Neath Port Talbot Council for Voluntary Service

Your local county voluntary council

7. Finding and getting money

7.14 Community Investment

What is ‘community investment’?

Community investment is a method of communities investing capital in business ventures whose purpose is for social and community benefit. It is about community involvement and empowerment, engaging communities to invest in themselves. By utilising the investment power of whole communities potentially large amounts can be raised without the need to turn to the private sector or wealthy individuals.

Community investment also can benefit communities by dealing with private sector failure, anchoring customer loyalty, and establishing a business model that serves and is responsive to the needs of the broader community.

It is important to note that ‘community’ does not just refer to a geographical group of people, it can also refer to a community of shared interests, shared values and shared identity.

Community investment is not a new idea, but in the last ten years there has been a resurgence of interest in using community investment to finance a range of community initiatives. One of the most common ways for business ventures to raise capital via community investment is through the sale of shares or bonds (see below for more information on what these are).

What kind of business ventures are suited to funding from community investment?

Community investment can be used to finance any initiative which is capable of generating a sufficiently attractive financial and social return on the investment. The list of possibilities is almost endless. Most products and services can benefit from being made to serve a community purpose. Here are some examples:

- **Waste recycling**: Waste recycling rates might be greatly improved by engaging communities in the ownership of waste recycling plants.

- **Community land trusts**: Affordable housing can be made more affordable if the land is bought and owned by the community.

- **Community supported agriculture**: Community supported agriculture demonstrates the value of establishing direct links between producers and consumers.

- **Low carbon initiatives**: Many carbon reduction initiatives are more economically viable if they are adopted by larger numbers of people. Community-scaled low carbon schemes could provide better household insulation, combined heat and power schemes, and larger-scale domestic electricity generation.

- **Community facilities**: Some urban areas have problems attracting GPs, dentists, nurseries and other forms of public services because they are put off by the relatively high cost of premises.

- **Community transport**: Community investment could have a major impact on car sharing clubs and other community transport initiatives. Some groups are already investigating the possibility of using community investment to finance the development of new rail services.

- **Community utilities**: Community ownership of next generation broadband cable networks is already a reality in some European countries, and could be introduced to the UK through community investment.

- **Community pubs**: Like village shops and post offices, pubs are in danger of closure in many communities. Community investment and ownership could enable these enterprises to become viable again.

- **Community energy:** the potential of community investment has been fully demonstrated in the renewable energy sector, largely thanks to the pioneering work of *Energy4All*, a development agency that specialises in creating community owned wind farms. It has raised over £10m in community investment funds, and pioneered the use of Industrial and Provident Society (IPS) legislation as a community investment tool.

- **Community Finance**: The community finance sector includes credit unions, Community Development Finance Institutions (CDFIs), the Community Investment Tax Relief scheme (CITR), the Enterprise Investment Scheme (EIS), social enterprise finance funds, and Community Development Venture Capital funds (CDVC). At present community investment is relatively under-exploited in the community finance sector, but community finance organisations are key components of the network of institutions that, if designed well and with supportive policies, can work together to form an effective social investment market.

What are ‘shares’ and ‘bonds’?

A *share* is a legal right to membership and part-ownership of an organization, in return for an investment. There are different types of shares with different rights, determined partly by the terms and conditions attached to the shares (the share agreement) and partly by the corporate legal form of the organisation itself. There are a number of corporate formats that can be used to issue shares, but the two that are usually most applicable for the third sector are the Community Interest Company (CIC) and the Industrial and Provident Society (IPS). Each of these bodies of corporate legislation affect the rights and duties of shareholders in different ways, some of which may be better suited to community share issues.

A *bond* is a form of loan. It is a legal agreement between the issuer of the bond and the purchaser, which usually states the amount of interest to be paid on set dates on the loan and when the loan will be repaid in full. Organisations usually turn to bonds when they are unable or unwilling to offer shares.

Which are better, shares or bonds?

There are a number of factors to take into account when deciding whether to issue shares or bonds. Much depends on an organisation’s priorities and principles.

Most organisations prefer shares over bonds, because share capital does not have to be repaid, and is a more flexible form of capital. While it is easier to raise the money in the first place when issuing bonds, the business plan has to show the ability to repay the loans (or raise another loan to repay the initial investors) within the stated time.

Some organisations are unable to issue share capital though (including charities and organisations incorporated as companies limited by guarantee without share capital), or are unwilling to do so, in which case bonds are their only option. All types of organisation can issue bonds, as long as the regulations governing financial promotions are followed. Other organisations, such as workers’ co-operatives, might like the idea of raising capital from their supporters but are not willing to compromise their principles of workers’ control. Bonds provide a good solution to this problem, because no voting rights are attached to bonds.
Some organizations have issued both shares and bonds. Bonds offers can be used to encourage existing shareholder members to increase their investment, albeit on a temporary and short-term basis.

So what is the key to an organisation successfully setting up a community investment scheme?

There are four key elements to all successful community investment propositions:

1. the business case for investment
2. the community
3. the governing document, and
4. the offer document.

