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The Community Interest Company (CIC): a New Form of  
UK Social Enterprise

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This paper examines trends in social economy institutional forms, and in particular looks at recent UK legislation (which has been approved, and is scheduled to be come into force in 2005) for a Community Interest Company (CIC). This will be a new type of company, designed for social enterprises who want to use their profits and assets in the public interest. The paper considers the extent to which this is a departure from an isomorphic path towards a new regenerative trend of the Co-operative form, and a development towards a new form, more properly considered as social enterprise.

### **Recent Trends in European Social Economy Structures: Isomorphism**

During the second half of the twentieth century, developments in the co-operative and mutual sectors have frequently been marked by a tendency to change structures and practices in order to compete more effectively with conventional business in increasingly deregulated markets. A central feature of these changes has been the adoption of capitalist structures and practices, so that an isomorphic trend is apparent with co-operatives and mutuals becoming more similar to capitalist business structures and practices.

At the extreme, these trends take the form of complete changes of institutional form through a demutualisation, and in the UK there have been many of these amongst mutual insurance societies and savings and loans mutuals, as well as a few co-operatives demutualising, by transforming into the conventional business form of limited companies.

There have been several major isomorphic trends in co-operative/mutual structures: firstly adaptation of the co-operative form, secondly the separation of economic and social dimensions of the co-operative/mutual organisation; thirdly hybridisation (especially increasing use of holding structures using share based legal forms); and fourthly degeneration.

**Adaptations of the co-operative form** – the post-war period in Europe has seen a number of significant legislative changes to the co-operative form in order to facilitate its operation in more competitive capital and product markets (see Monzon Campos et al, 1996). Three in particular are noteworthy:

issuing of non-voting shares to third-party financial partners

creating the capacity to change the membership base to include financial partners as members (as well as employees).

adapting voting rights (away from the principle of equality of members) towards voting rights being weighted according to the extent of patronage.

**Separation of economic and social objectives/aspects** – This has been a strategy pursued by many co-operatives in order to allow an unhindered focusing on each aspect, for example in consumer co-operatives where member relations become rather separate from customer relations, and are linked mainly to governance requirements. Thus the consumer is treated separately from the member - the consumer becomes the focus of economic activity, whilst the membership aspect becomes marginalised and dealt with through separate social administrative structures. This results in the idea of membership being reduced more and more to a tiny minority that might be involved with AGM meetings and the occasional social event but attempts to incorporate the idea of membership into the consumers base is neglected.

These trends can be seen in the following experiences:

- In Spain legislation in 1995 allowed co-operatives to raise equity to encourage greater capital investment (through share issues) subject to some restrictions:

limited to no more than 33% of capital employed

a limit of 35-45% of votes for shareholders (depending on region)

no limits to return on dividend.

- In Sweden, which has been a bastion of co-operation internationally, from the 80s there was a change to the consumer co-operative orientation to its members – with members losing to a degree their dominant position in the co-operatives; instead, “they were only “significant” customers among other consumers. ....and “many resources for general consumer policy have been discontinued: consumer research units, magazines and weeklies for consumer debate, consumer information and education, departments for member relations, laboratory facilities for product testing, etc.” Sven Ake Book and Kai Blomqvist, 1996.
- While in Swedish agricultural co-operatives trends can be seen away from solidaristic relations towards more market type relations between members and the co-operative. Thus: although proportional financing is the norm, this is modified in practice through additional regulations, which lead to larger producers paying proportionally less than smaller ones; similarly it used to be that pricing was the same for all members, now it is more cost-based – according the costs a member causes the co-operative – this again is likely to favour larger producers.
- In Quebec, the Mouvement Desjardins, a highly successful savings and credit union, has grown and developed as the markets have changed and internationalised, but as a result, creating tensions between:
  - Its co-operative and corporate components
  - The balance between members’ internal capital and institutional investors’ external capital
  - The balance between members and managers
  - The globalising of economies threatens Desjardins role in economic development of Quebec.

The outcomes of these tensions are unclear but indications are that under certain conditions members interests are clearly threatened by the corporate entity.

