Introduction: Values-driven businesses and values-driven capital

Orthodox economics has it that businesses are run for one reason alone: to maximise the profits which can be obtained.

Co-operatives, as businesses founded on democratic principles, demonstrate that the reality can be more complicated. For co-operatives, as for the wider family of social enterprises, commercial profitability is a necessary objective but not simply the sole aim of the enterprise. Co-ops are businesses that are, to a greater or lesser extent, values-driven.

In a similar way, orthodox finance has it that investors invest for the sole purpose of maximising the financial returns they can make. But this is also not always the case. For individual investors in particular, anticipated financial returns may only be one of a number of factors which come into play when an investment is made.

For example, family and friendship ties may play a part. More relevant to the theme of this chapter, an individual’s set of values and beliefs may be significant factors in investment decisions: the potential investor may be influenced, for instance, by their religious views, their political views, by their personal interests and concerns, or indeed simply by a general sense of community responsibility. In these circumstances financial factors, whilst likely to be still very important, no longer make up the only element of the investment decision. Capital which is invested in this way will be described in this chapter as values-driven capital.

The focus in this chapter is on what happens when values-driven capital comes into contact with values-driven business. We shall be looking at the mechanisms which have been developed to allow this process to happen. More specifically, we shall be looking to explore the relationships which develop between the investors and the businesses in this situation. How – if at all – do values-driven businesses adapt themselves to relate to the particular needs of their investors, who by the act of lending their money have become stakeholders in the venture?

Just to make it clear: we shall not be arguing that the answer for co-operatives looking for capital is necessarily to seek out values-driven capital; conversely, we are not suggesting that ethically or socially-minded investors inevitably have to put their money into co-ops or social enterprises. The argument this chapter advances is a much more specific one: that any discussion about possible new mechanisms for capitalising co-ops – including implications for the principles and control of co-op businesses in such a process - can be aided by exploring what has happened already on those occasions where values-driven capital has been invested in enterprises with more than simply commercial aims.

This will involve us in moving beyond the immediate co-op world, to look in particular at developments in ‘ethical’ investment in recent years in Britain. The focus will be primarily on the last twenty years.
This is not to say that values-driven capital hasn’t played an important role in the past (after all, many Victorian co-operators invested in their own societies primarily to support the co-operative principles which they held dear, rather than just to maximise their returns). Nevertheless, recent decades have seen the development what can be fairly be described as a distinctive movement, both in Britain and in other western countries, committed to promoting what is called ‘ethical investment’, ‘alternative investment’ or ‘socially responsible investment’.

The ethical investment movement in Britain

This movement is a broad-based one which brings together a diverse group of people. It includes, for example, both those coming from an activist political background on the liberal left and those with a committed Christian set of beliefs. More specifically, the ethical investment movement has over recent years appealed to those with an interest in world development issues, in environmental issues, in animal welfare, in the peace movement, and in many other causes. To the extent that there has been any relationship with the traditional co-operative movement in Britain, the main point of contact has been through the Co-operative Bank’s highly successful ethical banking initiative. CIS by contrast has been a somewhat modest player in the ethical funds market. There have been some important links with the workers’ co-operative movement; as we shall see, a number of workers’ co-ops have used ‘ethical’ share or bond issues to attract sympathetic capital.

It is convenient to begin the account by going back to the early 1980s. One place to start would be with the launch in 1984 by Friends Provident of the Stewardship unit trust, the first so-called ‘ethical’ unit trust in Britain. This idea (though becoming familiar in north America) was considered threateningly radical at the time in the conservative culture of the City.

During the rest of the 1980s, the Stewardship fund grew modestly in size, and was gradually joined by a number of competitors. By 1989, fourteen ‘ethical’ funds has been established, which together held about £42m of investors’ money.

Early ethical funds like the Stewardship attracted people who wished to avoid their own money being used indirectly to reinforce apartheid. In addition the funds tended to avoid companies connected to the alcohol and tobacco industries, with gambling and with the military sector. From the early 1990s, the situation changed as environmental and ecological concerns became more central.

Today here are currently about fifty-five ‘ethical’ investment funds in Britain. Whilst they have similarities with each other, there are also considerable differences. For example, some funds are much more active in positively seeking out companies to invest in, in contrast to those who simply screen out companies with undesirable practices. There are also significant differences in terms of the issues covered; these now can include a range of disparate concerns, from animal testing to pornography, labour rights to nuclear power, greenhouse gases to motorway building. Some funds are much more responsive to investor input and participation than others.
The growth of these ethical funds seems a heartening success story, even if the total amount invested in these funds, about £3.5 bn, is still only a tiny percentage of the overall total of investment funds under management in Britain. However, even the ‘modest’ £3.5 bn currently invested in ethical funds in Britain is a substantial sum of money when set against the sort of investment needs of co-operative businesses. The point at present, of course, is that almost none of the values-driven capital which has been placed in these funds is finding its way into co-operative businesses. Ironically, ‘ethical’ money is going almost exclusively into conventional capitalist concerns.

Mainstream ethical investment funds are not the only manifestation of the ethical investment movement. The Ecology Building Society, established in 1980 and incorporated in 1981, has successfully developed as a specialist mortgage lender with a commitment to environmental and social objectives. Shared Interest, established in 1990 and legally incorporated under I&PS Act legislation as a society for the benefit of the community, is effectively a savers’ co-operative, borrowing from UK savers and offering loans and capital to Third World producers. Triodos Bank, which describes itself as an ethical bank which ‘enables money to work for positive social, environmental and cultural change’, has broadened its appeal from its original roots in the Rudolf Steiner movement (the Dutch-based Triodos parent bank took over the UK’s Mercury Provident bank, first established in 1973, in 1995). Among other initiatives, Triodos has begun to develop its Ethical Exchange (EthEx).

**Direct ‘alternative’ investment**

All these initiatives have helped to broaden the range of options for those with values-driven capital to invest. However, the past twenty years have also seen another development. This has been the decision by a number of organisations and social enterprises of various kinds to appeal direct to individual investors for capital – to undertake their own ‘ethical’ share and bond issues.

In general, this trend towards developing ‘alternative’ issues (the term ‘alternative public offering’ has recently been proposed as a generic term) has taken place, as it were, below the radar – in other words, without a great deal of media or academic attention. New share or bond issues sometimes attract national newspaper attention or are publicised via the Eiris (Ethical Investment Research Service) newsletter, but very often the bulk of the money raised comes from existing networks of supporters or friends of the venture.

The table below, which is taken from work undertaken by Jamie Hartzell, lists the more significant share and bond issues of the past twenty years. (Only issues of more than £50,000 are listed.)

<table>
<thead>
<tr>
<th>Company</th>
<th>Date</th>
<th>Structure</th>
<th>Type of investment</th>
<th>Target to raise</th>
<th>Amount raised</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traidcraft</td>
<td>1984</td>
<td>PLC</td>
<td>Share</td>
<td>£0.3m</td>
<td>£0.3m</td>
</tr>
<tr>
<td>Mercury Provident</td>
<td>1985</td>
<td>PLC</td>
<td>Share</td>
<td>c£1m</td>
<td>£0.5 by 1990</td>
</tr>
</tbody>
</table>

1 EIRIS, Ethical Investor, Summer 2003
As Jamie Hartzell points out, this totals just under £30m in investment (taking into account that some is reinvestment by existing bond or loan stock holders). The size of

