you may have not thought about.

The Mercury Centre's work on ownership has led to the development of a tool known as OPTical, the Ownership Planning Tool. While the tool was originally created for existing business owners, we have found it useful in discussing community enterprise.

There are two diagrams that we created during the development of OPTical which I think help understand the elements of ownership.

The first (Diagram 1) is a companion to a definition of ownership. Our definition is "Ownership is an Investment in an Enterprise with the Objective of Creating Value". This diagram shows the six streams of investment - Purpose, Resources, Energy, Knowledge, Attributes and Skills.

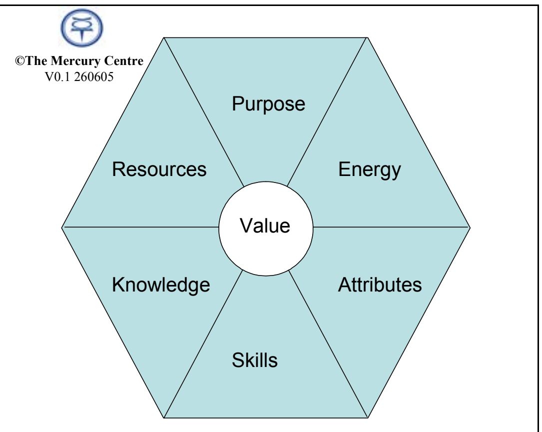


Diagram 1

Let's start looking at the next diagram (Diagram 2) from the general concept of ownership in a business.

A business owner invests assets in a business and receives a return on the investment of these assets. These investments are both tangible and intangible.

The tangible assets are fairly obvious and include money, property, equipment, knowledge and skills. Over time, stock and the retained profit or capital built by the business are added to the list of assets. The owner receives a return on these investments being a return on the assets in the business as well as a fair profit. The return also includes financial control and financial security.

The ingredients for a successful business sometimes forgotten are the intangible assets. The initial assets are the success drivers - passion, commitment, leadership and the like; as well as the business idea, relationships and networks. Over time, a loyal customer base and a reputation develops.

The return on the intangible assets is itself intangible. For the individual business person they include recognition, satisfaction, pride, choice of lifestyle, and of course, emotional control and security.

These elements are represented in this diagram (Diagram 2).

