

Ownership Matters

New Mutual Business Models

Cliff Mills

Mutuo – Communicate Mutuality

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Introduction

Investor-owned companies dominate the economies of the leading industrialised nations. Modern UK company law has made the limited company not only the easiest and most accessible form of business ownership, but from the proprietor's point of view the most attractive.

The investor-owned company has been hugely successful as a medium of business ownership. The number of live companies on the register at Companies House (about 1.5 million) confirms this. Through mergers and acquisitions, there are corporations of ever increasing size, which now challenge governments in the amount of power they wield. Great fortunes are created for investors, and executives of the most successful enterprises earn huge salaries. And when businesses fail, limited liability provides the protection for the proprietors.

In the UK as a result of privatisation's of the 1980s and 1990s a significant number of industries have been taken out of state-ownership. This has further dramatically increased the total volume of business held by investor-owned companies.

But this very process of privatisation, of changing from state-ownership to investor-ownership, (a process which undoubtedly opened up previously little known businesses to wider scrutiny and wider ownership), is itself now being criticised for having created organisations which put share-price before safety, which concentrate on dividends before quality of service, and which pay high rewards to executives when the public is dissatisfied with the services for which they are paying.

Whilst questions are now being asked about the privatisation process, little attention has been paid to the underlying corporate structure – the investor-owned company or joint stock company – and whether, in spite of its great success as a model for holding businesses, is it necessarily the most appropriate one. Although other models are in use (such as the company limited by guarantee and trust models), there still remains an assumption amongst many that the investor-owned company is really the only model to use in all but the most exceptional of cases.

Is there another way of doing this? Is there not an alternative form of ownership, which puts the interests of the community first?

The answer to these questions is: yes, there is a real, deliverable alternative. It is an alternative which brings multiple benefits, and which is economically achievable. It is an alternative with real attractions in terms of delivering public services and one, which looks to the future, as well as meeting current needs. Furthermore it is an alternative, which provides for greater participation by communities, for citizenship, and for local control of services.

The purpose of this short paper is to explain that alternative, a new mutual alternative, and to put forward reasons why it is an option that decision-makers should consider.

New Mutual Concept

The new mutual form of ownership is a radical new approach, but based on established principles and legislation. It is aimed at providing an alternative form of corporate model for the ownership of public services.

The starting point for the model is that public services are needed for the benefit of communities, and the individuals and organisations that make up communities. I have an interest in electricity, gas, water, transport and similar services being available, not just so that I have access to them when needed for my personal and work time use, but so that the community in which I live and work can function. Even if I choose not to travel by rail, those I work with, or members of my family, or those who visit me, may rely upon rail travel.

Public services therefore serve communities. It would be logical for them to be held within a structure focussed on serving the community and committed to carrying on its business for the benefit of the community.

This is precisely the model which is used – a mutual organisation registered under the Industrial and Provident Societies Act on the basis that it is conducting its business for the benefit of the community.

Just as a company has shareholders that own the shares, so a mutual organisation has members who also have a share. But there the similarity ceases. The member's share in the mutual organisation is nominal only. Any person receiving services is entitled to become a member and own a share. Unlike shares in a company, membership of the new mutual organisation gives each member one vote only, and it gives no right to a share in the underlying value of the business. The member has no entitlement to a dividend. Instead, the surplus (profit) generated from the trading activity is returned to the community in the form of better quality, or cheaper service.

In other words, individual members hold their share – that is to say they own the mutual organisation (nobody else owns it) – on behalf of the community. The mutual conducts its business for the benefit of the community, and the community ultimately controls it.

The community therefore owns the business, and the community is served by the business. It is in this sense that it is a mutual organisation.

In relation to some public services, it may be appropriate to enable employees to become members, in addition to those in direct receipt of the services (this is not necessary where employees are themselves in receipt of services). This might occur, for example, where the nature of the service was highly dependent upon the part played by employees in delivering the service.

A board of directors controls the mutual, in the same way as a company. The composition of the board, however, is different, and the corporate governance structure will depend upon the needs of the industry sector.

In all cases, the board contains directly elected representatives of the members, who are non-executive directors. Secondly, it contains other professional non-executive directors who are appointed by the rest of the board in accordance with an agreed policy designed to ensure that the board is properly representative of the community. Thirdly, it has a chairperson with appropriate skills and background.

For some public services, the board also contains representatives of the executives including the chief executive. In this model, the board itself is charged with the day to day responsibility for the management of the business. In other cases, there will be a separate management team itself charged with responsibility for day to day management of the business. In this model, the board sets strategy and policies for the business and is in a supervisory role, with the chief executive reporting to each board meeting on the progress of the business.

