7.0 Finding and Getting Money

Community Investment

Overview

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 more than just a means to raising funding for your organisation, but is about community involvement and empowerment, engaging communities to invest in themselves.

Image: Community Building

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 where often the wealth or financial benefit is then taken out of communities who often need it most. Community investment schemes will often operate in sectors or areas where there is often market failure such as local rural pubs, community broadband schemes or community sports venues.

Due to their community owned legal structures, community businesses are embedded in the fabric of their communities anchoring customer loyalty, and establishing a business model that serves and is responsive to the needs of the broader community. Often community businesses owned and invested in by their communities have more sustainable business models as they foster a different relationship and commitment level with their customers.

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The Plunkett Foundation undertake an annual report on the state of the community pub sector which highlighted that of the 100 plus community pubs across the UK there was a 100% survival rate in 2019 highlighting a sustainable business model and a different way to undertake business.

The Plunkett Foundation Annual Review

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 such as community energy activists or sports fans.

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).

The benefits of seeking investment from a community or community investment far outweighs going to the mainstream lending market as community investment gives its investors the opportunity to have democratic control or a voice in the community business and fosters a long term relationship with its investors as customers, volunteers and investors for future new initiatives.

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 community investment as long as you have the backing of your community and a willingness to invest in its long term future. 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, hence creating a more sustainable and robust business model.

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.

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 owned facilities are more likely to attract volunteers to support the running of the facilities and members are more likely to be returning customers as they have a vested interest in the success of the facility. This can allow community facilities to reduce rents where applicable or reinvest their profits into capital improvements.

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 by embedding their customers within their legal structure, giving customers control and a voice on how local services are run and designed.

We have lots of examples across Wales of communities coming together and turning around a failing pub using the community investment model, through reducing the debt liability, not being aligned to breweries and the connectivity with its customers which in turn increases sales and reduces losses from waste of stock etc.

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.

This may be particularly prevalent in rural communities where broadband services are limited.

Community Energy

The potential of community investment has been fully demonstrated in the renewable energy sector, largely thanks to the pioneering work of Awel Coop, Egni Coop, Gower Regeneration and Energy4All.

Collectively they have raised significant community investment funds, and pioneered the use of Cooperative and Community benefit 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.

Health and Social Care

Community investment would be well suited to H&SC organisations as they are normally undertaken by democratically owned organisations, where service users and their families have a voice and control over services impacting on them directly.

This legal structure can promote "client centred services" which are designed, developed and delivered by service users as promoted in the principles of the **Social Services and Wellbeing Act**.

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 only a few legal structures 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)** limited by shares and the **Cooperative Community Benefit Society**. 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 is patient (long term), and is a more flexible form of capital. This gives the organisation more flexibility in terms of repayment terms, which reduces the risk to the organisations with regards to interest payments and withdrawals of share capital.

In this instance community shares may be better fitted for start-up businesses or businesses where there is a need for longer, more patient 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, however they could run a closed share offer targeting their existing membership or a closed group of like-minded investors.

Some organisations have issued both shares and bonds such as Awel Community Energy Coop. 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. Business models can vary depending on the sector and the investment offer. The lending agreement with the investment needs to outline way how the business proposes to make money and pay back investor's capital in an open and transparent. 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. Having a well engaged membership allows a business to inform their business case from the offset allowing the business to understand client spending habits and to inform services, activities and products that the business will develop. A business case for community investment is different to that of a debt application as investors are often investing because they believe in a specific philanthropic cause or they want to save an asset or service within their community.

Investors' expectations are different to that of bank shareholders as they often invest on the basis that their capital is often at risk and that they may not get back all or some of the money they originally invested into a venture. Also community investors often accept at the point when they invest in a community venture that they may not see a return on investment from their investment until the point that the business matures which could take as long as 5 years.

This allows a community business to be agile particularly in the early stages of the business as they mutually share the risk, as well as the benefits with their membership. 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.