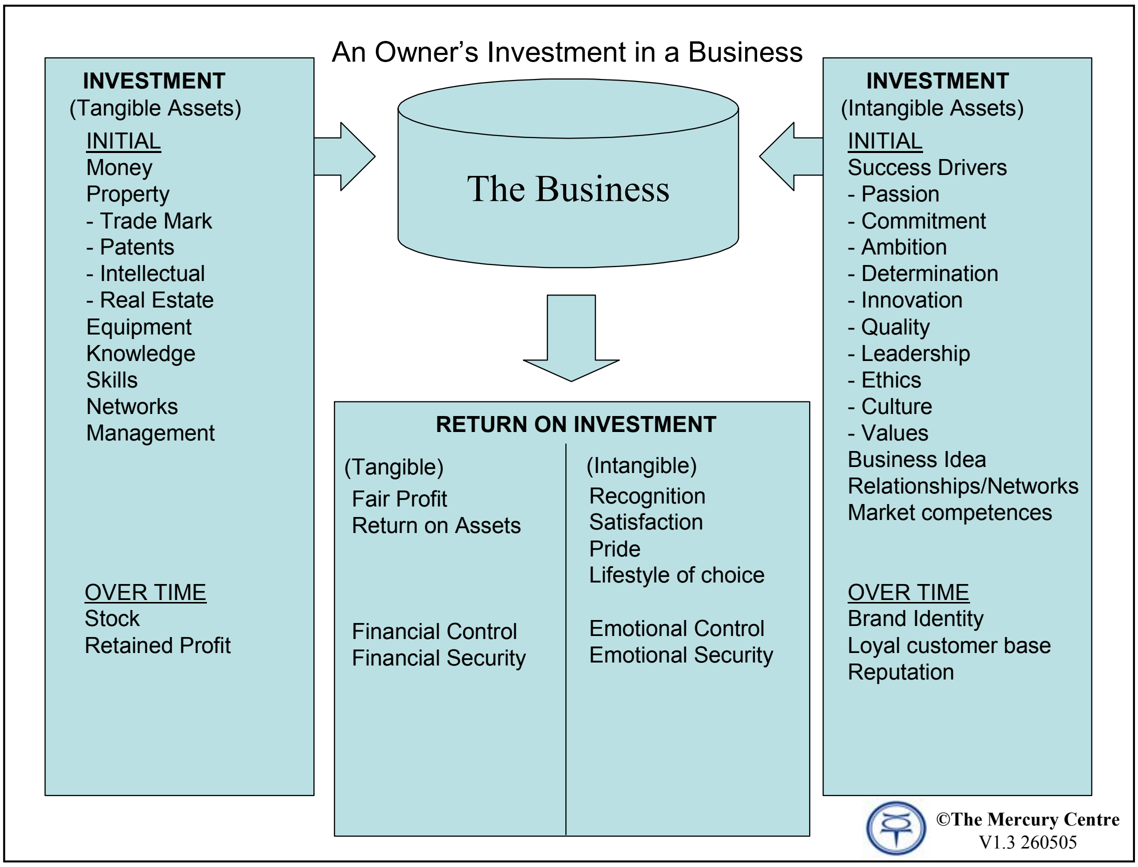


Diagram 2

We have identified four potential elements of ownership, not unlike Yin and Yang. (Diagram 3)

The things people look for in ownership are the rewards - the dividends of ownership; and the rights - the ability to have a say in what happens.

The accompanying elements are the risks and the responsibilities.

Ownership is not, as they say, all sunshine and lollipops.

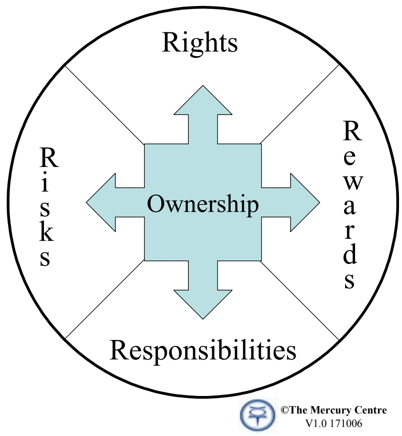


Diagram 3

By community enterprise ownership we mean the community - however it is defined - using a legal structure, to take ownership of an enterprise.

I will look at some of the issues created by this in a moment.

The advantages of community enterprise ownership are many but I would like to focus on four of them.

- The first is that the demands of the shareholders for higher returns are not as great with a community enterprise. The reasons people invest in it are not necessarily financial.
- The second advantage of community enterprise ownership is that it produces a concept not recognised in the economic rationalist world which is return on community investment, where measures such as training, job quality, wealth building opportunities, quality of life, and community health, both physical and mental, are quantified.
- The third equates to the old bundle of sticks - united we are stronger.
- The fourth is about "hurt money". As a credit union director, I learnt that when providing a loan for say a house, you never give 100% because people only become involved when they have to invest their money. This increases their commitment to the loan because it hurts if they want to walk away if the going gets a bit tough.

The development of the Ownership Evolution Model is part of the work at The Mercury Centre on ownership. The model gives us eight issue clusters to help us think through how ownership might affect us (Diagram 4). The eight issue clusters are Owner Composition, Market Place, Control, Governance Structure, Change Timetable, Affordability & Risk and Connecting to Ownership.

These issue clusters are influence by the number of owners and the value held by multiple owners. We have grouped the issues into those most affected by the number of owners and those most affected by the magnitude of the value (Diagram 5).