- In Italy the 1992 reforms raised the limits on social capital that members could hold, but perhaps of more significance was the extension of the position of financial members, so that they could hold up to 33% of voting rights, and 49% of seats on the board – thus challenging traditional notions of democratic member control.
- In France, a remarkably similar 1992 Act enabled co-operatives to issue shares up to 35% of the capital base, with voting rights proportional to capital owned, but with similar risks to traditional democratic member control.

### **“Degeneration” of the co-operative/mutual form**

There are 3 forms of degeneration. Constitutional degeneration where membership becomes restricted and employees are taken on to secure a greater proportion of the surplus to members. Organisational degeneration where the participatory structure of the co-operative/mutual becomes dominated by an elite; and goal degeneration where the goals of the co-operative/mutual change so that it becomes no different from a small capitalist business in the same sector. (see Cornforth et al, 1988.)

The co-operative principles are intended to counter these tendencies but most recent forms of co-operatives have model rules and constitutions that make it extremely difficult for constitutional degeneration to take place. Hybrid forms -

ESOPs, Employee Ownership structures, Sociedad Anonima Laboral (SALs: Spanish employee owned structures), which tend to be partially member owned enterprises - are particularly susceptible to this form of degeneration. On the other hand where the co-operative/mutual spirit only ever was skin deep, they (the members) may not see this development as a disadvantage.

### Factors influencing these trends

**Global competition** – this puts pressure on co-operative/mutuals to match prices to consumers and producers with those of capitalist companies. In many cases this can result in copying business practices rather than using the unique advantages of co-operative/mutuals.

**Manager dominance** of social economy structures – this may not be overt, but carried out through the discourse that the needs of the corporate form must take precedence over the needs and goals of members.

**Unintended consequences:** legislation to improve the ability of co-operative/mutuals to compete or liberalising markets sometimes have unintended consequences – thus for example following the UK Building Societies Act of 1986 which made it easier to convert from mutual to limited company status, a wave of demutualisations resulted. Building Societies (savings and loans associations) have declined from 84 societies employing 83k f/t staff and 24k p/t staff in 1993 to 65 societies in 2002 employing 29k f/t staff and 9k p/t staff.

**Access to Finance** - Capitalist firms can finance growth by raising finance through share issues giving rise to equity, and by acquiring loans from financial institutions and individuals. Most co-operative/mutuals and the socially owned enterprises rely on loans and member finance as their main forms of external finance. Many co-operative/mutual argue that they have to use capitalist type structures to access financial markets for growth – drawing on the relevant financial instruments – see table below.

**Table: Financial Instruments** (available for business organisations)

<u>Instrument</u>	<u>Characteristics</u>	<u>Advantages</u>	<u>Disadvantages</u>
Shares (voting)	Dividend payable	flexible	loss of control
Shares (preference, non-voting)	fixed % dividend	no loss of control	less flexible
Debentures	fixed interest, secured	no loss of control	higher interest
Commercial loans	Commercial interest rate		higher interest bank influence
Soft loans	fixed and variable interest	flexible	goal displacement?
- members	payment holidays	lower interest rates	(lender goals)
- community	repayment based on profit		
- sympathisers			

**Under-capitalisation and Decapitalisation** - Most small businesses suffer from shortages of finance, and small co-operative/mutuals without access to significant amounts of finance from owners/families may be pushed towards more capitalist/individualist forms in order to acquire sufficient finance.

## **A New Trend – against Isomorphism?**

In many European countries there have been important changes to social economy structures. In Italy since the 1980s we have seen a new co-operative structure: social co-operative, which combines elements of the non-profit (voluntary) organisation with that of the co-operative. Thus in contrast to traditional co-operatives where members are of one type (farmers, consumers, workers, etc) members in social co-operatives may be workers, volunteers, community members, municipal representatives, parents of disadvantaged workers, users of services). But the business operates to a substantial degree in the market in a similar way to that of traditional co-operatives. Several thousand of such co-operatives have been formed.