These structures create a different environment for those involved in the management of the business. The responsibility for them to achieve success in the running the business is no less than in any corporate model. Delivering high quality services at the best price is still the aim, and the executives and other managers are rewarded for achieving the targets based upon that. The drive for financial efficiency and success is as hard-edged as in public limited company (Plc). The key difference for them is that they are striving to run a successful business in order that it may best serve its community, rather than to generate the most profits for investors.

Management is incentivised by rewards based upon achieving targets. Both the management and the board are also accountable for their performance, and the community ultimately has the ability to determine who is running the organisation.

New mutual organisations are incorporated under the Industrial and Provident Societies Act, and are registered with the Registry of Friendly Societies, now under the control of the Financial Services Authority. They are registered as societies conducting their business for the benefit of the community, and require the approval of the Registrar before being permitted to amend their constitution (rulebook).

- The new mutual provides services to and is owned by the community.
- Delivering high quality services at the best price is the object of the business.
- The ultimate aim is to serve the community, rather than generating profits for investors.

Benefits of New Mutuals

Community ownership

The first most obvious benefit of the new mutual model is that it gives to the community the ownership and control of the organisation from which it is receiving the public service. The definition of *community* will vary according to the service involved, but in each case, the effect will be to give local control, and thereby to ensure that local interests are considered. Whilst hard decisions will still be required, when they are taken they will be based upon the interests of those whose lives and livelihoods will be affected.

Democracy

Membership is open to any person in receipt of the services. All members have the opportunity to participate democratically in the organisation. This means the right to attend and speak at meetings, to vote on resolutions and in elections of board members, the right to receive certain information about the business, and the right to participate in the democratic structures in the organisation. Ultimately this includes the right to seek nomination for election to the board.

Because membership is open to any person in receipt of the services, there is no financial barrier excluding those who cannot afford membership. This effectively means that those running such organisations are accountable to the community they are serving.

Citizenship

The ability to become a member, to receive information, attend and speak at meetings, to vote and to participate in democratic structures, all provide opportunities for individuals in a community to participate and have a role as a citizen within the community. Democratic organisations run for the benefit of the community enable individuals to influence and have a real sense of involvement in the life of their community.

The encouragement of competition in the supply of products and services may have benefited consumers through providing choice and competitive pricing, but when it is extended into the provision of all services including those still perceived as *public services*, it has another effect. It leaves the consumer as simply that – a consumer, a person who simply chooses to buy or not to buy. The concept of citizenship and membership of a community is further eroded.

Through organisations established to serve the community in a variety of ways (transport, utilities, social services, leisure and recreation) opportunities can be provided to encourage and develop participation by individuals who have an interest in the provision of such services.

As the state both centrally and locally divests itself of responsibility for the provision of services, as the role of government changes and individuals see themselves as having decreasing impact through the casting of a vote, the encouragement of citizenship, social responsibility and the fight against exclusion all require the creation of opportunities for individuals to take part and have a meaningful role in their community.

Employee participation

The opportunity exists for including employees within the constitutional structures of the organisation. This will be appropriate in cases where, for example, the success of the business and the nature of the service provided depend upon the commitment and dedication of the employees.

In other cases, it may be appropriate to recognise within the constitution the fact that the provision of employment is itself of benefit to the community.

Long term thinking

Investor-owned companies and specifically the Stock Market have for many years been criticised for leading to short-term thinking. The focus on the best interests of the company – effectively share-price and profitability – together with executive reward schemes based on share options encourage decision-making, which brings tangible quick results. Investment for the long-term is clearly necessary and takes place, but once again, it will be commercial expediency, which determines the priority of spending.

The boards and executives of new mutual organisations are freed from this disadvantage. They can and must take decisions based on what is in the interests of the organisation in serving its community. Those interests manifestly include both the longer-term interests of current members of the community, but also future generations.

Arguably the most serious longer-term need which should be informing current commercial decision-making is the environmental one. The most graphic examples of the shortcomings of decision-making within a company structure can be seen in this context. Unless there is some specific statutory requirement, or an unarguable commercial reason compelling a company to choose the less environmentally damaging but more expensive option A, whatever they may want to do their legal duties will drive directors to choose the cheaper but more harmful option B. As stated above, there is no room for altruism in an investor-owned company.

In a new mutual carrying on business for the benefit of the community, the directors would be at liberty (and may be legally obliged) to choose the less harmful but more expensive option A.

- New mutuals give control to the community.
- They are democratic and open, and accountable to the community.
- They encourage citizenship and participation by individuals.
- They provide the basis for long-term thinking.

Opportunities for New Mutuals

Investor-owned companies will continue to be the appropriate model for business ownership in the majority of instances. However, new mutual structures provide options that should be considered in a number of situations including the following, where a model designed to create wealth is less appropriate than one based on serving a community>

Public or community services – Where the business is in the nature of a public or community service, such that continuity and quality are essential.