<table>
<thead>
<tr>
<th>Company</th>
<th>Year</th>
<th>Type</th>
<th>Description</th>
<th>Amount</th>
<th>Current Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traidcraft PLC</td>
<td>1986</td>
<td>PLC</td>
<td>Share</td>
<td>£1m</td>
<td>£1m</td>
</tr>
<tr>
<td>ICOFund IPS Bond</td>
<td>1987</td>
<td>IPS</td>
<td>Bond</td>
<td>£0.5m</td>
<td>£0.5m</td>
</tr>
<tr>
<td>Paperback IPS Bond</td>
<td>1987</td>
<td>IPS</td>
<td>Bond</td>
<td>£0.05m</td>
<td>£0.05m</td>
</tr>
<tr>
<td>Centre for Alternative Technology PLC</td>
<td>1990</td>
<td>PLC</td>
<td>Share</td>
<td>£1m</td>
<td>£1m</td>
</tr>
<tr>
<td>Mercury Provident PLC</td>
<td>1991</td>
<td>PLC</td>
<td>Share</td>
<td>£0.5m</td>
<td>£0.4m</td>
</tr>
<tr>
<td>Traidcraft PLC</td>
<td>1991</td>
<td>PLC</td>
<td>Share</td>
<td>£0.6m</td>
<td>£0.4m</td>
</tr>
<tr>
<td>Ecological Trading Company IPS Bond</td>
<td>1993</td>
<td>PLC</td>
<td>Share</td>
<td>£0.75m</td>
<td>£0.2m</td>
</tr>
<tr>
<td>ICOF Community Capital IPS WSC</td>
<td>1994</td>
<td>IPS</td>
<td>WSC</td>
<td>£0.45m</td>
<td>£0.45m</td>
</tr>
<tr>
<td>Paperback IPS Bond</td>
<td>1994</td>
<td>IPS</td>
<td>WSC</td>
<td>£0.07m</td>
<td>£0.07m</td>
</tr>
<tr>
<td>Out of This World IPS Bond</td>
<td>1995</td>
<td>IPS</td>
<td>Bond</td>
<td>£1m</td>
<td>£1m</td>
</tr>
<tr>
<td>Shared Interest IPS Bond (5 year)</td>
<td>1995</td>
<td>IPS</td>
<td>Bond (5 year)</td>
<td>£1m</td>
<td>£0.65m</td>
</tr>
<tr>
<td>Triodos Renewable Energy Fund PLC IPS Bond</td>
<td>1995</td>
<td>PLC</td>
<td>Share</td>
<td>£1m</td>
<td>£1m</td>
</tr>
<tr>
<td>Shared Interest IPS Bond (5 year)</td>
<td>1996</td>
<td>IPS</td>
<td>Bond (5 year)</td>
<td>£1m</td>
<td>£0.85m</td>
</tr>
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<td>Bay Wind IPS Bond</td>
<td>1996</td>
<td>IPS</td>
<td>WSC</td>
<td>£3.1m</td>
<td>£1.2m</td>
</tr>
<tr>
<td>Out of This World IPS Bond</td>
<td>1996</td>
<td>IPS</td>
<td>Bond</td>
<td>£0.2m</td>
<td>£0.2m</td>
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<tr>
<td>Shared Interest IPS Bond (5 year)</td>
<td>1997</td>
<td>IPS</td>
<td>Bond (5 year)</td>
<td>£1.3m</td>
<td>£1.3m</td>
</tr>
<tr>
<td>Out of This World IPS Bond</td>
<td>1997</td>
<td>IPS</td>
<td>Bond</td>
<td>£0.2m</td>
<td>£0.2m</td>
</tr>
<tr>
<td>ICOFund IPS Bond (10 year)</td>
<td>1997</td>
<td>IPS</td>
<td>Bond (10 year)</td>
<td>£1m</td>
<td>£1m</td>
</tr>
<tr>
<td>Aston Reinvestment Trust IPS Bond</td>
<td>1997</td>
<td>IPS</td>
<td>WSC</td>
<td>£0.41m</td>
<td>£0.41m</td>
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<tr>
<td>Triodos Renewable Energy Fund PLC IPS Bond</td>
<td>1998</td>
<td>PLC</td>
<td>Share</td>
<td>£1.5m</td>
<td>£1.5m</td>
</tr>
<tr>
<td>The Phone Co-Op IPS Bond</td>
<td>1999</td>
<td>IPS</td>
<td>WSC</td>
<td>£0.4m</td>
<td>£0.4m</td>
</tr>
<tr>
<td>Shared Interest IPS Bond (5 year)</td>
<td>1999</td>
<td>IPS</td>
<td>Bond (5 year)</td>
<td>£1m</td>
<td>£1m</td>
</tr>
<tr>
<td>Ethical Property Company IPS Bond</td>
<td>1999</td>
<td>PLC</td>
<td>Share</td>
<td>£1.32m</td>
<td>£1.32m</td>
</tr>
<tr>
<td>Bay Wind PLC Bond</td>
<td>1999</td>
<td>IPS</td>
<td>Bond</td>
<td>£0.67m</td>
<td>£0.67m</td>
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<tr>
<td>Citylife (Sheffield) IPS Bond (5 year)</td>
<td>1999</td>
<td>IPS</td>
<td>Bond (5 year)</td>
<td>£5m</td>
<td>£0.8m</td>
</tr>
<tr>
<td>Citylife (Newcastle) IPS Bond (5 year)</td>
<td>2001</td>
<td>IPS</td>
<td>Bond (5 year)</td>
<td>£2m</td>
<td>£2.0m</td>
</tr>
<tr>
<td>Shared Interest IPS Bond (5 year)</td>
<td>2001</td>
<td>IPS</td>
<td>Bond (5 year)</td>
<td>£1m</td>
<td>£1m</td>
</tr>
<tr>
<td>Unit E IPS Bond (5 year)</td>
<td>2001</td>
<td>PLC</td>
<td>Share</td>
<td>£1m</td>
<td>£0.66m</td>
</tr>
<tr>
<td>Citylife East London IPS Bond (5 year)</td>
<td>2002</td>
<td>IPS</td>
<td>Bond (5 year)</td>
<td>£50m</td>
<td>£1.9m</td>
</tr>
<tr>
<td>Shared Interest IPS Bond (5 year)</td>
<td>2002</td>
<td>IPS</td>
<td>Bond (5 year)</td>
<td>£1m</td>
<td>£1m</td>
</tr>
<tr>
<td>Ethical Property Company IPS Bond (5 year)</td>
<td>2002</td>
<td>PLC</td>
<td>Share</td>
<td>£4.2m</td>
<td>£4.2m</td>
</tr>
<tr>
<td>Traidcraft PLC</td>
<td>2002</td>
<td>PLC</td>
<td>Share</td>
<td>£3.25m</td>
<td>£3.25m</td>
</tr>
<tr>
<td>Aspire</td>
<td>2002</td>
<td></td>
<td></td>
<td>£14m</td>
<td>£14m</td>
</tr>
<tr>
<td>London Rebuilding Society IPS WSC</td>
<td>2002</td>
<td>IPS</td>
<td>WSC</td>
<td>£0.06m</td>
<td>£0.06m</td>
</tr>
<tr>
<td>Triodos Bank NV IPS Bond</td>
<td>2002</td>
<td>Dutch Issue</td>
<td>Shares to be traded on Ethex</td>
<td>£14m</td>
<td></td>
</tr>
<tr>
<td>Unicorn IPS Loan stock</td>
<td>2003</td>
<td>IPS</td>
<td>Loan stock</td>
<td>£0.3m</td>
<td>£0.3m</td>
</tr>
<tr>
<td>Shared Interest IPS Bond (5 year)</td>
<td>2003</td>
<td>IPS</td>
<td>Bond (5 year)</td>
<td>£1m</td>
<td>£0.8m</td>
</tr>
<tr>
<td>Golden Lane Housing IPS Bond (10 year)</td>
<td>2003</td>
<td>Charity</td>
<td>Bond (10 year)</td>
<td>£14m</td>
<td>£14m (estimate)</td>
</tr>
</tbody>
</table>
the issues has increased considerably in the past two years, and it is significant that
the two big public issues of 2002, that of Traidcraft for £3.25m and the Ethical
Property Company for £4.2m, were successfully fully subscribed.

The list demonstrates the breadth of organisations and businesses choosing this route
to capitalisation. They include a number of financial and quasi-venture capital
institutions, raising money in order to lend on; Industrial Common Ownership
Finance (Icof), for example, has raised funds on a number of separate occasions for
lending to workers’ co-operative clients. Also in the list are a number of trading
enterprises. These include workers’ co-operatives (such as Paperback and Unicorn
Grocery), the new-wave retail co-operative Out of this World (the trading name of the
Creative Consumer Co-operative Ltd), and non-co-operative businesses with ethical
or social objectives, such as the fair trade company Traidcraft.

There has been wide variation in the extent to which these ‘alternative public
offerings’ are – in principle at least – hoping to reward investors with financial
returns. In general, individuals who are tempted to buy these shares or bonds do so
primarily not for financial motivation but as a way of supporting an organisation or
business whose aims they support – a point which tends to be clearly emphasised in
the prospectuses. There is, however, a spectrum here: in some cases, the investment
made may be very close to that of an outright donation, where the investor has little
expectation of dividends or interest or indeed even of having their capital returned; in
other cases, there is a strong expectation that investors will be rewarded financially,
although sometimes modestly.