Italy, thus, has a favourable context for social co-ops (and co-ops in general) and has emerged as a leader in this form of social enterprise (Borzaga and Defourny, 2001). But the emergence of similar trends in the development of co-operative/mutuals and social enterprise can be seen in many other countries. These include the introduction of new legal status the "enterprise à finalité sociale" in Belgium (1995), the "social solidarity cooperative" in Portugal (1998), the "social initiative cooperative" in Spain (1999), the "social cooperative with limited liability" in Greece (1999), and the "société coopérative d'intérêt collectif" (SCIC) in France (2001), and the proposed "Community Interest Company" (CIC) in the UK. The replication of social co-ops in other countries has been a development that indicates there may be isomorphic trends across social economy sectors, responding to new situations in welfare systems, for example. There have also been developments of co-operative/mutuals in new sectors, such as Sweden, where social co-ops in the nursery or crèche sector take the form of parent or worker owned structures.

## **Social Economy Legal Structures in the UK**

This paper now turns to examine experience in the UK. Almost all UK social economy structures are registered under Industrial and Provident Society (I&PS) legislation or Company Law (limited by guarantee). In either of these cases the shares are of nominal value, limited liability applies, and the organisation is owned by member shareholders who may vary in number.

A company limited by guarantee (CLG) is registered under Company Law with nominal shares, limited liability, giving members democratic voting rights (1 person 1 vote). They are regulated by Company House. Many voluntary organisations and co-operative/mutuals currently use this form, since it is cheaper to register and make amendments than I&PS legislation.

An Industrial and Provident Society is an organisation that conducts a business or trade, either as a co-operative/mutual or for the benefit of the community. An Industrial and Provident Society is registered with the Registrar of Friendly Societies. Its actions and conduct will be regulated by the provisions of the Industrial and Provident Societies Acts, 1965 - 1978. A Friendly Society is a voluntary mutual organisation whose main purpose is to assist members (usually financially) during sickness, unemployment or retirement, and to provide life assurance. 'Benevolent Societies' are another form of I&PS but for the benefit of the community rather than for their own members (a society 'for the benefit of the community' is commonly known as a "bencom".)

From the report of the chief registrar of Friendly Societies 2000/1:

"The organisations on our register range from internationally-known building societies and insurance companies to tiny village allotment societies. They include co-operative societies, housing associations, loan societies, scientific and literary societies, working men's clubs, benevolent societies, cattle insurance societies,

agricultural pest clearance societies, superannuation funds, and most recently credit unions.”

Thus they include the full spectrum of social economy forms of activity, from those which are club-like such as sports clubs, largely run by volunteers such as community associations, to much more commercial businesses like consumer co-operatives.

Being registered as an I&PS with the Registrar of Friendly Societies, means that there are certain requirements it has to meet, and some restrictions on its activities. The Registrar can help preserve the identity of the organisation, since he/she will not register any amendment to the Rules that are not in accord with the democratic and community benefit principles established in the constitution.

The I&PS is required to file annual reports to the Registrar. It must appoint qualified auditors, and audited accounts have to be presented to the Annual General Meeting (AGM) as well as to the Registrar. The Constitution is crucial as it guides everything that an I&PS can do. An I&PS Constitution is often based on the Model Rules which “sponsoring bodies” such as federal bodies and development agencies supply.

Finance may be raised through members’ subscription to share capital, member loans, bank loans and the issue of loan stock (and retained earnings in future years). Outside finance must be without voting rights, although often in established co-ops “old” members (who are no longer active) continue to hold shares.

An organisation with charitable objectives can apply to the Charity Commission to become a charity or have charitable status (in addition to I&PS or Company limited by Guarantee status). A charitable trust would be appropriate as a complement to any of the above structures, if there were charitable activities (such as education) to be undertaken for others i.e. not for members. It has the advantage that donations are tax free (so tax can be reclaimed thereby increasing the original sum donated); and its activities are non-profit so not subject to tax.

**Social enterprise** – this is not a well defined category; in general people in the UK have a vague notion that it is a business with a social purpose. Experienced practitioners would generally accept that social economy legal structures (CLG and I&PS) are the most appropriate and commonly used structures for social enterprise.