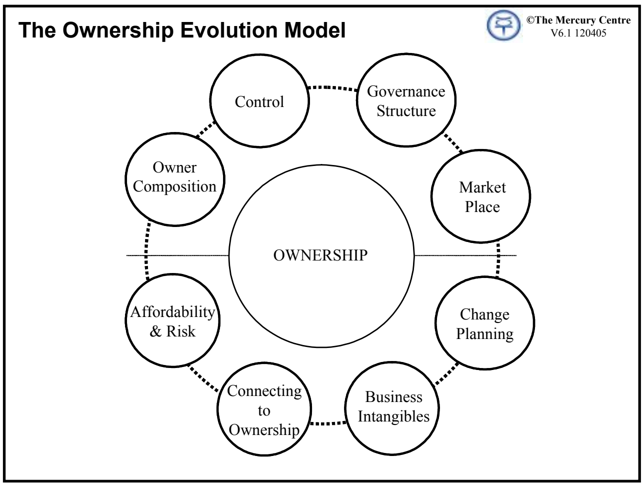


Diagram 4

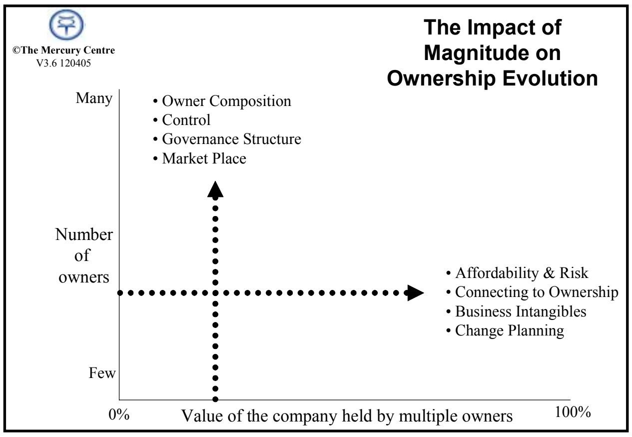


Diagram 5

I'll now use these issue clusters to look at community enterprise ownership.

Owner Composition

The first set of issues deals with owner composition. The first one is who can be an owner? When I first became involved in credit unions, they used a word that I didn't fully comprehend. The word was bond which was a legal term to describe the attributes of the group of people who were eligible to join a particular credit union, for example the people who lived or worked in Maleny where the only people eligible to join Maleny Credit Union. While a bond was seen by some as restrictive and is not often used today, the underlying meaning of the word was what holds the members together?

And that leads to the first question to answer - who cares enough to support the enterprise? I believe that the process used by The Mercury Centre to form a co-operative also suits the formation of a community enterprise. I suggest that the first step should be to form an incorporated association.

This makes the venture tangible and it is an inexpensive way of creating a corporate structure. This allows four things to occur.

- Recruit members - charge a joining fee of $100. This will test how committed people are to the idea. Besides, at 100 people, that's a total of $10,000 towards a start-up fund.
- Obtain institutional support - seek out support from the various levels of government, local business associations and the like.

The other two are plan for the co-operative and develop the governance processes and I will come back to these shortly.

So who can be owners? Is it only individuals? What about companies, churches or mosques? Can it be families? What are the criteria for ownership? Living in the town or is it the district, and for how long? If companies are allowed to be owners, what about branches of big companies e.g. the local bank?

How much can they own? Is it equal shares? Can one person own more than other? Is there a maximum or a minimum level of ownership?

Market Place

The market place cluster of issues starts from the premise that there are shares in the enterprise, and that in itself is an issue. Will there be shares? This is not necessary, but it provides a measure and symbol of ownership.

Will these shares pay dividends or will the dividends come through patronage or usage rewards or will it be a combination of both?

How many shares will there be? Will it be a fixed number? How will the value of the share be set? If it matches the value of the business, do people understand that the value of their shares may fall?

How do people buy and sell their shares? When one person wants to leave the town or just stop being an owner, who do they sell their shares to?

Let us take an example of an enterprise with 100 owners, people from the town, who buy 10 shares at $100 each. This gives a capital of $100,000.

If the $100,000 is invested in the business to buy stock or equipment or as working capital, does the business have a spare $1,000 to give back to the person leaving? Perhaps, but what if 10 people want to leave at the same time?

Control

The Control Issue Cluster defines the extent of democracy. The questions to be decided are about voting at general meetings and voting for the board of directors. Is it one person one vote? Is it voting on the basis of shareholding? Do all the people putting money in have a say?

Governance Structure

The first issue to address is the need to have a clear governance process because this is a key ingredient of any enterprise.

Each type of body corporate is incorporated under a specific Act and draws its powers, authority and limitations from that Act and associated Regulations. When formed, the body corporate adopts a set of rules or constitution that applies additional powers, authority and limitations which apply only to that body corporate.

> ***A creature of the Law***
>
> *A body corporate is created and maintained by a legal system. The legal features of a body corporate are:*
> - *Perpetual succession (continues unchanged despite changes in individuals);*
> - *A capacity to sue and be sued;*
> - *A common seal; and*
> - *The capacity to acquire hold and dispose of property in the corporate name.*

For example in Victoria, co-operatives are incorporated under the Victorian Co-operatives Act 1996 and companies under the Commonwealth Corporations Act 2001.