It is these latter ‘alternative public offerings’ which have begun to attract the attention
of institutional investors as well as individuals. Henderson, for example, invested
£500,000 in the Ethical Property Co’s first share issue in 1999 and a further £381,000
in the share issue in 2002. Henderson was joined for this latter issue by a second fund
management company Morley, who invested £500,000. These investments mean
that a tiny part of the ethical funds managed by these companies is now directly
invested in ‘alternative’ public share offerings rather than in mainstream quoted
companies. Henderson is known to be keen to find other ‘APOs’ to invest in, though
as the firm’s head of SRI research has pointed out the investments it makes must meet
investment as well as social criteria. The problem, as he has pointed out, is the
current lack of supply of suitable shares2.

Other experiences of ‘social’ investment in Britain

The examples of alternative share and bond issues in the table above are not the only
occasions when share issues have set out to attract values-driven capital. In at least
three other areas of life in Britain there is a considerable tradition of using share issues
to bring in capital from investors whose motivations are by no means exclusively
financial. These are the railway heritage scene, the tradition of theatrical ‘angels’,
and the appeal by football clubs for support from local fans. We shall briefly look at
these areas.

2 Andrew Bibby, Doing the right thing can pay good dividends too, The Observer, 9 Mar 2003
The history of preserved heritage railways in Britain goes back to 1960, when the first train was operated on the Bluebell Railway in Sussex. There are now over 100 such railways in the British Isles, with a combined turnover in 2000 of £42m\(^3\). Most of these railways have required significant restoration work, and several have over the years appealed to railway enthusiasts and local people for the capital needed through share issues. No comprehensive listing of these share issues appears to have been compiled, but one source has suggested that a total of around £15m has been raised in total\(^4\). Recent successful share issues include £0.5m raised by the South Devon Railway and £1m by the Wensleydale Railway. The Wensleydale Railway is particularly interesting, since its motivation is primarily as a community-led attempt to improve transport provision in a rural area rather than as a project for railway enthusiasts.

### In summary: Wensleydale Railway

- Wensleydale Railway Association launched after public meeting in 1990, with the aim of reopening a forty-mile branch line through Yorkshire Dales (18 miles closed, 22 miles previously used as goods line).
- Associated private limited company The Wensleydale Railway Company Ltd created in 1992; acquired various assets and ran public bus services linking with Settle-Carlisle railway; a second private limited company established to acquire old station buildings
- Wensleydale Railway plc formed in 2000. Up to £2.5m shares offered; over £1m issued.
- Prospectus states that profits will be used in short and medium term to finance the business. “It is the intention of the Company to commence payment of dividends as soon as the Company is able to do so.”
- Shareholder benefits include free day passes on railway services
- Capital used initially primarily to operate passenger trains on former goods line
- 99 year lease of former goods line negotiated with Railtrack/Network Rail. Train service began Summer 2003

Traditional dividends have been paid by the Dart Valley Railway, the strongly commercial heritage line in south Devon. In general, however, investors receive their return not in the form of money but rather in kind, typically a number of free return tickets each year.

Existing and would-be shareholders in the Dart Valley Railway and Severn Valley Railway (another major heritage line, which ran a significant share issue in 1988) have access to a market-making service run by the Bristol-based stockbrokers Rowan Dartington, though trade is quiet (“Once every three or four months for Severn Valley, less for Dart,” according to the brokers). Another stockbrokers also offer a similar service, and there is talk of consolidating these arrangements in the near future. Otherwise, each railway tends simply to keep a register of would-be buyers and sellers of shares.

Heritage railways have developed complex legal structures to enable them to operate commercial or quasi-commercial train services, to attract share capital, but also to

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\(^3\) See [http://ukhrail.uel.ac.uk/facts.html](http://ukhrail.uel.ac.uk/facts.html)

\(^4\) Peter Ovenstone, chief executive Heritage Railways Assoc, in personal communication March 2002
remain accountable at some level to the network of volunteer enthusiasts who are key to their success. The usual pattern is to create a plc as a separate entity from the members’ preservation society. Many railways also have linked charitable trusts.

Satisfying the interests of volunteer enthusiasts and shareholders, whilst running a sometimes significant trading operation, has been known to lead to problems. The Severn Valley, for example, encountered difficulties in the mid-1990s when one significant shareholder, a retired solicitor, disagreed publicly with the policy of the then Board.

In the very different circumstances of live theatre, there is a similar reliance on a pool of committed investors prepared to risk their capital to fund new productions. The tradition of theatrical ‘angels’ – individuals who put in investment money – is a long one in the industry. The act of investing is a high risk one, and for every profitable Mousetrap there are many other productions where money is lost. Typically, angels find that at least half the productions they invest in result in a complete loss of capital; one production in four or six will, with luck, be a financial winner. The Society of London Theatre, which keeps a central register of potential ‘angels’, currently has about 300 individuals’ names.

The traditional arrangement is for the cost of a production to be divided into a number of units, offered to investors. For example, a play costing £1m to stage might be divided into 200 units of £5000 each. This money is used to pay script royalties, appoint a director, recruit the cast, book a theatre and pay for publicity. In the event that the play is successful in generating enough income from audiences to meet these costs, investors receive back their original stake. If a play continues to make profits, these are conventionally shared on the basis of 60% to the investors and 40% to the producer.

A more high-profile public appeal for investors has recently been made by Old Vic Productions, which launched a share issue to raise up to £2m in the summer of 2003. The issue follows three earlier similar calls for capital, in 1993 (£500,000), 1998 (£200,000) and 2000 (£1.6m). The 2003 share offer is primarily to fund two major productions, Billy Elliot: The Musical and The Old Vic Theatre Company. The prospectus emphasises the non-financial benefits of shareholding: for example, those investing the minimum £4,000 investment receive complimentary tickets to shows and a number of other incentives, such as backstage tours. The levels of these incentives increase depending on the size of investment - those investing at least £50,000 receive an invitation to Elton John’s post-Oscar party in Hollywood!

By contrast, football supporters who take shares in their teams can generally expect a less glamorous pay-back. After the Hillsborough football disaster, a number of clubs funded the costs involved of moving to all-seat stadiums through debenture stock sold primarily to fans. These issues were primarily fund-raising ploys: the bonds were non-interest bearing but gave the investor the occupy the same seat in the stands year after year – on a paying basis.

5 Richard Grant, Steam train investors shunted into a siding, Mail on Sunday, 1 Oct 1995
6 see for example Christopher Atkinson, The play’s the thing, so be an angel, Financial Times, 10 June 1995
7 Old Vic Productions plc prospectus, 2003
Most football clubs have traditionally been private companies dominated by a small number of major shareholders, often local businessmen, and minority shareholders such as individual fans have had no real power to influence Board decisions. From the 1980s, as football has changed from being primarily a sport to being primarily a business, a number of clubs have chosen to seek stock exchange listings, either on the full London Stock Market or on the junior AIM or Ofex exchanges. Tottenham listed in 1983, Millwall five years later, and about a further twenty clubs joined them over the next ten years. (As is well known, these publicly quoted shares have in many cases performed disastrously).

Whatever the volatility of the share prices, supporter-investors in the larger listed clubs have at least the protection of holding publicly-traded shares in companies subject to Stock Exchange regulation. The situation facing investors in smaller clubs – many of which have been in grievous financial circumstances in recent years – is less satisfactory. The ownership and financing of local football clubs (those below the top Premiership sides) has become an issue taken up within the co-operative and mutual sector (one suggestion, for example, is that football clubs should consider restructuring themselves as community-owned mutuals, using legal models based on I&PS legal structures).

The Supporters Direct initiative, launched in 2000, has helped establish Supporters’ Trusts in eighty clubs and in two cases, Lincoln City and Chesterfield, the football clubs are now actually owned by their respective Supporters’ Trusts. These developments are the subject of a recent Mutuo report.

**Issues raised by alternative share and bond issues**

There is already, therefore, considerable experience in Britain of the use of investment capital in businesses and enterprises of various kinds, where the investors are not putting in their money solely on the basis of their assessment of the financial returns.

We will now focus in on some of the specific issues which have arisen, by looking in more detail at three of these ‘alternative’ issues: Traidcraft, Centre for Alternative Technology and Bay Wind. The case studies have been chosen partly because of the size of the capital obtained (in each case within the £1m+ range being studied in this report) but also because in different ways they focus on the key issue under consideration: how organisations or businesses which are motivated by social or ethical principles adjust to meeting the needs of their investors.