- **Community assets** – Where the service is based upon what may be characterised as *community assets* of which the community has a sense of ownership.
- **Monopoly** – Where the provider of the service has an effective monopoly, whether or not there is a statutory regulator attempting to maintain some sort of balance between the interests of customers and the interest of shareholders.
- **Other dependence** – Where substantial numbers of individuals are dependent upon the service and effectively have no choice about where to purchase the service.

The presence of one or more of the above features would suggest that a new mutual option should be considered.

Reference has already been made to utility companies. These businesses involve a number of features described above. A new mutual model had been developed for the water industry, and a mechanism for transition from investor to community ownership has been devised to meet the requirements of the Regulator.

The current best value reviews being undertaken by local authorities are leading to the consideration of a number of alternative approaches to the provision of services. New mutual models are in the process of development for the provision of care for the elderly, and the provision of leisure facilities. Many services currently provided by local authorities display one or more of the features outlined above, or simply do not readily lend themselves to implementation through investor-owned companies (such as crematoria, cemeteries and parks). New mutual structures provide alternative options.

New mutual solutions are also appropriate for consideration in relation to housing. Although housing associations provide a similar solution through the traditional housing association model, this model is not open and democratic.

There is one area where new mutual structures are already being implemented. Supporters Direct is a Government backed organisation seeking to promote the interests of members of football clubs by combining their influence as shareholders. A football club is not only a community-based organisation; it also has an effective monopoly on the rights associated with the club concerned. It is an example of a business where it is arguably less appropriate for an investor-ownership model to be used rather than a community-ownership model. The change in the dynamic of decision-making caused by a different model could have significant results. To-date some 28 football clubs have created some form of Supporters Trust as a means of mutually holding shares in clubs since the formation of Supporters Direct. Other sports clubs could follow the lead taken by Supporters Direct in relation to football.

Other alternatives to investor-owned companies are used in a number of situations referred to above. The traditional housing association model has already been mentioned.

The company limited by guarantee is also used commonly described as a *not-for-profit* organisation. A company limited by guarantee (CLG) differs from an investor-owned company in that it does not generally have a share capital (no new CLG can be registered with a share capital since the Companies Act of 1980), and the liability of members is limited to the amount guaranteed in the memorandum of association (commonly £1). The main distinction between the company limited by guarantee and the new mutual models is that membership of a company limited by guarantee is not open. Members tend to be selected by the directors.

This model is commonly used in a charitable context. Whilst it is appropriate in this area where those responsible for running a charitable organisation wish to select appropriate members in the interests of maintaining the original charitable intentions, it is less appropriate for a business which is not trading for charitable purposes. This is particularly the case where openness and accountability are important, and where the risk of accusations of cronyism exists. To enable those responsible for running the business to choose members clearly introduces a serious structural flaw.

- New mutual structures are suitable for public services, businesses based on community assets, monopolies and other situations where significant numbers of people depend upon the service.
- Some utility businesses are appropriate for new mutual models.

- Services currently provided by local authorities such as care of the elderly, leisure and housing are appropriate for new mutual models.

The Future is in Your Hands

The investor-owned company has been the dominant corporate structure in the United Kingdom in the last two centuries. It reached its zenith in the years of Margaret Thatcher's government (1980s and early 1990s) with the privatisation programme, which brought very large businesses out of state-ownership and into investor-ownership, and was intended to lead to widespread share-ownership.

Investor-owned companies have no place in their structure for customers, employees, and both of those groups are at a disadvantage in the key decision-making process in company boardrooms. In spite of the efforts of regulators, recent events are demonstrating that the company model does not work in certain applications, when put to the test. The legal duty of directors to act in the best interests of the company, and effectively its investors, means that safety, environmental concerns and other long-term issues including the interests of future generations do not receive and will never receive the priority they need if the interests of the community are to be properly protected.

New mutual models are already available in some areas and being developed in others. These models provide real alternatives for those considering options for delivery of services.

Not only do these models address the weakness of the decision-making process in the traditional company structure, they provide many benefits in their own right including:

- local community control; a constitutional role for employees;
- the encouragement of citizenship; and
- the promotion of long-term thinking in the interests of the community and nature.

The opportunities that these models create now need to be seized by those in a position to decide the future ownership of some of our most important assets.

Further Information & Contacts

Cliff Mills has written widely on the institutional and legal aspects of mutual and social ownership. He is a partner at Cobbetts solicitors and can be contacted at:

www.cobbetts.co.uk

This is an edited and abridged version of an article titled *A lawyer's Perspective*. The full article and other articles on new mutualism can be found in ***Ownership Matters – New mutual business models*** by Ian Hardgreaves, Cliff Mills and Jonathan Michie (March 2001). The booklet is priced at £5.00 plus p&p and is published by ***Mutuo.co.uk***. Copies of the publication can be obtained from:

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