By incorporation we have created a legal person as opposed to a natural person.

This legal person, the corporation, "thinks" by way of a board.

Section 198A of the Corporations Act says "The business of a company is to be managed by or under the direction of directors."

It is important to note that the concept of corporate governance, just as with corporate social responsibility, is that corporate means any body corporate not a large corporation.

> ***The Board runs a corporation - The Process is Corporate Governance***
>
> *Term first used in the late 1980s from the Latin*
> *Corporat = "form into a body"*
> *Gubernare = "to steer or rule"*
> *Web resources - Google results:*
> *- "What is Corporate Governance?" = 21,700*
> *- "Corporate Governance" = 27,200,000*
> *- www.corpgov.net – links page*

There is no shortage of resources on corporate governance on the web but let us look at what it contains.

The Organisation for Economic Co-operation and Development (OECD) has developed a set of corporate governance principles.

> ***OECD Principles***
>
> *Corporate governance is the system by which business corporations are directed and controlled*
>
> *Basic Aspects of OECD Principles*
> - *The Rights of Shareholders*
> - *The Equitable Treatment of Shareholders*
> - *The Role of Stakeholders*
> - *Disclosure and Transparency*
> - *The Responsibilities of the Board*

The OECD principles state, in part

"The corporate governance structure specifies

- the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and it
- spells out the rules and procedures for making decisions on corporate affairs

By doing this, it also

- provides the structure through which the company objectives are set, and
- the means of attaining those objectives and monitoring performance"

These principles are available in full on www.oecd.org, under the corporate governance button right next to the button marked corruption.

Quality Governance

At The Mercury Centre, we have developed the Quality Governance system (Diagram 6), which combines both Quality and Corporate Governance.

