

## **Changing the face of social enterprise in Australia: legislating for the “Community Interest Companies”.**

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Social enterprises are a way of doing good outside of the constraints of charitable status.

Social investors invest in social enterprises for a social purpose that can be achieved through generating revenue from ‘trading’ as a market based business.

To facilitate social investment, social enterprises must demonstrate that they can secure their social mission through locking in their assets for that mission. This is done through what is termed an “asset lock”. A statutory asset lock ensures that the business cannot be wound up, or the assets sold, for personal gain.

NFP structures such as the company limited by guarantee and the incorporated association are incorporated with an asset lock, but neither can provide for “patient capital” equity holdings on the part of investors.

For-profit structures such as the private company limited by shares (aka the Pty Ltd company) can access equity capital from investors for a social purpose, but find that they cannot install a secure and irreversible asset lock under this form of incorporation.

Securing an asset lock in private company structures requires a “Trust” to be set up to protect the assets. This can involve considerable expense (through the legal work required), as well as complex governance, administration and reporting arrangements.

The cost and complexity involved in setting up such trust structures can act as a barrier towards equity financed social enterprise development.

Longstanding UK social enterprise exponent, Jonathan Bland, who toured Australia recently, made the following point in his essay “Social Enterprise in Australia: Realising the Potential” (see: <http://www.probonoaustralia.com.au/news/2015/07/social-enterprise-australia-realising-potential#>) that Australia needs to “get the legal and regulatory framework right – this could mean creating new legal models for social enterprises like the highly successful Community Interest Company in the UK or introducing tax relief like the new Social Investment Tax relief in the UK which incentivizes private investment into social enterprise.”

The Social Enterprise Legal Models Working Group (LMWG) (<http://www.employeeownership.com.au/social-enterprise-legal-models/>) has been assisting social policy groups such as the PM’s Community Business Partnership (CBP) with reviewing this issue. A discussion paper on “Legal Structures for Social Enterprise in Australia” has recently been submitted to the CBP.

Angela Perry, Chair of Employee Ownership Australia ([www.employeeownership.com.au](http://www.employeeownership.com.au)) and member of the CBP says "There is an acceptance in the charity and not for profit world that the environment is changing. Many NFPs are looking for ways to ensure that they are sustainable in the long term and for some NFPs this means having a ‘profit for purpose’ part of their structure. Where it is currently very complex is when there is a significant asset involved, like a building for a cafe or training school. In these instances, there is no simple way to ensure that the asset is secured for social purpose and this is where an entity like the “Community Interest Company” could be very effective. It also helps investors and the community identify where a trading entity has a social purpose and this will assist impact investing opportunities as well as giving people confidence in the integrity of the social enterprise sector, which has to be a positive thing."

So what is a “community interest company” - or CIC?

CICs are a type of company legislated for in the UK in 2005 for social enterprises to use their profits and assets for public good. A CIC cannot be a charity.

CICs are easy to set up, with all the flexibility and certainty of the company form, but with special features to ensure they are working for the benefit of the community. So rather than being driven by the need to maximise return for shareholders, CICs are specifically “for social purpose” whose profits must be reinvested for that purpose.

CICs are quite diverse in the UK. They tackle a wide range of social and environmental issues and operate in all parts of the economy. They include community enterprises, employment projects, social firms, public service mutuals and social businesses operating locally, nationally or even internationally. All are social in that their ‘purpose’ is served through the setting of a social objective, with annual reporting of impact against that objective. The legislation stipulates the way the mission/asset lock will operate and defines what limitations there are on profit distribution. All are regulated by the CICs Commissioner (<https://www.gov.uk/government/organisations/office-of-the-regulator-of-community-interest-companies> ).

There are over 11,000 CICs in the UK. The growth rate has exploded this year (2015) – with 300 to 400 new CICs being registered per quarter. CICs remain relatively small though (being in the main ‘start-ups’), but according to the report “The RBS SE 100 Index: A Five Year Analysis of the UK’s Social Enterprises, 2010 – 2014” (<https://se100.net/analysis/annual-2014> ), CICs make up 80 of the top 100 fastest growing social enterprises in the UK. They also make up 1 in every 200 new companies formed in the UK, which is pretty impressive, seeing many ordinary companies sit on the shelf whereas almost all CICs are ‘active’.