As mentioned in the introduction to this chapter, the act of accepting capital from investors creates a new class of stakeholder in the venture. One issue, therefore, is how investors relate to existing stakeholders. A number of questions arise. For example, what legal rights or powers, if any, should investors be given? What formal and informal mechanisms need to be developed to involve investors and to

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8 Christine Oughton, Cliff Mills, Malcolm McClean, Peter Hunt, Back Home: returning football clubs to their communities, Mutuo, 2003
communicate with them? What should be the relationship between the investors and those who work in the organisation?

What degree of risk should investors carry? Should investors be expected to carry a greater burden of risk than other stakeholders - for example, those who are employed in an enterprise?

What sort of financial return, if any, should investors receive if a venture is operating profitably? Are there potential conflicts of interest with those who might want these funds utilised in other ways – for example, by paying higher wages or reducing prices to customers?

There are also technical issues to be answered. What options are there for investors who subsequently want to, or have to, withdraw their money from the venture? How is the market value of shares to be determined in the future?

**Case study 1: Traidcraft**

Traidcraft is one of the leading fair trade organisations in Britain, selling an extensive range of products (including fair trade foods and drinks, crafts, clothing and paper products) primarily from developing countries. The company is based in substantial premises in Gateshead.

Traidcraft’s turnover in 2002-3 was £12m. Almost half of these sales came from Traidcraft stalls run by volunteers, and held typically in churches or in workplaces. Wholesale trade (particularly to supermarkets) has grown considerably in recent years, and brought in £3.3m in 2002-3 (27%). Mail order sales accounted for £1.4m (12%). The company also sells to independent retailers (£1.6m in 2002-3, 13%). Pre-tax profits were £416,000, post-tax profits £321,000.

Traidcraft has a history which goes back to 1974, to early moves to import craft goods direct from producers in developing countries as a way of helping poverty relief and economic development. Traidcraft plc has been trading since 1979. The company’s first share issue in 1984 was a landmark in the development of this kind of direct ethical investment in Britain, and was highly successful: the full offer of £300,000 was fully subscribed, with many would-be investors disappointed. Two years later, a second share issue, this time for £1m in share capital, was also very successful and was fully subscribed. This was followed by a third share issue, in 1990-1991, when 600,000 shares were offered and about £400,000 was raised. (The third issue, unlike the first two, was not eligible for tax relief for investors under the Business Expansion Scheme).

More recently, Traidcraft has gone back to its supporters a fourth time, with the ambitious aim of raising a further £3,250,000 in capital. This share issue, which opened in October 2002, was also fully subscribed.

Traidcraft is run according to a set of ‘Foundation Principles’. There are eighteen principles, under five main heads:

- Traidcraft is a Christian response to poverty
- Traidcraft’s mission is fighting poverty through trade
• Traidcraft respects all people and the environment
• Traidcraft abides by and promotes fair business practices
• Traidcraft strives to be transparent and accountable

Traidcraft plc, the trading company, is one of three closely-linked organisations. Traidcraft Exchange is a registered charity which works to raise awareness of fair trade and ethical business principles and which provides training, consultancy and information services. The Traidcraft Foundation, also a charity, is the vehicle which ensures that both the plc and Triadcraft Exchange remain true to the Foundation Principles.

Until the 2002 share issue, Traidcraft plc was effectively under the direct control of the Traidcraft Foundation, which owned 100% of the voting (A) shares in the company. Shareholders who invested in 1984, 1986 and 1990/91 received non-voting B class shares. They had the right to elect a single Director, but otherwise has very little direct power over the company in which they had invested their money.

This has now changed. Since 2002, Traidcraft plc has had a single class of voting Ordinary Shares, bringing together all previous and new shareholders. However the Traidcraft Foundation continues to own a single Guardian Share, which gives it a range of powers designed to protect the Foundation Principles and the original Traidcraft vision.

This reason for this move was explained in the 2002 share prospectus as a desire to make the company more transparent and accountable to all stakeholders, including shareholders:

“The Directors believe that this new structure is more appropriate for Traidcraft plc’s future development because it should make the Company more accountable to its shareholders for the effective application of their capital to its mission. At the same time, Traidcraft’s Foundation Principles and the Company’s commitment to social accounting (both defended by the Traidcraft Foundation through the guardian Share and the Deed of Mutual Covenant) will continue to ensure that the Company works in the interest of wider stakeholders and, in particular, in the interests of its suppliers from poor communities in the developing world.”

The original 1984 share issue attracted 845 shareholders, the majority of whom invested £200 or less. The vast majority were individual investors, though some shareholdings were acquired by church groups such as Parish Councils. The 1986 and 1990/91 issues increased the number of investors, and by the time of the 2002 issue the company had approximately 3,600 investors. This has now risen to about 5,500, still primarily individuals.

Traidcraft has sought to find out more about its new crop of investors through a questionnaire, which has achieved a 50% response rate and which is currently being analysed. The company’s chief executive Paul Chandler says that the average shareholding (£1250) is considerably larger than previously, and that shareholders are somewhat younger than in the past. 75% declare themselves to be Christian. There is also a strong correlation with supporters of organisations such as Oxfam, Christian Aid, Amnesty International and the National Trust. Perhaps significantly, half appear to be completely new supporters, not previously known to Traidcraft as mail order customers or volunteers.

Traidcraft plc’s share prospectus have always been honest about the financial returns on offer to investors. As the 1986 prospectus put it, “Dividends will be low… and the directors do not envisage a substantial appreciation in the share price”. At that stage, the company declared
that dividends above 6% would not be paid. Subsequently, the Memorandum and Articles have been changed so that they set a maximum dividend on shareholder funds at no more than 2.5% above Bank base rate (paying more requires the specific agreement of the holder of the Guardian Share).

In practice, no dividend to shareholders has been paid since 1987, a consequence partly of difficult trading circumstances in the late 1980s and early 1990s. However, this issue was revisited at the time of the 2002 share issue, and the current intention of the directors is to recommence modest dividend payments, probably from 2004. The company’s profitability has improved markedly in the past two years, and both 2001-2 and 2002-3 have seen best-ever pre-tax profits. Corporation tax was paid for the first time in many years in 2002-3.

The 2002 prospectus states:

“Maximising the financial return for shareholders is not a principle aim of the Company. However the Board believes that, in order to demonstrate the viability of fair trade, it is important that it does seek to pay a reasonable level of dividends. In deciding on the allocation of future distributable profits the Board has indicated its intention to consider paying dividends up to the prevailing rate of inflation…”

In actual fact, a significant number of shareholders have waived their rights to future dividends, in favour of the Traidcraft Exchange charity.

The 2002 prospectus is also honest about the illiquidity of the shares (“Over the 23 year history of the Company, it has been difficult for individuals to sell their shares when they want to”). Indeed, before the 2002 issue there was a backlog of previous shareholders wanting to sell, some of who had been waiting a considerable time. The Board has arranged for the stockbroker Brewin Dolphin to coordinate a matched bargain service, although Brewin Dolphin says that this has been used only on a modest basis. The firm charges its minimum commission rate on this service, £255.

In terms of capital appreciation, the 1990/91 share issue attempted to factor in a small element of growth by offering £1 par shares at £1.10. Subsequent to this, the company’s substantial trading losses meant that, in relation to net asset value, Traidcraft shares fell in value. Currently, Brewin Dolphin recommends a £1 share price for the matched bargains it coordinates.

Judging from the success of the 2002 issue, these possible drawbacks are clearly overridden in the minds of many investors by the opportunity to support a pioneering and high-profile fair trade organisation. Traidcraft’s overtly Christian background also undoubtedly helps in this respect. However it is interesting that the Board has recently addressed the role of shareholders within the company, and has recognised the need to involve them as stakeholders in the company – something which arguably did not occur in the 1990s. The 2003 AGM, held in September in Newcastle, for the first time gave shareholders a formal role in the company, including voting on directors’ appointments and directors’ remuneration. Traidcraft also encouraged shareholders unable to attend the AGM to submit questions, which were then answered via the website, to create a kind of ‘virtual AGM’.

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9 Personal communication with author, February 2003
Looking further ahead, Traidcraft plans to bring shareholders together with other stakeholders (particularly its suppliers in developing countries) in 2005, at the time when the company will be developing its next strategic plan.