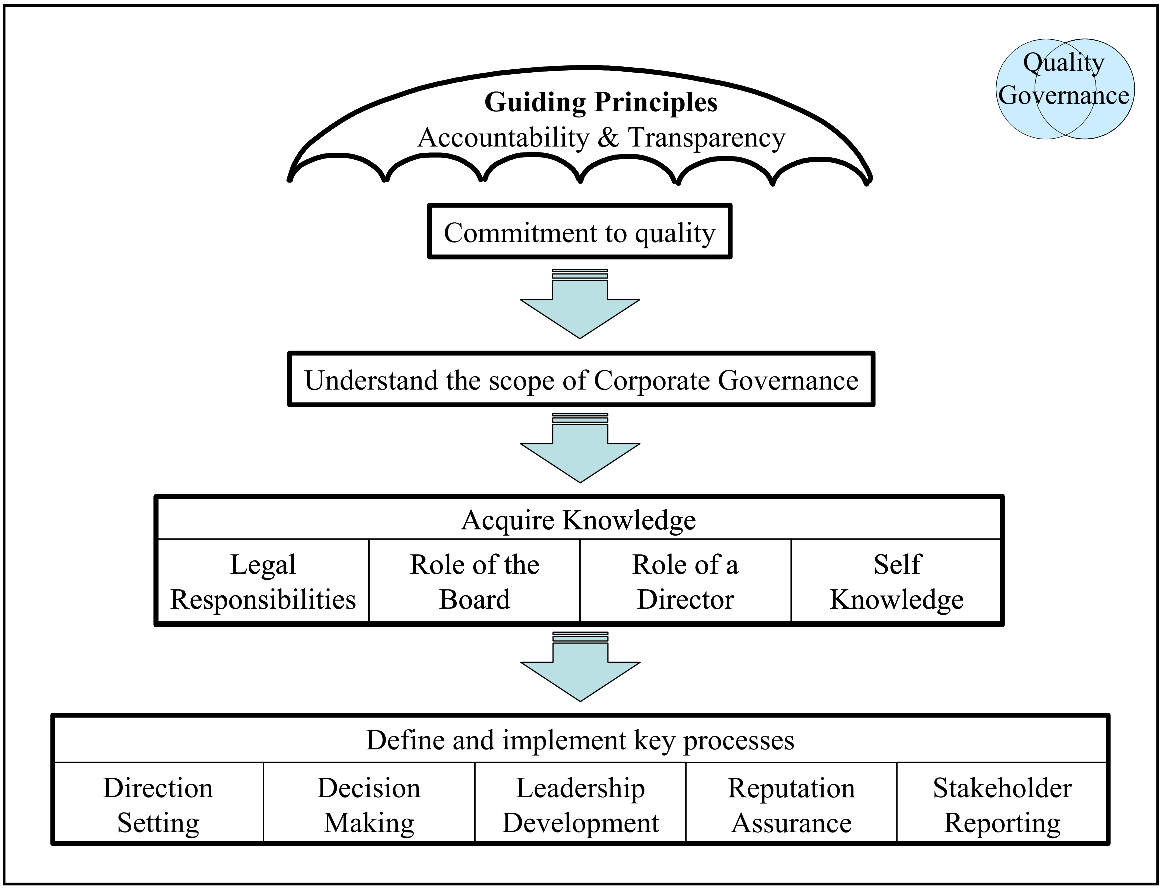


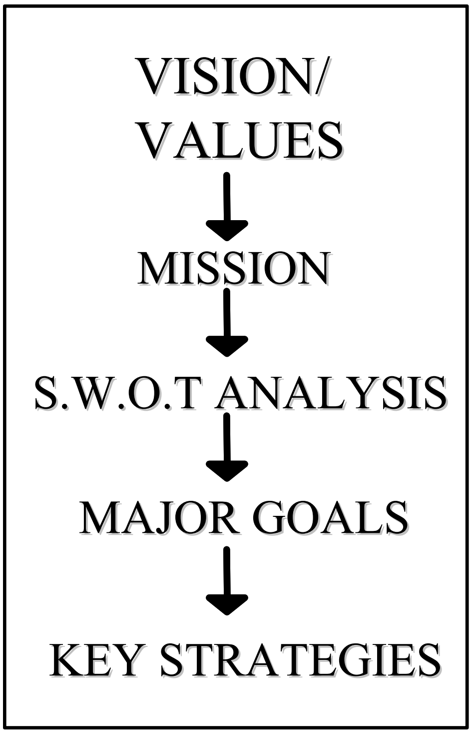
Diagram 6

The guiding principles in our system are accountability and transparency.

At its foundation are the five key processes that the Board undertakes to manage an organisation: Direction Setting; Decision Making; Leadership Development; Reputation Assurance; and Stakeholder Reporting.

I want to focus for a moment on the direction setting process. This is a key activity for a community enterprise.

It is the process of deciding who you are, what you believe in and where you are going. It can be a quite simple process and it is vital to success.



STRATEGIC PLAN

Now back to the issues of governance. Part of having a clear governance process is the issue of managing interests. This is managing the competing interests of all the owners to ensure fair outcomes for everyone. And, as the number of owners increases more effort through formal structures is required to service their needs.

Another connected issue is to have checks & balances to ensure a structure that promotes balance between shareholder interests.

Setting boundaries between the board and management is important. Let the manager manage. Set clear job roles, expectations and measures. Make sure that both the board and the manager have common agreed measures of the manager’s performance.

Understanding your role is important particularly in the early days. Board members in the start-up phase often end up doing a range of tasks in operating the business, sometimes even paid. But it is important to remember that these roles are separate from the role of board member. Unless you understand which hat you are wearing, there can be blurring of responsibilities and you start to lose control.

Change Planning

Change is inevitable for every enterprise and it will happen internally and externally. It is important to recognise, understand and prepare for it.

For every great idea to work there needs to be a champion, someone who pushes hard to make it happen. One of the issues for community enterprises is that they can become the “founders”. The founders are the people that come up with the idea and put the hard yards in. They are proud of what they achieved. But it can become their life, their passion, their whole interest, to the point where they don’t know when to go, and they are resistant to change and are unable to hand over which affects the viability of the enterprise.

As well a successful enterprise itself will grow and change and the leadership of the enterprise needs to consider how to respond to that change.

Engaging with the next generation is vitally important making sure younger people value the enterprise and the hard work in its creation, and that the knowledge learnt and history is passed onto them.

Affordability and Risk

The Affordability and Risk Issue Cluster looks at whether the proposed owners can afford the outlay required to buy into a business and whether they have the financial capacity to cope with a loss should one occur.