### **New UK Trends – against isomorphism?**

The UK, partly because of the large experience of de-mutualisations of mutual societies and co-operative structures, there have been several important responses to these forms of privatisation, which mark a new trend regenerating the values of mutuality and mutual practices. This has been led, to a certain extent, by activists who have formed pro-mutual groups (“Save our building societies”, and Mutuo (a pressure group cum think tank).

There has been a recognition by many commentators in the press and in academic communications of the value of diversity in the market (this has been particularly effectively argued in the case of Building Societies – savings and loans mutuals). And indeed it seems to be recognised to a certain extent by recent Government measures to protect Building Societies from demutualisation that they have performed an important role in giving consumers good value for money and protecting consumer rights.

Several measures have been taken to give greater protection to mutuals firstly as a response by mutuals to insist on ‘charitable assignment’ - that is new members

have to sign, giving up their rights to residual assets i.e. accepting they will not have a claim on the assets of the mutual in the event of privatisation or demutualisation; as a result the residual assets will be given to a charity or to another mutual. The second form of protection can be seen in new legislation: the Industrial and Provident Societies Acts 2002 which amends the procedure whereby such a society may convert itself into, or amalgamate with or transfer its engagements to, a company i.e. it is designed to make it more difficult to demutualise a society. The procedures have increased the percentage of people required to vote for constitutional change: 50% of members now need to vote and there needs to be a majority of 75% of the votes in favour of demutualisation. These measures have led to a refocusing by mutuals on members and membership. Another reaction or response that marks a resurgence of mutualisation can be seen in the rise of social enterprise as the embodiment or part of the embodiment of New Labour's 'third way'.

Finally, there has been some continental European influence where experience of new forms of co-operative (social co-ops) and social enterprise has seen a closer linking between the co-operative form and the voluntary organisation form and a re-assertion of the traditional social economy values.

### **Social enterprise and CICs**

In the UK, the Department of Trade and Industry has established a Social Enterprise Unit. Part of the motivation of promoting social enterprise is an interest in reforming public services delivery (incorporating co-operative/mutuals and non-profit structures into the spectrum of service providers); and partly an interest in involving community/civil society stakeholders combat social exclusion. The activities of this Social Enterprise Unit have played a role in promoting a huge interest in social enterprise in the UK – this can be seen in outcomes such as the development of strategies for social enterprise and new legislation to facilitate the creation of new locally based social enterprise through the community interest company (CIC).

The Community Interest Company is being launched as a new legal form in the UK, and it may become an important model of social enterprise. The context for this development is a resurgence in interest in mutuality after declines in the co-operative/mutual sectors due to demutualisations and poor performance – developments that parallel similar isomorphic tendencies in other countries.

"...The Government will seek to develop further the Community Interest Company (CIC), an entirely new legal form designed for socially responsible enterprises. The Government does not intend that CICs should deliver essential public services such as schools or hospitals. However CICs have a clear role to play in complementing government services at the community level in areas such as childcare provision, community transport or leisure." HM Treasury Budget Report 2003.

The Bill (legislative act) reached Report Stage and Third Reading on 19 October 2004 and it received its Royal Assent on 28 October 2004. There is currently a detailed consultation on draft regulations with the social enterprise sector, and this will close on 4 January 2005. The new legal form is due to 'Go-live' in July 2005. The legislation will establish a new type of company, the community interest company, for use by social enterprises wishing to operate as companies.

The CIC is designed to be a flexible structure facilitating entrepreneurial activity.

It has 3 main characteristics:

Non-profit

Benefiting the community

## Asset lock

The CIC is intended to be used by non-profit-distributing enterprises providing benefit to a community. Such enterprises are currently operating in areas such as childcare, social housing, leisure and community transport. Many of them already incorporate as companies, either as a company limited by guarantee (CLG) or a company limited by shares (CLS). The defining characteristics of the CIC are intended to make it particularly suitable for some types of community-based social enterprise - those that wish to work for community benefit within the relative freedom of the non-charitable company form, but with a clear commitment to a non-profit-distribution status. CICs will be subject to the general framework of company law. Thus the CIC will be a new variant of existing forms of company. It can either take the form of a CLG or CLS .