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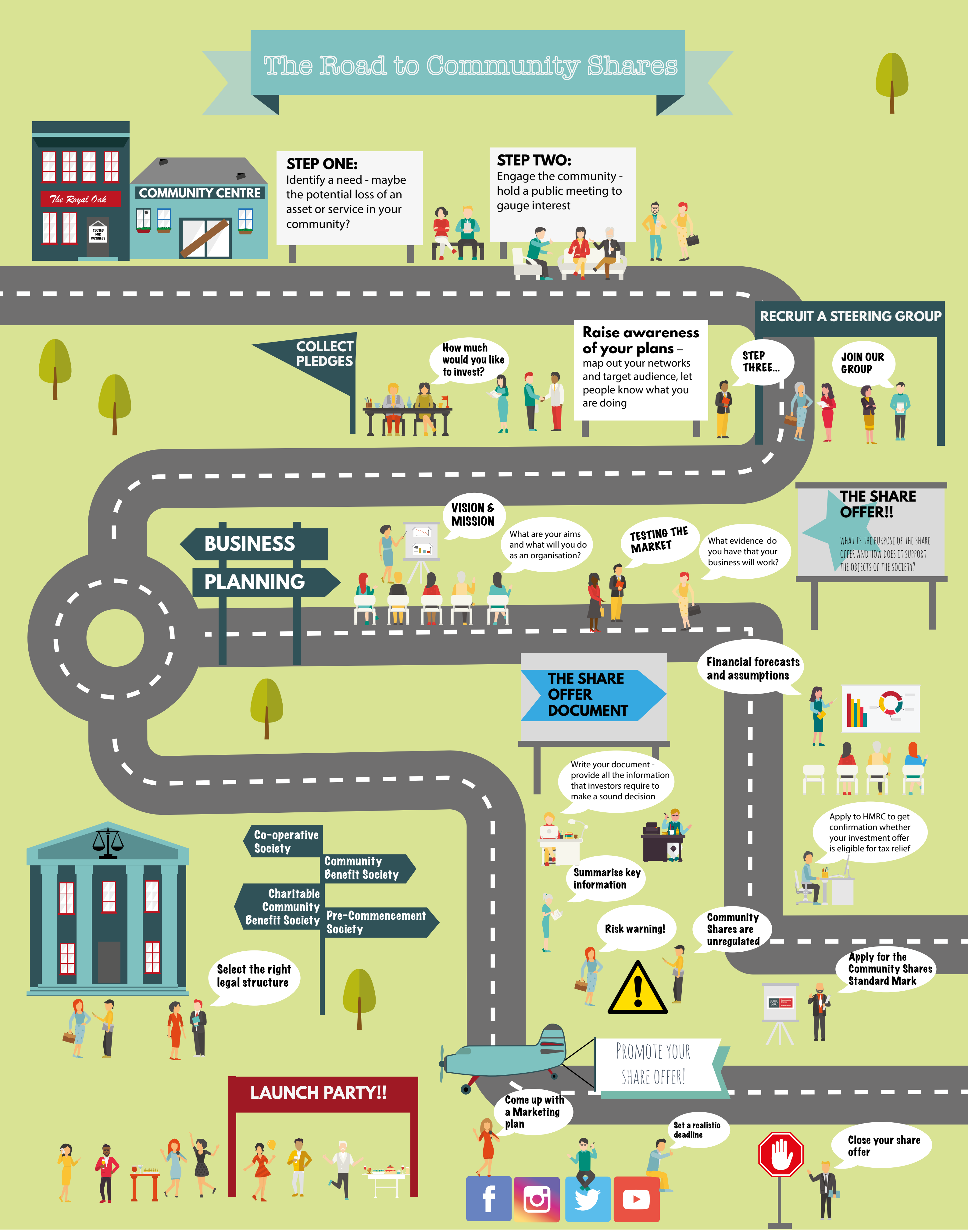
More information is available in the Business Model chapter of the Community Shares Handbook:

[Community Shares Handbook - Business Model]

The process of running a share offer is outlined in the infographic on the next page.