The size of the total transaction will affect the ability of the proposed owners to afford their individual shares with the difficulty increasing as the size of the enterprise increases.

Should they risk it? The ability of the proposed owners to risk a given amount of money decreases as the outlay required increases because of the impact of individual loss.

Connecting to Ownership

Why would the community support the enterprise? How do you develop a culture of participation? How do you get the owners to think as owners?

Business Intangibles

However the ownership is constructed, who will bring to the enterprise the success drivers of the passion, commitment, leadership and the like? How will the enterprise obtain the intangible assets? (Diagram 2)

How does Community Enterprise Ownership happen?

There are two options for creating community ownership. They are to start your own or buy one.

I would like to describe a model we are developing at The Mercury Centre.

Community Enterprise Co-operative

The Community Enterprise Co-operative is a local multi-purpose enterprise supported by a number of partner organisations.

The co-operative would operative in a clearly defined community area principally on a geographic basis. People from that community would become members/owners of the co-operative. The co-operative would focus on increasing the economic activity in the area through micro-business and employment initiatives with an emphasis on a “buy-local” approach. This has the potential to build self-esteem and pride in that community.

The partners in this model would be:

- A community development facilitator which would provide support to the community using many of the traditional community development approaches. These approaches would be adopted by co-operative over time. Support for micro-businesses would be included in the scope of the facilitator's work.

- A community development foundation which would build capital for investment in the co-operative(s) and derive funds to support the facilitator.

- A micro enterprise facilitator and micro finance foundation would provide the specialist support for the micro businesses.

The co-operative would also partner with local and other service providers for example TAFE and business enterprise centres, to deliver services to match local needs such as local training and business support; and an approved deposit taking institution (ADI) - a credit union or bank - would provide financial services to the community.