Case study 2: Centre for Alternative Technology

The Centre for Alternative Technology occupies the site of an old slate quarry near the mid-Wales town of Machynlleth. Since the 1970s, the Centre has been offering a practical demonstration of the benefits of alternative technologies, both to day visitors to the site and through its programme of educational work, training and consultancies.

In the late 1980s the Centre planned a major development programme to improve facilities for tourists. The centre-piece was the development of a water-powered funicular railway to carry visitors up to the quarry. To fund the railway and other infrastructure work, the Centre for Alternative Technology plc issued a £1m share issue. The shares (which were eligible for Business Expansion Scheme tax relief) were taken up quickly, by about 2000 investors. Investments ranged from £100 (the minimum) to a few larger holdings (around £12,000-£14,000). There are currently about 1800 shareholders.

CAT has operated from its earliest days as a worker-managed venture, and although not legally a co-operative it continues to operate according to collective working principles (all permanent staff have wage parity, for example). The relationship between CAT’s staff and its shareholders may be particularly relevant to workers’ co-operatives, therefore.

The share issue was arranged to protect the element of worker control of CAT: investors were allocated class B non-voting shares, whilst 50,000 class A voting shares were acquired by an employee share-ownership trust which raised £50,000 to pay for their purchase via a loan from Unity Trust. There are also two Guardian shares, held by a registered charity (the Society for Environmental Improvement Trust). This essentially provides a mechanism to protect the original vision of the Centre; the Trust is controlled by a number of key people associated with the Centre in the early days. Through the Guardian shares, they have a veto over proposed changes to the plc’s Memorandum and Articles.

The current structure of CAT is made up of the plc, which runs the commercial trading aspects of the Centre and the associated Centre for Alternative Technology Charity Ltd, which undertakes the charitable educational work of the centre (including work with schools, residentialis and information services). The plc has a turnover (2001) of £1.7m, of which about £300,000 is from visitors’ admission fees; the charity turnover is about £1m. The charity plc directors are appointed by an Employee Benefit Trust (which has taken over the Class A shares from the original employee share-ownership trust). Since employees are not permitted to be charity trustees, the charity has independent external trustees who nevertheless work closely with the Centre’s management. However, these formal structures co-exist with more informal arrangements which maintain the traditional principle of collective working and which are coordinated through the an elected management group meeting on a weekly basis.
There have been no dividends paid since the share issue. The original prospectus made it clear that dividends would have relatively low priority in terms of profit allocation, and since then CAT plc has made either trading losses or only relatively small profits in most years. A good trading period in the mid-1990s was used to allocate £10,000 to buy back shares, enabling some investors who wished to sell their shares to do so. Dividends might have been considered after another good year, 2000, had it not been immediately followed by the Foot and Mouth emergency. Most of the profits were used to build reserves, with 20% going for a staff bonus, and 10% for a new stakeholder pension scheme for staff. (Wages at CAT continue to be well below national average, with full-time permanent staff currently on £14,000 a year.)

Partly to assess shareholder attitudes to (the lack of) dividends, a questionnaire was sent out in 2002. 677 of the 1800 shareholders replied. Among the findings were:

- The main reason for buying the shares: potential dividend (6.4%), capital appreciation (8.9%), a type of donation (28.6%), support for a good cause (87.2%)
- Views on wanting to receive a dividend: yes (17.2%), no (49.7%), ambivalent (13.3%), if profitable (7.7%)
- If a dividend were paid: would keep it (31.7%), would waive it (21.1%), would donate to CAT Charity (37.2%), “it depends” (10.5%)

The problems and delays facing shareholders wishing to sell (particularly in cases where the investor has died and the shareholding has become the responsibility of executors) have clearly caused some worries for CAT. The problem was only partially resolved by the £10,000 share buy-back. Currently about £20,000 shares await new purchasers. Sixteen share transfers were arranged in 2002 via the plc’s Company Secretary (who keeps a list of would-be sellers); 33 transfers were made in 2001 and 55 in 2000 (the larger numbers were mainly because existing shareholders offered to buy significant numbers of further shares, allowing several smaller holdings to be ‘mopped up’). All transfers up to now have been at par (£1). On legal advice, the Centre does not advertise that investors have shares to sell; a further problem is that would-be new investors want to support the Centre’s work directly, rather than buy ‘second-hand’ shares.

Some investors have chosen to donate their shares to the CAT Charity (Gift Aid relief is not available, unfortunately). A further number have indicated that they intend to bequeath their shares to the CAT Charity.

CAT encourages supporters of its work to become members (£16 a year). Members receive, among other things, a quarterly magazine *Clean Slate* and an invitation to an annual conference. Whilst some shareholders are also members, there is no automatic overlap. Shareholders receive fund-raising newsletters and details of CAT’s publications, and can also attend the AGM (this is a separate event to the annual conference). Last year about fifty attended, an increase on much poorer turn-out in previous years. Shareholders also have their own representative as an observer (without voting rights) on the plc Board; the current representative was chosen by election some years ago.

Since 1990, CAT has undertaken further significant capital developments through grant support and fund-raising, and this route is now clearly preferred as an alternative to further share issues. (The cost of meeting the legal obligations towards its shareholders is also a burden on the plc.) There is a sense, in fact, that the share arrangements are something of a left-over
from a previous period of CAT’s development, and that – despite its best intentions – the Centre has never quite been sure how best to relate to its investor-supporters. The 2002 questionnaire to shareholders can be seen as an attempt to tackle this and to find out more about investors’ attitudes and requirements.

**Case study 3: Bay Wind**

Bay Wind, the community-based co-operative set up to support the development of wind energy in Cumbria, is often cited as a model of how new co-operative businesses can be established. Firstly, Bay Wind represents a venture by a co-operative into the area of energy generation, identified as a promising area for growth. Bay Wind has also been profitable: the co-op has experience of running two successful share offers (the first in 1996/7 raised £1.2m, the second in 1998/9 the full £670,000 on offer), and since then has been able to pay significant dividends to its investors: 6.07% gross in 2002, for example. Perhaps not surprisingly, there are many would-be shareholders queuing up, waiting to acquire shares.

Bay Wind chose the traditional Industrial and Provident Society route to incorporation, structuring itself as a community co-op. The co-op members are the shareholders (only investors can be members), limited to the standard I&PS £20,000 investment maximum. As in standard co-op practice, each investor receives one vote, regardless of investment size (the share issues imposed a £300 minimum holding). Bay Wind today has about 1300 member/investors, of whom approximately 40%-45% live in the south Cumbria/north Lancashire area, close to the location of its wind turbines.

Bay Wind’s origins are somewhat unusual. It was effectively created in a top-down manner by Wind Company, a UK operation of the Swedish wind energy developers Vindkompaniet, who at the time were developing a five turbine site at Harlock Hill, Cumbria. Vindkompaniet, whilst a commercial enterprise, had experience of working with community groups in Sweden to support wind energy generation. The first share issue raised the capital to purchase (at market price) two of the Harlock Hill turbines erected by Wind Company. Subsequently, Bay Wind raised capital in its second share issue to purchase (again at a commercial price) one of four turbines at the Haverigg II wind farm, also developed by Wind Company.

Unlike most co-ops, therefore, Bay Wind’s investors found themselves coming in as members of an embryonic organisation which, whilst legally a co-op, was heavily dependent on the expertise of its ‘godparent’ Wind Company/Vindkompaniet. When Vindkompaniet subsequently decided to withdraw from the UK market, the co-op urgently needed to find its own management expertise and develop administrative structures. Bay Wind was fortunate in that, following an appeal, a number member/investors with business experience came forward to strengthen the co-op’s Board.

One decision taken was to acquire complete control of the Harlock Hill wind farm by purchasing the remaining three turbines there. This acquisition was made in 2001, though not through a third share issue. The cost was met partly from the co-op’s reserves (members had previously agreed that money allocated to a depreciation fund could be utilised in this way) but chiefly via a business loan from the Co-operative Bank. The cost of acquiring the turbines in this way was calculated to be cheaper than using share capital.
The issue of dividend payments (more correctly, since Bay Wind is an I&PS, ‘share interest payments’) has been discussed several times by the co-op’s members, most recently in a long debate at the last AGM. When the first dividend payments were made, several investors were clearly surprised (“We got lots of letters saying ‘I never expected to see any returns, in fact I didn’t expect to see my money again’”, recalls Andrew King, Bay Wind’s chairman). However, other investors clearly do welcome, and indeed have come to expect, these financial returns. The AGM discussion clearly demonstrated considerable spread of opinion in this respect.