Each of these elements is indivisible from the other, and weaknesses in any single element will undermine the overall strength of the proposition. We will look at each of these briefly in turn:

- **The business case for investment**

  Community investment is only viable if the venture can work to a business model. It is not suitable for charitable organisations that are reliant on grants, gifts and donations as their main source of income. Some community organisations are engaged in activities which fundamentally must be met through charity, whether from the public purse or private sources. However, there is a growing range of community services where the business model is fully or largely accepted.

  Ownership and investment go together to form a strong bond, engaging communities in enterprises that serve their interests. Community investment can strengthen the business model, but it also carries the risk that people's money will be lost, or their expectations will not be met. In light of this it is crucial to develop a strong business case, and one of the best ways of doing that is to engage the community in the ownership and control of the enterprise. It is vital, however, to ensure that in pursuing such a project that you have the capacity and resources to hold public meetings, run publicity campaigns, issue direct mailings of offer documents, and process share applications and associated queries.

- **The community**

  As highlighted at the beginning of this document, in the context of community investment the term 'community' needs to be more than a label for people living in the same place. Community also needs to be about shared interests, shared values and shared identity. Indeed, in the globalised world of electronic communications, there are a growing number of virtual communities built on identity rather than place. Community investment relies on identifying and engaging a target community in an enterprise that affects the quality of life for that community.

- **The governing document**

  Community investment often works by selling a share in the enterprise to people in the community. These people, as shareholders, control the enterprise and their rights as shareholders are embodied in the constitution of the enterprise which is more generally known as the 'governing document'. A governing document generally does two things: it expresses the purpose of the organisation, its aims and objectives; and it describes how the organisation will operate. If the organisation plans to sell shares to members it must adopt an appropriate legal format for its governing document, either as a company or as a co-operative society or community benefit society.

- **The offer document**

  Inviting people to invest in an enterprise and risk losing their money must be carried out in a responsible manner. The offer document is the term used to refer to this invitation to invest, whether it is in the form of a printed document, website, video, or even a presentation at a public meeting.

  In most (but not all) circumstances, inviting members of the public to invest is a regulated activity, covered by the Financial Services and Markets Act 2000 (FSMA). It is worth noting that if your offer document needs to be regulated by FSMA there can be an associated cost which may be a significant sum, as the prospectus would need to be signed off by an individual/organisation which is regulated by the Financial Services Authority (FSA). Some types of financial promotion are exempt from regulation though (such as community benefit societies), or fall outside the scope of the Act, but even in the absence of statutory regulation there can still be legal liability to investors.

  This may well be the case if losses were incurred by an investor who relied on the document, information, or advice in deciding to enter the investment contract and if the loss was due to a false or misleading statement of fact, or any negligent statement. It is therefore vital that all information provided in documentation, on videos or websites, at public meetings, and in any other communications with potential investors is accurate and not misleading in any way.

  A key issue in respect of the offer document is whether share capital is deemed to be 'withdrawable' or 'transferable', as the offer document must state clearly which type of share capital is on offer.

  - Withdrawable share capital is a type of share capital unique to Industrial Provident Societies (see below), where members are allowed to withdraw their share capital subject to terms and conditions set out in the society's rules. This will usually include a minimum period of notice of withdrawal, and provision for the directors to prevent withdrawal if in their judgement it would jeopardise the finances of the society.

- Transferable shares cannot be withdrawn from a society; instead the member must find a willing buyer, at a price acceptable to both parties. Very few societies issue transferable shares, primarily because of the problems members face when they want or need to cash in their investment.

Does an organisation need a specific legal structure to set up a community investment scheme?

It is highly advisable for any organisation planning to raise investment capital from the community, to become a corporate entity by adopting a legal form that provides them with the scope and flexibility to achieve their ambitions.

There are three main legal forms that can be used for community investment purposes:

1. Industrial and Provident Societies
2. Community Interest Companies, and
3. Charities.

Some organisations have used other legal forms, such as the public limited company or the company limited by guarantee, although these forms offer no special provisions to protect the interests of the community. We will look at each of the three main legal forms below:

- **Industrial and Provident Societies**

  Industrial and Provident Societies (IPSs) are registered and regulated by the Financial Services Authority. Like companies, IPSs are corporate bodies with limited liability status, but otherwise they are significantly different in form, and have four unique attributes which make them a highly effective vehicle for community investment. These unique attributes are:

  - Shareholder democracy
  - Withdrawable share capital
  - Limits on shareholdings
  - Limit on share interest

  There are two main types of IPS: co-operative societies and community benefit societies. The main difference between these two types of IPS is their relationship with members.

  (i) *Co-operative societies* are run for the mutual benefit of members, and in addition to the interest that members receive on their share capital, they might also receive a dividend on their transactions with the society. Members can decide at the end of the financial year to return part of any surplus to members, based on the scale of the members' transactions with the society.

(ii) *Community benefit societies* are run primarily for the benefit of the broader community, rather than just the members of the society. Membership is open to anyone who supports the objectives of the society. Community benefit societies can pay members interest on their share capital, but they cannot pay dividends to members on their transactions with the society.