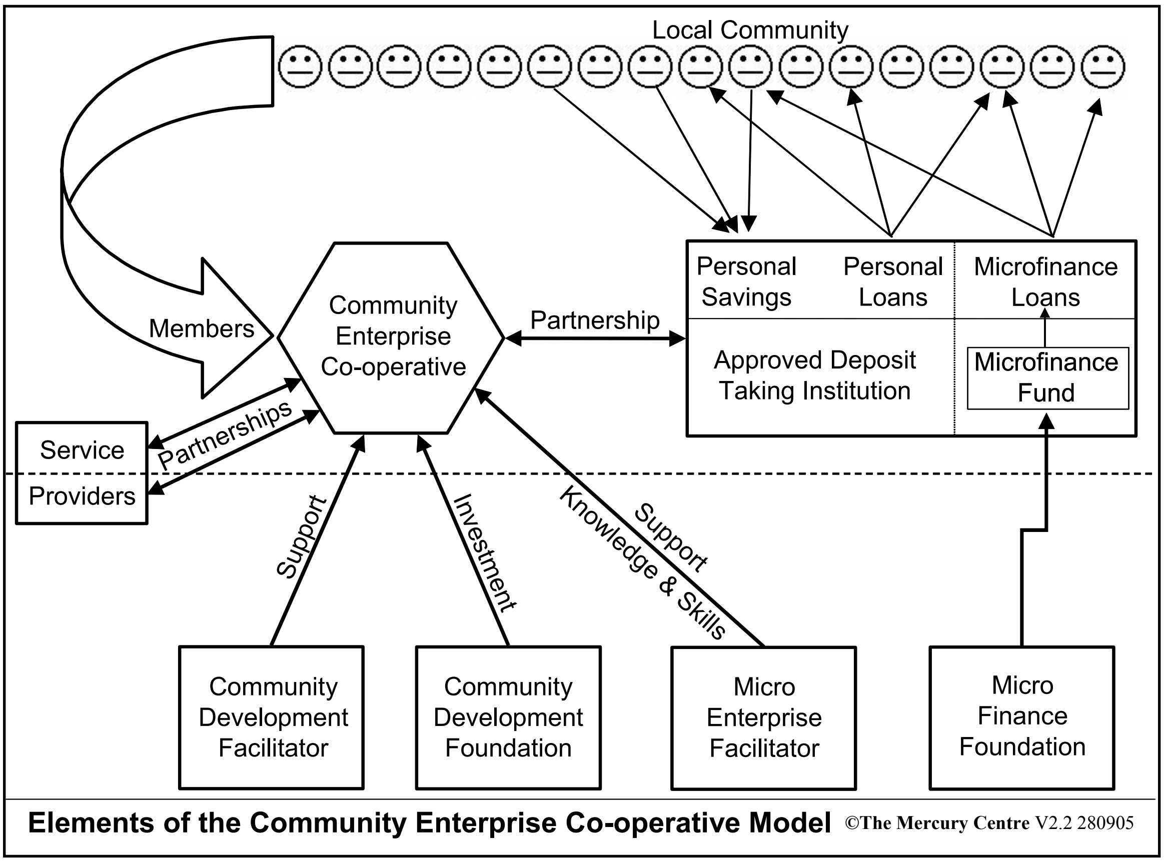


Diagram 7

And that completes the full model (Diagram 7). The components of a community enterprise co-operative can be used independently and not all co-operatives established would adopt every element of the model.

Buying an Existing Business

The concept of a buyout accepts that there is good-will on the part of the seller and that the purchaser is one of the existing stakeholders. Currently, the management buyout attracts the most press, but the principles are similar for the other forms.

Broad based buyouts have three forms.

- Community: where ownership of an important community asset is undertaken by the community
- Employee: where the employees buy the business
- Multi-stakeholder: where there can be a combination of stakeholders, for example, community, employees, and the local development corporation.

Assessing the buyout

A buyout is no different to any other business purchase and should use standard business practices.

Deciding whether to proceed also depends on the level of support and planning. It is important not to get too caught up in the buyout and ensure that the outcome is better than a straight sale of the business.

It is important to obtain professional advice from people who understand this process. Always go into a buyout with your eyes open.

Use standard business practices

- *assessing commercial viability*
- *due diligence*
- *business valuation*

Deciding whether to proceed

- *scale of community support*
- *ownership planning done?*
- *better result for all than a trade sale?*

Need for professional advice

- *informed external advisers*
- *raising finance – the business plan*
- *legal and disclosure documentation*
- *capital gains tax concessions*

Essential ingredients for a buyout

The essential ingredients are

- It must be a good business
- All parties must be involved and the financial commitments understood - "eyes open"
- Owners need support especially in establishing governance systems and training in management and financials
- Business development after the transaction is important.

Business Succession

The Mercury Centre believes that there are many opportunities for community based business especially given aging Australia and the high number of family owned businesses.

These statistics are from research by CPA Australia.

CPA Australia Research

- *Family businesses are 83% of all businesses*
- *The typical family business owner is 57 years old and 40% will leave business within the next 5 years;*
- *For 66% business will fund their retirement but only 38% have succession plans;*
- *Only 25% of owners plan to pass on their business to family members.*

Other research suggests that

- A growing number of transfers will take place outside of the family
- One third of business owners believe they will have problems selling their business
- Too many sellers and not enough buyers
- Increasing number of businesses will be vulnerable to transfer failure
- Bungled successions are costing jobs and vital services
- Some small rural businesses not profitable enough to attract new investors.

Buyouts Identified

There have been 300 community and employee buyouts in past 5 years in the UK. We have identified over 30 examples in Australia, such as:

- Caravan Park (Albany, WA)
- Cheese Factory (Kenilworth, Qld)
- Cinema (Bowraville, NSW)
- Cinema (Gulgong, NSW)
- Cinema (Young, NSW)
- Cinema (Manildra, NSW)
- Cinema (Ouyen, Vic)
- Cinema (Tumut, NSW)
- Hotel (Devinish, Vic)
- Hotel (Hopetoun, Vic)
- Hotel (Red Cliffs. Vic)
- Hotel (Yinnar, Vic)
- Hospital (Hobson Bay, Vic)
- Hospital (Yeovil, NSW)
- Manufacturer, (Sydney, NSW)
- Petrol Station (Kaniva, Vic)
- Petrol Station (Yackandandah, Vic)
- Plywood Factory, (Kyogle, NSW)
- Store (Culgoa, Vic)
- Store (Lexton, Vic)
- Store (Nuriootpa, SA)
- Store (Walbundrie, NSW)

Many of these buyouts were rescuing vital businesses from closure. Community renewal through social and financial investments is also an outcome for many.

Two Funding Ideas

There are two funding ideas I would like to leave you with.

