

For and Against the Community Interest Company

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In this article *Malcolm Lynch, Head of the Charity and Social Economy team at Wrigleys solicitors* examines the proposed new UK legal form for social enterprise – the **Community Interest Company** (CIC). The government's stated intention in promoting this new legal model is to improve access to finance, create a strong new brand, provide protection from demutualization and preserve assets and profits for solely social purposes. If it is about social enterprise this means that it has nothing to do with the charity sector? Wrong. It has everything to do with the charity sector but, understandably, it needs some clarification as to when and how.

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Introduction

Let us start with the definition of social enterprise given in Prime Minister's Strategy Unit report – [Private Action, Public Benefit](#). It's certainly not a term of science and I am sure it is one which has given the Charity Commission some cause for concern since it appears to cover a very wide range of activity, both charitable and non-charitable. The Strategy Unit Report defines *social enterprises* as:

“... organisations which, like mainstream businesses, trade in order to build long-term sustainability, but which operate for a social purpose and use their profits for this end.”

Confusion with Charities?

Within the definition you could be forgiven for thinking that what it is about is a charity carrying on primary purpose trading in pursuit of its objects. And so it is, if the examples given by the Strategy Unit are considered. They include *Apex Leicester Project*, a charitable company providing advice, guidance, support and training for

disadvantaged and unemployed people, particularly ex-offenders. They describe themselves as social entrepreneurs running a business. Much of their income is from service level agreements and contracts. So it is clear then that social enterprise is about running a charity in a businesslike way? Not quite, but the business and businesslike element are key.

Another example given is *Anybody Can*, a social firm, but not a charity, dedicated to challenging social and economic exclusion by supporting development of enterprise and social entrepreneurship which enables the inclusion of disabled and otherwise disadvantaged people. It is a Company limited by guarantee which holds a stake in an events managing company. You might be forgiven for thinking why the parent organisation might not have been a charity, and therefore the structure might have been a charity with a trading subsidiary.

Philanthropic Trading

So, what we are looking at currently as social enterprise is trading activity for social purposes where profits are returned to the community but may or may not be restricted entirely to charitable purpose. Philanthropic trading perhaps? Exploring some of the limitations of charity trading and boundaries of philanthropy can assist in finding the value or not, in the community interest company. The CIC will have difficulty in being a brand for social enterprise since it will encompass only non-charitable social enterprise.

Charitable and philanthropic trading operates in a twilight zone between private enterprise and charitable and voluntary giving. There has been little in the way of support services for this kind of trading, no advisory agencies except perhaps sporadic cooperative development agencies promoting or facilitating such social business activity. This has changed. The Government has a Social Enterprise Strategy which is led by the Department of Trade and Industry (DTI). The strategy consists of a national policy document on social enterprise, the development of regional policy on social enterprise through regional government, a mandatory requirement for social enterprise to be part of the delivery requirements of Business Links up and down the country (England) – (Wales, Scotland and Northern Ireland are ploughing similar furrows); and in some areas, the creation of funding packages to assist the development of social enterprise in the region.

The proposal for the CIC is yet another building block of this policy. For charities, understanding whether or not you may be, or want to be, a social enterprise may be of benefit in terms of:

- access to legal and business advice through the Business Link service;
- potential access to certain funds within regions particularly directed to social enterprise; and
- potentially this new legal structure.

A charity cannot directly become a CIC. It can set up a CIC subsidiary or sponsor a CIC to carry on its activities. However, the CIC would have to pay full market value in order to take over the assets of the charity. The Government is also considering what can be done to assist social enterprise to benefit from the public procurement

regime for local authority services. If progress is made here then there may be some substantial advantages forthcoming for charities too.

Does the CIC achieve what it was set out to achieve?

Difficulties in raising finance are common for charities. If a charity can carry out primary purpose trading through the charity then it has the opportunity to build up *risk capital* through receipt of grants and retention of profits which are untaxed. However, if a charity carries out trading through its subsidiary it has to follow the Charity Commission guidance on *Charities and Trading*. Understandably, the past failures of charity governance in this area have made the Charity Commission wary of any arrangement between the charity and its trading subsidiary, which is seen to be a vehicle for purely investment purposes.

This is an area of difficulty for charities and social enterprise. Some trading activity which charities wish to undertake is almost primary purpose trading. If it was entirely primary purpose then it could have been carried on within the charity. Since it is not primary purpose then the charity has difficulty to support it through its grant-making powers as a *social investment* under the helpful guidance issued by the Charity Commission, unless it can find part of the trading activities of the subsidiary which are purely charitable. This is where the CIC will come into its own, being a legal form for *almost* charitable trading.

Programme-related Investment

In the United States, investment in trading activity which is consonant with a charity's primary purpose but is not charitable, for example the development of cancer relief drugs by pharmaceutical companies, is known as programme-related investment. It is investment but, essentially, venture capital investment. The Charity Commission has, unfortunately, blurred this very useful distinction in its guidance on *Social Investment*. Most early stage investments by charities in their trading subsidiaries are pre-venture capital investment with all the risk that entails. The CIC does not remove this difficulty, but perhaps it might give more comfort to the Charity Commission where a charity is seeking a joint venture partner for its trading subsidiary.

Asset Lock

Since the CIC takes the form of a company limited by shares or a company limited by guarantee, with some additional bells and whistles, a charity would be advised to use this form for its trading subsidiary. The *Company (Audit, Investigations and Community Enterprise) Bill* issued in December 2003, proposes that a regulator may set a limited return on investment capital and that on a winding-up the assets are distributed for public benefit purposes. This permits a charity to have a greater comfort when entertaining a relationship with a private sector partner, and hopefully, greater comfort for the Charity Commission too. For this reason the asset lock (or common ownership as it used to be known) is a welcome boon.

However, the introduction of the CIC will not completely eliminate the problems of raising capital for philanthropic enterprise. I have mentioned the difficulties for charities putting monies into trading companies. All small businesses have difficulty

in accessing private capital and the loan and equity gaps for small business are well documented. Social enterprise will be in no different a position with this reform, unless exemptions currently available for some industrial and provident societies under the *Financial Services and Markets Act 2000* are extended to the CIC.

However, there are a dozen or so loan funds for social enterprise in existence, many of which are now able to give their private and corporate investors tax relief under the ***Community Investment Tax Relief*** introduced in 2003. The Charity Bank has used this relief to attract deposits very successfully. With the exception of the *Renewable Energy Investment Club*, there are no mechanisms directed towards small-scale equity investment in social enterprise, where investment returns are likely to be lower and risk higher.

Conclusion

Perhaps the most critical change to assist funding of the CIC is in the hands of the National Lottery Charities Board. The *National Lottery Act 1993* provides that the National Lottery Charities Board may make grants to both charities and institutions other than charities that are established for philanthropic purposes or benevolent purposes. The proper implementation of this Act in favour of philanthropic organisations will be of enormous significance to the financing of the CIC and make the CIC legislation worthwhile.

Further Information

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