As a result of the consultations the LMWG has undertaken while reviewing the policy issues involved (with views primarily from people who have been in social business for some time), three points support the “need” for CICs in Australia. These are:

1. With the demand for equity capital in social enterprise, there is an increasing number of pty ltd companies appearing in that space. Funders, donors, philanthropists and impact investors want ‘comfort/security’ that the enterprise upon achieving ‘financial success’ will not be sold or wound up for personal gain. CICs preclude this through the regulated “asset lock”.
2. Without access to an asset lock, the alternative to ensure that assets are secured for the social objective is through setting up a trust – an expensive and complex process. This could be avoided with the ‘low cost’ registration of a CIC if it were available. This also aligns with the Federal government’s ‘red tape reduction/reducing the costs of compliance’ strategy.
3. Successful social entrepreneurs looking to ‘exit’ the business (as is their wont – it is part of the entrepreneurial spirit) need assurance that the social business they have set up will maintain the social objective that it was set up for. CICs do this in perpetuity.

In line with these points, Ben Gales, the CEO of Social Enterprise Finance Australia ( <http://sefa.com.au/> ) puts forward the situation with his company as an example. He states that “SEFA provides a commercial investment return as well as a social return for its investors. Both are important for our backers. They want to know that this mission is embedded in our organisation’s DNA today and in the future. We are a B Corp. But we need to go further. So we have had put in place a somewhat complex legal protection framework, to provide mission and asset locks. If a hybrid legal model existed in Australia, such as the Community Interest Company, it would have saved us a lot of time, effort, cost and complexity.”

In researching the history of the CIC legal form, the LMWG studied the original policy document on the topic - the report of the UK Cabinet Office (2002) called "Private Action, Public Benefit: Organisational Forms for Social Enterprise" (<http://www.employeeownership.com.au/wp-content/uploads/2015/09/Social-enterprise-Organizational-Forms-for-Social-Enterprise-DTI-2002.pdf> ) . This report details (pages 13 to 16) eight issues supporting the case for a specific legal structure for social enterprise, with the most prominent being the "lack of a robust lock on assets against conversion into a for-profit enterprise".

The issues that have arisen from the surveys done by the LMWG in Australia are very similar to those outlined in the UK policy report. These issues are now listed on the "CICs in Australia" web-page ( <http://www.employeeownership.com.au/a-community-interest-company-structure-in-australia/> ) .

To come up with a solution, the LMWG has been working on what a specialist legal model for social enterprise could look like in the Australian legislative environment – something that is modelled on the UK's CIC but in legislative terms is best implemented under Australian Corporations law.

What it has found is that the 'Community Contribution Company' (<http://www.fin.gov.bc.ca/prs/ccc/> ) recently legislated by the Government of British Columbia in Canada serves this purpose admirably. This model is based on the CIC and would be easy to implement in both policy terms and through legislative amendment here – and importantly (given the need indicated Federally to avoid the cost of setting up a new regulator), it could operate within our existing regulatory framework, ie: ASIC.

To conclude in support of introducing a CICs model in Australia, Sandy Blackburn-Wright of "Social Outcomes" ([www.socialoutcomes.com.au](http://www.socialoutcomes.com.au) ) makes the comment that "if we need social enterprises to scale effectively, we will need patient equity capital to come into the equation. We will need social enterprises to be able to incorporate with a mission lock of some sort for when they become successful financially, or when founders move on and ownership needs to change hands. CICs can do this if we had that form of incorporation in this country. One of the working groups of the International Taskforce on Social Impact Investing has done a great paper on "Mission Alignment" (<http://www.socialimpactinvestment.org/subject-papers.php> ) options in this area, which is worth considering. "

Given the diverse and well informed opinions which are arising from across the social enterprise sector in Australia on the need for CICs, the LMWG is looking to document these as 'case study' material. So if you think your social enterprise could benefit from a CICs style legal structure for the reasons outlined above, we would be keen to hear from you.

About the author: Alan Greig is a Board member of Employee Ownership Australia Ltd, a Director of The Mercury Centre Cooperative Ltd and Co-ordinator of the Social Enterprise Legal Models Working Group (LMWG). He is not a lawyer, so the above represents opinion only. He can be contacted at [ahgreig@bigond.com](mailto:ahgreig@bigond.com). You can see more on the history and work of the LMWG at: <http://www.employeeownership.com.au/social-enterprise-legal-models/> . You will find there also a "Legal Models Comparison Matrix" that was released recently. It provides the minimum requirements for incorporating a social enterprise under any of the six forms of incorporation currently available in Australia. The LMWG also did a webinar on legal models - the recording of which is linked on the page - which answered a number of questions on CICs.