The first is about the start up phase. eGive is a not-for-profit service provider that provides a range options for electronic giving. My favourite is the direct debit facility. The service costs less than $20 a month and provides the ability to debit a donors bank or credit union account for the cost of 17 cents a transaction. Research shows that when someone signs up to donate in this way it will continue for an average of three years. For example, if 102 people to donate $10 a month, the result will have $10,000 in a year. The details are available at www.egive.org.au.

The second is the idea of a community foundation. Community foundations are relatively easy to create using a trust deed. It is important to have a respected and reliable trustee organisation. A foundation is a vehicle that allows external funders to invest in your community. The foundation’s aim would be to invest in your local community in what ever form is appropriate. Once established other people and organisations can be brought on board. This is not charity but a true investment in your community’s future.

An example from NZ

The Buller is an isolated area on the West Coast of the South Island with a low population spread over a large area.

> ***Buller Community Development Company Limited***
>
> *Mission: "To Promote the Social and Economic Development of the West Coast Region"*

The West Coast covers 10% of New Zealand's land area but has less than 1% of the population with long distances to markets. The West Coast strip is longer in distance than between Auckland and Wellington with a range of mountains between it and the populated East Coast.

Over 10 years, the Buller Community Development Company (BCDC) went from an idea to physical reality that employs 25 full time and about 50 part time staff, runs a fertiliser manufacturing plant, a nursery, delivers a wide variety of training throughout New Zealand and delivers a range of social services in the region. It does this without any Government subsidies or grants.

Economic restructuring in the mid eighties resulted in unemployment was over 15% with little manufacturing left in the town. The local community had no ability to control decisions impacting on it. Community controlled business resources were seen as an alternative. The company obtained funding under the pilot Local Employment & Economic Development Scheme with funding assured for three years.

The company set growth goals based on a policy of non-competition with existing business and gave a high priority to achieve self sufficiency to ensure the company's future.

The company has grown to include:

- A profitable fertiliser business using waste as the input
- An employment training unit based on realistic job opportunities which now provides training throughout NZ;
- A commercial nursery to take advantage of the growth in the horticulture industry in the region which has been expanded since its original purchase
- A large free website for information, business and tourist ventures on the West Coast www.westcoast.org.nz
- A comprehensive social welfare program in the region which the company subsidises by $90,000 per annum.

Business plans include:

- An expansion of industry based training by identifying key industries BCDC where could provide training, and the development of training modules specifically for these industries for registration as NZ standards
- Supporting tourisms expansion to double the national growth by:
  - Provision of ESL courses in Westport with an environmental component
  - Development of eco-tourism training
  - Inbound tourist involvement that has a significant component in the region
- Identifying opportunities that fit with BCDC's goals and utilising existing financial and people skills to develop new ventures

- Increasing mentoring and business start up advice and provision of management support until a business is self supporting.

Their opportunities include:

- Contracting of Public Health delivery in the primary care area in particular with new initiatives to improve the range of services delivered locally
- Providing services withdrawn by Government such as driving licence testing
- Entered into a partnership with a Polytechnic to provide tertiary training locally for students
- Leasing an additional nursery that will specialise in restoration projects with seed sourced from mining sites and propagated and planted on restored ground with a contract for 35,000 plants initially.

The role of the Buller Community Development Company is described in these words from their Chair.

> *BCDC is an important part of the economic life of the region and has achieved the critical mass and financial base to take opportunities as they arise.*
>
> *It has the ability to step in and influence economic activity for the benefit of the community.*

Race Mathews on Change

I wanted to leave you with a story from a paper by Race Mathews to a credit union conference. The story is about organisations reinventing themselves to meet community needs.

It is about a co-operative in Detroit. "The co-operative in question was formed in the nineteen-thirties in response to a pressing social need for affordable, hygienic household milk delivery services.

When the corporate dairies moved in with comparable services at a comparable price, the co-operative re-invented and re-positioned itself so that the social capital it had accumulated was applied to meeting a pressing social need for affordable optometrical testing and the supply of spectacles.

When this function in turn was taken up by the optometrical corporations, a further re-invention of the co-operative took place. The co-operative at this point re-tasked itself to meet a pressing social need for accommodation and support services for older people. It now operates condominiums - large apartment blocks - for older people across America.

Each condominium is now a free-standing, self-governing co-operative in its own right, within the over-arching co-operative structure."

Thank you.