### **The distinguishing features of the CIC will be:**

- the need to satisfy a community interest test, confirming that the enterprise will pursue purposes beneficial to the community and will not serve an unduly restricted group of beneficiaries. The test is that of a reasonable person judging if the CIC's activities to benefit the community;
- exclusions from CIC status: political parties, companies controlled by political parties, and political campaigning organisations;
- charitable status : CICs will not be able to have charitable status, but charities can establish CICs as subsidiaries;
- annual reporting: CICs must produce company reports containing key information relevant to CIC status, lodged with the public register of companies;
- an asset lock - CICs will be prohibited from distributing profits they make to their members;
- CICs limited by shares can pay dividends to "investor shares", subject to a cap regulated by the Regulator; but a CIC limited by guarantee, will not be to make such distributions ; limits on conventional interest payments on fixed term debt will not be applied;
- a CIC's residual assets, when it is wound up, will not be distributed to its members, rather they will pass to another similar organisation with restrictions on profits distribution like another CIC or a charity;
- the Regulator approves applications for CIC status, receives copies of the community interest company reports and polices the requirements of CIC status, including compliance with the asset lock. The CIC Regulator<sup>1</sup> will have close links with the Registrar of Companies.

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<sup>1</sup> Note that during the debate on the Bill, an amendment was made changing the role of the regulator as a response to pressure from the social enterprise sector: Lord Sainsbury, the DTI minister, speaking to the amendment said:

*"We have subsequently held discussions with the Social Enterprise Coalition and have reached the conclusion that it would be helpful to have an amendment requiring the regulator to have regard to the outcome of consultations with all appropriate organisations, including representative bodies. The amendment to Clause 24(4)(b) therefore directs the regulator to have regard to the outcome of consultations with organisations representing CICs and others with relevant experience. This would include any relevant panels of experts. We believe that the regulator is also likely to want to enter into a memorandum of understanding with the Social Enterprise Coalition, and perhaps other organisations, about how consultation of this sort would work in practice."*

CICs are required to provide an *additional annual community interest company report* to the registrar of companies; this covers: what the CIC has done during the year to benefit the community; the steps, if any, that the company has taken to involve in its activities its stakeholders; information about payments related to its financial instruments, and the remuneration of its directors.

### **Issues/Concerns arising from the CIC legislation**

There has been an extensive consultation on elements of the proposed legislation. The issues and concerns arising are as follows:

- the CIC legal structure facilitates small, community-based social enterprises, gain access to finance but also locks-in its assets and profits so that public interest is preserved.
- it provides a recognised vehicle for many social enterprises with improved access to finance, a stronger 'brand' and preserving assets and profits for social enterprise
- the CIC form can be seen as a complement to Industrial and Provident Society legislation providing choice for social entrepreneurs (but not a substitute for reforming the latter which is too cumbersome); . the Company Limited by Guarantee legislation impedes some entrepreneurial activities.
- if this model is to have a role delivering public services, the social enterprises will have to operate on a reasonable scale and have clear mechanisms for involving stakeholders in their governance.

On the other hand:

- the proliferation of legal forms may confuse both the wider public and social entrepreneurs setting up social enterprise. It is not clear that these difficulties could not be resolved by reforming I&PS legislation.
- this measure aims to solve the problems of the sector cosmetically; it fails to address more serious issues such as who bears the risk when these organisations deliver public services, and whether private finance should be involved.
- there are too many legal forms, it would be better to reform charity law to allow them to trade more freely
- there will not be a clear understanding how a CIC differs from a Community Benefit Society (bencom) or from a CLG with objects beneficial to the community.
- the issue of a strong new brand might detract from the charity brand, if CICs, as non-profits, can be involved in activities that are non charitable. However it should not be seen as the only "brand" for social enterprise: as can be seen by the comments of John Battle MP who noted that "the Social Enterprise Coalition welcomes the introductions of CICs" and pointed out that:

*" we should not see the new CICs...as a brand for all social or co-operative ventures or mutuals. It is another form within that family, which we should experiment with and support ."*