Wales Co-operative Centre
Canolfan Cydweithredol Cymru

ARIENNIR GAN Y LOTERI GENEDLAETHOL
NATIONAL LOTTERY FUNDED

For more information on how Community Shares could help you visit communityshares.wales.coop or contact the team on csw@wales.coop / 0300 111 5050

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.

It is important at the start of any community investment campaign that you map who your community are and understand what your offer may be to that community. For example a community energy wind-farm offer may promote the wider environmental benefits to community energy activists whilst promoting the benefits of a community benefit fund to local people who may be able to directly benefit from local funding opportunities from a wind-farm scheme.

Understanding your community/ies is critical at the start of any community investment campaign as it will inform your key messaging and marketing campaign for your community investment offer.

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.

If you are neither of these structures the options available may include converting your structure or setting up a linked company or society. We would recommend getting advice from a business advisor to explore the options as there are particular pitfalls to the various structures. **Wales Cooperative Centre** or your local **CVC** may be able to assist with this.

The offer document

Inviting people to invest in an enterprise and risk losing their money must be carried out in a responsible manner and depending on the legal structure will be regulated by different bodies. 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 **Cooperative and Community Benefit 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 or to retain like-minded investors who invest on the basis of supporting a community venture as opposed to the need for a financial return.

They also have a community shares standard mark which is a quality mark assessment to ensure that community share offers are promoted in line with best practice and regulatory recommendations. We would encourage anyone developing a community share offer to get in touch with the **Wales Cooperative Centre** who have licensed community shares practitioners who can support this process and assess community investment documents and award the standard mark.

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The community shares unit has created a Community Shares Handbook which outlines how community share offers should be prepared and promoted to the wider community in line with best practice.

[Community Shares Handbook]

The standard mark may give investors' confidence that further due diligence has been undertaken on your offer and also some institutional investors may also require this as part of their investment offer if you are attracting institutional 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 (now known as pre commencement societies
   i.e. societies registered before 1st August 2014) and Cooperatives and Community Benefit Societies (registered after 1st August 2014)
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

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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 **CIC**s 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 **CIC**s 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 Society 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.

We would always recommend to get advice from a business advisor when setting up your legal structure and do so once your business model has been developed as each structures has potential limitations which may impact on the structure you adopt e.g. if you want to employ directors of the company, your trading model and how you want to distribute benefits.

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
Community Shares
http://communityshares.wales.coop/

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, fact sheets and details of case studies.

http://communityshares.org.uk/share-offers/microgenius

Community Shares and Bonds
Community Knowledge Hub
https://libraries.communityknowledgehub.org.uk/resource/community-shares-and-bonds-sharpest-tools-box

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.

Community Shares: Practitioner's Guide to Governance and Offer Documents
Co Operatives UK
http://communityshares.org.uk/standard-mark-practitioners

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.

Simply Legal
Co Operatives UK
https://www.uk.coop/resources/simply-legal

Simply Legal provides information on legal forms for community enterprises

Further Information

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

Examples of Community Shares offers
Wales Co-operative Centre
https://wales.coop/

Community Shares in Wales: https://www.youtube.com/watch?v=KvLWf9tLm9c

Vale Cricket Club: https://www.youtube.com/watch?v=Vqv2mXiWg9U

Le Public Space: https://www.youtube.com/watch?v=v_RXVz1aSkE

Graigwen Woods: https://www.youtube.com/watch?v=qrTyrGT_LjE

MiFi Community Broadband: https://www.youtube.com/watch?v=zqj6pFVNysM

Cefnogi Trydydd Sector **Cymru**

Third Sector Support **Wales**

Third Sector Support Wales is a network of support organisations for the whole of the third sector in Wales.

It consists of the 19 local and regional support bodies across Wales, the County Voluntary Councils (CVCs) and the national support body, Wales Council for Voluntary Action (WCVA).

For further information contact
https://thirdsectorsupport.wales/contact/

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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.