There is one other major difference between a co-operative society and a community benefit society. Since 2006, community benefit societies have been able to install an asset lock in their rules which ensures that the assets of the society will permanently be used for the benefit of the community and cannot be distributed to members if the society is dissolved, amalgamated or converted into a company. This new regulation does not extend to co-operative societies.

The choice between registering as a co-operative society or as a community benefit society is relatively straightforward. Co-operative structures are most appropriate for organisations whose members have a transactional relationship with the organisation, as customers, suppliers or employees. Community benefit structures are more appropriate for organisations that aim to serve a broader community purpose and do not have a transactional relationship with their members.

- **Community Interest Companies**

Community Interest Company (CIC) legislation, introduced in 2005, provided a new regulatory framework governing the three main forms of company:

  - a company limited by shares
  - a company limited by guarantee, and
  - a public limited company.

Like any other company limited by guarantee, a CIC company limited by guarantee cannot issue shares, although it can promote the sale of bonds and offer membership as a separate consideration. There is provision for the creation of a CIC public limited company.

The government invested a lot of energy into enabling CICs to adopt a company limited by shares structure, which would allow equity investment by individuals, and at the same time protect the interests of communities. This was achieved through the following specific provisions:

(i) An asset lock preventing any residual assets in a CIC being distributed to members if a CIC is sold, dissolved or amalgamated

(ii) A double dividend cap which prevents a CIC from distributing more than 35% of its profits to shareholders in any one year, and limits dividend rates to base rate plus 5%. Unused dividend allowances can be rolled forward to

future years but the 35% cap on distributions in any one year cannot be exceeded.

There is also a range of other regulatory requirements CICs must meet, which includes passing a community interest test and producing an annual community interest report.

- **Charities**

As a legal form, charities offer very limited scope for community investment. Charities can and do issue bonds, but they cannot issue share capital. Charities issuing bonds and other forms of debt, are exempt from regulation under the Financial Services and Markets Act.
Before embarking on raising capital through community bonds, charities should consider the impact this type of financial promotion may have on their voluntary fundraising activities. Encouraging donors to become investors might have a lasting impact on their relationship with the charity. The problem with bonds, and all other forms of debt, is that eventually the capital has to be repaid. This means that the charity has to behave like a business and generate sufficient profit to repay capital. The only alternative is for the charity to find donors willing to pay off its debts to bondholders. In this sense, bond finance can only ever be a temporary solution to the funding needs of charities.

How do you choose which legal form is best?

Determining the most appropriate legal form for an organisation will largely depend on its underlying purpose and objectives. For organisations pursuing charitable objects, and which are not overly reliant upon trade, then a charitable form is probably most appropriate, even though it will only be able to raise community investment in the form of bonds. For organisations that get most or all of their income through trade, and which also have clear community or social objectives, then either an IPS or CIC form will be most appropriate. Both these forms can be used to issue shares or bonds, and both forms support a profit-making business model.

Conclusion

Community investment works best when it works with a specific community, on a project with achievable aims and a low risk profile. If your idea is solely around social outcomes it may be better delivered as a charitable project. Community investment is about financial as well as social return.

Further information

The following sources can provide you with further information on what community investment is and how it may work for you:

- *Community Shares* is a research project examining the potential of community shares and bonds as a way to attract extra investment, and their website offers resources, factsheets and details of casestudies - www.communityshares.org.uk/.

- *Community Share and Bond Issues: The sharpest tool in the box* is a publication from 'DTA' which looks at what share and bond issues are, how to organise them, and so on - www.dta.org.uk/Resources/Development%20Trust%20Association/Documents/Other/community%20shares%20Final.pdf

- 'Co'Operatives UK' has produced a number of booklets that may be of use:

  - *Community Investment: Using Industrial and Provident Society Legislation* tells you more about the IPS format, and gives you help on how to get started - http://offline.cooperatives-uk.coop/live/images/cme_resources/Public/In%20the%20Spotlight/ITS%20Sept/Community-Investment-guide.pdf

  - *Community Shares: Practitioner's guide to governance and offer documents* offers guidance on community share offers and provides tools such as checklists that you may find to be of use - www.communityshares.org.uk/sites/default/files/practitioners_guide_final_7_7_10.pdf

  - *Simply Legal* provides information on legal forms for community enterprises - http://offline.cooperatives-uk.coop/live/images/cme_resources/Public/MakingLocalFoodWork/SimplyLegal.pdf

Disclaimer
The information provided in this sheet is intended for guidance only. It is not a substitute for professional advice and we cannot accept any responsibility for loss occasioned as a result of any person acting or refraining from acting upon it.

For further information contact

Neath Port Talbot Council for Voluntary Service
Tŷ Margaret Thorne, 17-19 Stryd Alfred, Neath, Neath Port Talbot, SA11 1EF
Registered Charity: *1064450*

Tel: 01639 631246 info@nptcvs.org.uk
Fax: 01639 643368 www.nptcvs.wales

Produced by WCVA, County Voluntary Councils and Volunteer Centres.
Last Updated:01/07/2011

Tel: 0300 111 0124
www.wcva.org.uk