### **Analysis of CICs Prospects**

The CIC is designed to be a flexible structure, however this means that it can take quite diverse forms:

Capitalist share structure (CLS) vs social economy democratic structure (CLG)

Non-profit but possibly dividend paying (capped)

Multi-stakeholder vs single owner stakeholder

Involving stakeholder or not involving stakeholders

Community interest report but undemanding and not sent to stakeholders

Thus it covers both capitalist share structures and social economy democratic structures; but with a non-profit orientation, though possibly dividend paying (albeit capped). It may involve multi-stakeholder structures but alternatively could be wholly owned by a charity or other corporate entity. The CIC must produce a *community interest company report* which specifies how it involves stakeholders, but if it doesn't involve stakeholders that is acceptable. The report is sent to the company registrar and regulator, from whom any stakeholder may obtain a copy – it is not required to be sent to stakeholders (unlike annual financial reports for shareholders).

The model seems to be based on an outcome approach where community benefit, non-profit and asset preservation (via the asset lock) are emphasised while the *means* or processes for achieving those important outcomes are not considered important. Thus democratic process and social capital - which might be ways of involving stakeholders are not considered central parts of the identity of this form (or its brand). It downplays democratic structures which clearly does not fit well with traditional co-operative/mutual values. And although its common attributes fit well with the voluntary sector, its downplaying of stakeholder involvement does not fit those traditions. (NB As a class of entities it would not (in all its forms) meet the European benchmark – the EMES criteria of a social enterprise, see: [www.emes.net](http://www.emes.net). However it might fit a broad view of a social enterprise as a business with a social purpose.)

It is also important to note that rather than locating a new social enterprise structure within traditional social economy legal structures of friendly societies and industrial and provident societies<sup>2</sup>, where protection of values and identity by the regulator have been stronger, the new legal structure is located within company law.

However it is difficult to predict the final outcomes, in all probability there will be a mixed result for this new sector – based on the following scenarios:

Best case scenario: its diverse flexible structure draws in entrepreneurs and capital to expand the social enterprise sector.

Worst case scenario: its diversity, undermines a clear identity and common set of values, adding little to a misunderstood social enterprise brand.

Even worse scenario: it opens a path for small business entrepreneurs to access government grants for community service provision; they don't involve stakeholders, pay poor wages, make good profits which are used by management to pay themselves above average salaries, with good perks (expenses, additional benefits, etc).

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<sup>2</sup> Indeed there appears to be a policy of neglect of the I&PS legal framework in operation currently, since costs of registering and amending rules are higher than CLGs, and despite pressure for reforms, no progress has been made.

## **Conclusion**

This paper has reviewed trends in co-operative/mutual structures in the second half of the twentieth century, noting a tendency for isomorphism with conventional business. It has noted modifications to the traditional co-operative/mutual form which were initiated to allow it to compete more effectively in global markets: through improving the access to finance, facilitating the separation of economic and social dimensions of the enterprise, and utilising corporate holding structures to achieve growth through joint venture, merger and acquisition. While competitiveness may have been enhanced, such measures may also have resulted in a move away from co-operative/mutual or social economy values, and in a number of sectors there have been substantial levels of demutualisations.

However in the last 20 years or so there has been a resurgence of social economy values particularly in new market sectors associated with welfare services. And new forms of social enterprise have been developed in many European countries. This raises the prospect of a resurgence of social economy values reversing the isomorphic trends seen in traditional sectors.

In the UK, new legislation for a Community Interest Company appears to fit within a similar regenerative tendency. However, despite an apparent orientation towards mutualism linked to New Labour's Third Way, it is difficult to argue that the new CIC legislation represents a resurgence of interest by policy makers in the traditional values of the social economy. Instead, it seems like a very British pragmatic approach to community development focusing on outcomes, but the risk is its neglect of process values will undermine the brand, and miss the opportunity of increasing the capabilities of communities to take part in their own development. Its flexible structure may bring new benefits to disadvantaged communities, but in this strength is its weakness – diversity and lack of identity. Time will tell which proves more important.

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