The co-op policy is that trading surpluses (after development costs and depreciation) are distributed in full to members. This has resulted, given current low interest levels, in what can be considered to be relatively high dividend payments. (In fact, dividend payments in 2003 are expected to be lower than in 2002, since the good summer weather meant wind levels were much lower).

Bay Wind’s strategy now is to seek to replicate its model by helping other locally based community wind energy generation co-ops become established. Co-operative Action has helped fund a development worker at the co-op, and Bay Wind has identified prospects for community groups to acquire a number of wind turbines on wind farms currently being developed, particularly in Scotland. At the same time Bay Wind has established Energy4All, currently a wholly owned subsidiary established as a limited company. The idea is that each new co-op will contract to receive management and admin services from Energy4All, which will be converted into a company jointly owned by each participating co-op (in other words, in operation if not in legal structure, Energy4All will be a secondary co-op).

There is no recognised market in the shares but a number of Bay Wind investors (or, more frequently, the executors of their wills) have sold shares since the original share issues, having been given the names and addresses of potential investors by the co-op. Although the high demand for shares might suggest that the shares could be sold at a premium, in fact shares appear to have changed hands either at par (£1) or at 80p (representing the fact that most original investors benefited from EIS tax relief, so that £1 shares effectively only cost them 80p). Bay Wind’s shareholders are almost exclusively individuals; Andrew King says that the £20,000 maximum investment acts as a strong deterrent for institutional investors.

Values-driven capital and institutional investors

So far, much of the emphasis in this chapter has been on individual investors. There is a reason for this: historically, those who have responsibility for other people’s money (including trustees of pension funds, charities or private trusts) have tended to be highly cautious in their investment decisions, concerned that they could be operating outside their legal powers if they choose investments on any grounds other than financial returns.

A landmark pensions case in 1984 appeared to reinforce this message. The case was related to attempts by NUM-appointed trustees of the pension fund of the NCB (subsequently British Coal) to cease to invest, among other things, in companies in competing energy industries – investments which, after all, it could be argued threatened the jobs of the very people who were in the pension scheme. The court
judgment nevertheless suggested that trustees had little room to introduce non-financial criteria into their investment decisions\(^{10}\).

The overall climate has, however, changed in recent years, helped by the growth of interest in corporate social responsibility (CSR) and by evidence that ethical investment policies do not necessarily mean that returns will automatically be lower. One key factor (according to Russell Sparkes, author of the book Socially Responsible Investment\(^{11}\), a ‘historic’ step forward) has been the decision by the UK government to require pension fund trustees to state whether or not they are taking social, environmental and ethical considerations into account when fixing their investment strategy. This new requirement, announced in 1999, has been operative since July 2000.

Partly as a consequence, the last few years have seen a dramatic increase in the numbers of institutional investors engaging in forms of socially responsible investment (SRI). According to Russell Sparkes, an overall total of £224 bn in assets in Britain was invested in 2001 according to some form of SRI criteria, made up of £13 bn from church investors, £25 bn by charities, £80 bn from pension funds and £103 bn from insurance companies, together with the £3.5 bn held in ethical funds. This compares with a total of just £22 bn in 1997. Nevertheless – as with the money invested by individuals in ‘ethical’ funds - the vast bulk of this money is held in conventional shareholdings. Only a tiny amount is currently being invested directly in values-driven businesses.

As mentioned above, the Ethical Property Co is highly unusual among ‘alternative public offerings’ in having institutional investors as investors. Henderson and Morley are able to justify their holdings primarily because the funds raised have been reinvested in the relatively secure home of property. The Ethical Property Co also has a track record of paying dividends. Among other recent ‘APOs’, perhaps only Bay Wind might have been immediately attractive to institutional investors – and the problem here, as we have seen, is that the maximum investment is legally limited to just £20,000.

**In summary: Ethical Property Co**

- Company was established in 1998 ‘to meet the property needs of the social change sector’.
- First share issue in 1999 raised £1.72m, and was over-subscribed. Six properties were acquired, for rent to charities and campaigning bodies
- Second share issue in 2002 raised a further £4.2m, also invested in property for use by groups working for social change
- Share price increased to £1.05 for second share issue
- Ethical Property Co has a policy of paying dividends. Dividends of 3p per share paid in 2000 and 2001
- Institutional investors invested £500,000 in first share issue, £881,000 in second issue
- Ethical Property Co discussing creation of an ethical exchange for buying and selling its shares

\(^{10}\) Cowans v Scargill 1984

\(^{11}\) Russell Sparkes, Socially Responsible Investment – a Global Revolution, publ John Wiley, Dec 2002
Values-driven capital and social enterprise in Britain

Does this mean therefore that for values-driven businesses, including co-operatives, looking for financing there is little opportunity to access values-driven capital held institutionally, as opposed to that made available by individuals?

A comprehensive answer to this question would involve moving beyond the particular focus of this chapter into the much broader realm of the funding options for social enterprises and community companies. This has been a major area of attention both for the UK government and for others concerned with the development of social enterprises in Britain. One detailed investigation of the current situation is the report The Financing of Social Enterprises: A special report by the Bank of England, published in May 2003. This noted:

“There is little evidence of demand for, or supply of, conventional venture capital or business angel finance to the social enterprise sector… There is however evidence of demand among social enterprises for some form of ‘patient’ finance, particularly at the start-up or expansion stages. The term is variously defined to range from ‘investment’ grants to products that are structured as debt or equity, where investors are willing to accept lower, and in some cases, uncertain, financial returns in exchange for social outputs.”

More immediately relevant to the theme of this chapter is the debate focused on the government’s proposal to create a new legal framework for a ‘Community Interest Company’. The government’s plans were developed in the consultation document, Enterprise for Communities: Proposals for a Community Interest Company, issued in March 2003 and in the more detailed working paper Finance for CICs which accompanied it.

Central to the idea of a CIC is the principle that profits and assets are to be used for the public or community benefit. This principle will be defended partly by a regulatory regime and partly through a legal ‘lock’ on the distribution of profits and assets. However, as the government has recognised, this raises issues about the access which CICs would have to equity or quasi-equity capital and about the power and rewards which investors in CICs should be given. In other words, there will be very similar issues facing CICs to those which we have already addressed in this chapter.

The government’s general stance is set out as follows:

“The Government expects CICs to display a strong focus on stakeholder needs. The regulator will produce guidance setting out best practice in involving stakeholders and in balancing the interests of different stakeholder groups…”

In terms of capital, the consultation document comes down against the idea that CICs could issue shares that pay an uncapped dividend. It proposes instead that CICs should be able to issue tradable fixed rate or capped rate shares (‘preference’ or ‘investor’ shares), with dividends capped at a level linked to the bank base rate or similar benchmark.
It also debates the degree of influence which investors should be allowed to enjoy within a CIC:

“There is clearly a tension between the desire to secure a good return on investment and the drive to operate in the public or community interest. The Government therefore proposes that CIC legislation should place limits on the power that investors may have to control the activities of CICs... In order to maintain the primacy of the community interest objects of the CIC, it will be important to ensure that the investor shareholders cannot control the management of the company...”12

There is, of course, no guarantee that the government will follow up the CIC consultation with legislation or that the CIC proposals as outlined here will be left unchanged. Furthermore it is unlikely that co-operative businesses will choose to incorporate via a CIC framework in preference to the established route via the Industrial and Provident Societies Act (or even the Companies Act). Nevertheless, co-operatives looking for new funding mechanisms will inevitably need to engage in some of these same issues. The discussion over investor rights and investment mechanisms for CICs should be followed closely, therefore.

**Venture capital and values-driven businesses**

For smaller and medium-sized start-ups and developing businesses in need of equity capital, one common route is to look for venture capital from external investors.

The operation of the venture capital industry is well known. Investments are high-risk, and investors know that a substantial proportion of their holdings will fail. The idea is that the successes, however, more than compensate. Venture capitalists exchange their initial investment for a significant shareholding in the business and for the right to nominate directors of the company.

Venture capital is restless money, and investors typically look for an exit route after a few years, to enable them to liquidate their holdings. This is traditionally provided through the mechanism of an Initial Public Offering (IPO) – by which stage, hopefully, the company’s success will mean a healthy share value and a healthy return – or via a take-over.

The difficulty in reconciling the operation of the venture capital market with co-operative and other types of social enterprise is also well-known. For co-operatives, there are both structural and philosophical problems. Because of their legal structures, co-operatives do not have the same share mechanisms as plcs through which venture capitalists can arrange their investment. There are potential problems, too, in reconciling co-op members’ interests with those of the investor. For example, employees may be better served if a business expands very gradually; by contrast venture capitalists are likely to be looking for very rapid growth.

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12 Enterprise for Communities: proposals for a Community Interest Company, UK government, 2003
But without risk capital structured as equity, young businesses face a heavy burden of debt. Are there possibilities, therefore, of translating the basic venture capital model into the particular circumstances of co-operative and social enterprises? Is it in fact possible to have values-driven venture capital?

As we shall see later in this chapter, the concept of ‘social venture capital’ has begun to develop in the US context. It has also begun to be discussed in Britain. The idea of a community development venture fund was one of a number of proposals made in the Social Investment task force report Enterprising Communities: Wealth beyond Welfare, published in 2000. The idea can be seen as a development of the community-based loan and grant fund schemes available for social enterprises.

We can also note the launch of the first self-described ‘ethical’ Venture Capital Trust, the Pennine Downing Ethical VCT. This seeks to invest in companies which ‘make a positive contribution to society through the provision of useful products and services, by the creation of jobs and through good management, without compromising expected returns on investment’. This fund to date has had a disappointing performance. (VCTs, established in 1995, are fully quoted companies very similar to investment trusts in concept; they provide a tax-efficient way of investing in a portfolio of emerging companies).

Any discussion of venture capital in relation to values-driven businesses such as co-operatives has to look at the experience of the workers’ co-operative Poptel, which turned to conventional venture capital to aid its development. Poptel is the subject of the fourth detailed case study in this chapter.

**Case study 4: Poptel**

Poptel was one of the relatively small number of workers’ co-ops established in the 1980s which developed from small roots into more substantial commercial ventures. It had a high profile in the broader co-op movement, and the company was instrumental in establishing the international .coop suffix for co-operative business web addresses. It helped provide internet facilities for many campaigning organisations, NGOs and trade unions.

Poptel continues to trade but is no longer a co-operative, ownership having effectively passed in 2002 to the primary venture capitalist investor Sum International. A small web design spin-off, Poptel Technology, remains co-operatively run. Poptel’s former retail broadband business has been passed (along with some former Poptel staff) to another co-operative business, the Phone Co-op.

For many years, Poptel was simply the trading name of Soft Solution co-operative, originally established in 1983 as a common ownership workers’ co-op. Employees were invited to join Soft Solution after they had worked for Poptel for six months (originally one year).

In the late 1990s, in the context of the dot.com boom, the internet expansion and the high degree of competition in the IT sector, Poptel faced an urgent need for more funds, both to update its core IT capital equipment and for working capital. It approached financial institutions
in the co-operative sector, but in the end negotiated a £1.5m facility with the private equity organisation Sum International. The deal involved the creation of a new holding company, in which the investor held 25% of the shares and the Soft Solution co-op held the remaining 75%. Sum International took up a number of places on the board of the new company, and also by agreement arranged for the company to have a new managing director. One of Poptel's founders remained Chair of the board. At the time, employee directors argued that the new arrangements, especially the presence of non-executive directors on the board, strengthened the management of the business. Subsequently, they have admitted that there were tensions between old and new board members over the direction of Poptel's development.

Following the injection of venture capital, Poptel was able to invest in a new Network Operation Centre (the IT hub of the business). The business also set its sights on rapid expansion, with the number of staff increasing from around 20 to about 55. Major resources were invested in developing a Professional Services division, offering design and build services for websites for organisations and corporates. This business grew fast, but income was dependent on individual contracts and was therefore lumpy. Poptel also invested heavily in developing the .coop idea, for which it was to operate the international registry service.

Poptel had originally operated on a wage parity basis. This was changed early in the co-op's life, partly to reflect market realities in the IT sector. Unlike most IT businesses, however, staff did not hold shares individually, and therefore did not have access to the sort of share option schemes common elsewhere in their sector. The co-op had a number of discussions about moving from collective towards individual shareholding in the business. However, this debate became purely theoretical as Poptel hit further financial turbulence.

Among other problems, the .coop project encountered unexpected delays and Poptel found itself in 2000-1 facing a series of further cash-flow difficulties requiring more capital injection. A further £3m was obtained; £1m more came from Sum International and £2m was invested by the Baxi Partnership. Baxi Partnership (see below) is an investment vehicle established to promote employee owned businesses.

Had the market valuation of IT companies continued in the way seen in the late 1990s, Poptel could have successfully brought in further venture capital without diluting too much the percentage of shares held by the workforce. But unfortunately the market in IT-related shares had crashed, as the dot.com bubble imploded. The new investment therefore took the external shareholders' share in Poptel up to 49%.

Poptel's staff were conscious of the importance of maintaining their co-operative status by holding at least a bare 51% majority ownership in the business, and had devised a way to finesse the share ownership arrangements to try to make this possible. The device involved utilising a Soft Solution Employee Benefit Trust. Part of Baxi's investment would be in the form of a loan to this body, which in turn would hold some of the parent company's shares. According to Malcolm Corbett, Poptel's corporate affairs director at the time, the net result was by 2001 Poptel's shares were held as follows: Soft Solution owned 44% of the shares, the EBT held 7%, with 49% held by external investors. It was a solution which, just, allowed the workforce to maintain overall control.

However, this device could not be utilised a second time. It was clear by 2002 that Poptel would not be able to continue trading without further capital injections. As Malcolm Corbett has put it, “The only people at the table were Sum”. The end result was that Sum International took
majority control of Poptel, a solution which certainly left some key players with a bitter taste. The former worker-appointed board members stepped down and Sum’s founder partner Yoram Amiga became non-executive Chairman. Sum has also appointed a new managing director, who has adopted a US-style management style designed to encourage employee participation.

The Poptel story might be read as a Faustian bargain by a workforce with private capital which unreeled to the inevitable outcome, when the investors were left in full control. The co-op’s former senior managers do not accept however that this was inevitable. Rather, they say, it was the result of an unlucky combination of external factors over which they had little control. It is true that the trading situation for all IT companies in recent years has been highly challenging, and many conventional businesses have also foundered.

It should perhaps also be added that Yoram Amiga from Sum International claims to be a strong supporter of the idea of co-operative business and has even suggested that Poptel could be reconverted in the future to a co-op. It is not clear how in practice he would see this process taking place.

The Poptel story brings in, albeit not in the happiest of circumstances, the work of the Baxi Partnership, a equity fund dedicated to supporting the concept of worker-ownership. Baxi Partnership, which when created was worth £20m, is highly unusual and is perhaps the closest in the British context to anything representing a genuine values-driven capital fund. Unlike a traditional venture capital fund, Baxi Partnership offers ‘patient’ capital. It is managed by David Erdall, and – apart from its unfortunate foray into Poptel – has successfully invested to date in a number of employee-buyouts of existing businesses.

The Baxi Partnership fund was extricated from the remains of the central heating and boiler company Baxi, which had previously been run as a fully employee-owned business but which had through trading difficulties been taken over in the late 1990s and had lost its employee-ownership structure. Baxi, previously a privately owned business, had been sold to the workforce by its owner Philip Baxendale in 1983 for a fraction of its market value. The fund, therefore, enables the impulse behind this original action to be maintained, albeit now in a different way.

When the Baxi Partnership invests, it normally takes at least 50% of a company’s shares, so that each company in effect becomes part of the overall Baxi Partnership group. The remaining 50% may be held by individual employees or by trusts working for the benefit of the workforce; outsiders may also hold shares “provided that the reason for allowing this is to help achieve the main purpose of the trust”. An agreement is made between Baxi Partnership and each company, which among other things specifies an internal market in company shares is to be operated. The aim is “so that after holding shares for a few years each employee can sell them”.

Baxi Partnership Ltd itself is owned by a trust which was established by a 2000 Act of Parliament. This sets down that the trust must make its decisions for the benefit of employees of the companies in the Baxi Partnership - in other words, the beneficiaries

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13 For further information, see the more detailed case study on Poptel written by Andrew Bibby (2001), available at www.andrewbibby.com/socialenterprise. See also Andrew Bibby, Investors 1, Workers 0 in the capitalist stakes, Financial Times, 8 July 2003.
of the trust are the employees of the companies in which it has invested. The trust is also committed to the aim of business success and of a partnership culture in the workplace\textsuperscript{14}.

The Baxi Partnership has identified four key scenarios when it may be able to assist businesses:

- family owners who want to take their capital out
- corporate owners who want to sell a non-core subsidiary
- venture capitalists who are looking for an exit
- entrepreneurs who want to move on.

Its first two investments were in the Scottish engineering company Woollard and Henry (£1.3m), a family concern which was contemplating selling out to a competitor, and in the Lancashire container manufacturer UBH International, as a phoenix bid to rescue a company in liquidation (about £1m). More recent investments by Baxi Partnership have included a £2m loan to Loch Fyne Oysters, the seafood and game company, as part of an employee-buyout following the death of the founder of the business\textsuperscript{15}.

**The wider picture: values-driven capital in other countries**

What of the situation elsewhere in the world? The debates and experiences in Britain which have been described in this chapter in many respects mirror very similar developments elsewhere in the world.

In the United States, the idea of socially responsible investment has reached a much more mainstream position than in Britain. According to the most recent (2001) report by the (US) Social Investment Forum, some $2,340 bn of assets out of the total US investment assets of $19,900 bn are in ‘socially screened investment portfolios’ – or in other words, more than 10\% of the total\textsuperscript{16} under professional management.

Within this amorphous total the Social Investment Forum distinguishes between three broad categories of socially responsible investment, of which the largest consists of investments which are screened according to certain ethical criteria. In 2001, this comprised $2.03 bn. Secondly, there are investments which are used as a basis for shareholder advocacy, or in other words where investors attempt to use their investment to encourage or discourage certain practices by the company (in 2001, this comprised $903 bn, including about $600 bn where funds are also ethically screened). Finally, a small share of the total ($7.6 bn) is represented by the ‘community investing’ category, such as that undertaken by Community Development Financial Institutions (CDFIs) in the US. CDFIs (there are now over 360 in the US) have developed since the 1960s and play a valuable role in supporting community

\textsuperscript{14} see Mark Nicholson, Evangelist for employees as owners, Financial Times, 21 Nov 2002; Andrew Bibby, The challenge when labour employs capital, Financial Times, 31 Oct 2002; see also www.baxipartnership.co.uk

\textsuperscript{15} Mark Nicholson, Loch Fyne Oysters to be owned by staff, Financial Times, 4 March 2003

economic regeneration, particularly among lower-income and ethnic minority communities.

As SIF’s figures above demonstrate clearly, the vastbulk of socially responsible investment in the US remains invested in conventional companies. However one development in recent years of note has been the interest among charitable foundations, public pension funds and private equity funds in the possibility for values-driven venture capital.

One interesting example is the Investors’ Circle, which describes its objective as ‘venture capital for a sustainable future’. The organisation currently has about 100 members, made up of individual investors, venture capital fund managers and foundation representatives who ‘believe in the power of venture capital to act as a tool for social change’. Each month about 15-20 vetted business proposals are circulated to members of the organisation, who can then choose if they wish to negotiate direct with the individual companies. The Investors’ Circle says that, since 1992, it has helped facilitate the investment of $85m in almost 150 companies. Investors’ Circle works closely with an ‘ethical’ venture capital fund Commons Capital, and has also spun off its own non-profit foundation, IC Foundation17.

A similar approach is taken by Vancadia Capital Corporation, based in Vancouver and Arizona. Vancadia is a merchant banking operation which specialises in investing in socially responsible companies, generally those which have advanced beyond the start-up stage and have reached a development and expansion phase. Among others, Vancadia has recently provided venture capital to a company producing fruit juices, a renewable energy business and a service provider in the ICT sector18.

As well as these examples of ‘social’ venture capital, the large mutual fund manager Calvert which specialises in ethical funds has begun to channel a very small share of money invested in two of these funds into individual businesses, on a venture capitalist basis. The Calvert Special Equities Program invests in “high-risk, socially and environmentally responsible enterprises… [which] provide market-based solutions to some of the more difficult social, environmental and health problems”. Currently some 30 investments, ranging from $100,000 - $1m, have been made19.

The development of ‘social’ venture capital in the US has been the subject of a recent academic study which looks at tentative steps by charitable foundations and pension funds in this direction. It makes the observation:

“Foundations have clearly had mixed results from their involvement in social private equity, and it is too soon for many to ascertain whether it was a success. Currently, small foundations invest small percentages of their endowments, which means there is limited capital available and a limited number of investments to evaluate.”20

17 see www.investorscircle.net
18 see www.vancadia.com
19 see www.calvertgroup.com/sri_654.html
Even ‘social’ venture capital, however, requires a similar level of investor intervention in a business as conventional venture capital, which as we saw in the case of Poptel can lead to difficulties for co-operatives.

A number of north American co-ops have attempted to get round the difficulties of attracting risk capital from external sources in creative ways, including establishing separate legal entities which are wholly or partly owned by the parent co-op. One example is the walnut growing co-op Diamond of California, which was motivated by the desire to reduce the burden on co-op members of financing the co-op’s development. Diamond’s solution has been reported in a recent Ernst and Young report for Canadian co-operatives as follows:

“The co-op took advantage of a recently available tool, known as Cumulative Recourse Offered Preferred Shares (CROPS), which offers a method to raise money in the private market, with the best characteristics of both equity and debt. A key consideration for this capitalization method is that the co-op did not want to lose control of the co-op. The main financial advantages offered by CROPS are that it strengthens a co-op’s balance sheet by raising equity-like capital on a cost effective basis; rating agencies regarded CROPS as equity for rating purposes since the shares are subordinate to bank debt; it enhances a co-op’s creditworthiness; and the new financing tool is competitively priced.”

In outline, Diamond established a wholly owned limited partnership, which raised $15m as a loan and lent it on in turn to the parent co-op as preferred stock.

Another similar example is that of Capital Desjardins, a wholly owned subsidiary of the co-operative savings banks/credit unions Fédération des caisses Desjardins du Québec. This was set up in 1994 with the aim of obtaining external capital and in turn investing it in the individual savings banks, in order to help them improve their capital ratios and financial position. Capital Desjardins successfully raised US$200m in 1995 in debenture stock and a further $800m in 2002.

The Ernst and Young study mentioned above also looks at examples from elsewhere in the world where co-ops have chosen to seek direct external capitalisation. In Australia, a number of agricultural co-ops have developed classes of share with subordinated voting rights which are traded on the Australian Stock Exchange (ASX). One example is the cotton marketing co-op Namoi, which raised A$35m in 1998 through Co-operative Capitalization Units. These quasi-shares attract dividend payments, as decided by the co-op Board, and to share in the distribution of surplus assets in the event of dissolution. Holders of the units can nominate up to three independent Directors, but do not have conventional shareholder voting rights. Other Australian co-ops to have issued CCUs include Norco Co-operative, a dairy food manufacturer, and Walgett Special One Co-operative, a grain handling business.

In Canada, a number of provincial governments have made changes to co-op legislation to permit non-member investment, unequal voting rights and the transferability and appreciation of shares. One agricultural co-op which has used

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21 Ernst and Young, Canadian Agricultural Co-ops, Capitalization Issues and Challenges: Strategies for the Future, Nov 2002
these powers is the Saskatchewan Wheat Pool, which issued non-voting class B shares in 1996 as a means of funding its growth strategy. Class A shares (voting shares) are held by co-op members and are non-transferable and non-appreciable, with no entitlement to dividends. Class B shares bring no voting entitlements, are restricted to 105 ownership, but do receive dividends and can be transferred (they are traded on the Toronto Stock Exchange).

The Ernst and Young study notes “Since the share issue, the co-op has suffered financially and attracting and retaining members has been difficult. Those that hold true to the traditional co-op model criticize the co-op’s share issue and feel that it has contributed to the financial problems of the company, since they have betrayed their members with outside interests”22.

Conclusion

As this chapter has tried to demonstrate, there is already a wealth of experience, both in Britain and abroad, of ways in which equity and quasi-equity capital can be brought in to values-driven businesses. There are clearly difficulties which may need to be overcome and conflicts of interest which may require attention. Nevertheless, co-operatives looking to develop new long-term funding mechanisms are not starting out at square one, and can build on the experiences of those who have already followed this path.

22 ibid