REPORT

CO-OPERATIVE CAPITAL UNITS IN A NON-DISTRIBUTING CO-OP MODEL

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Research Report for CBH Group Ltd | CERU

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Note

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EXECUTIVE SUMMARY

Co-operative ownership structures have distinct benefits for their members, but also introduce challenges that can ultimately impact on member engagement, loyalty and the sustainability of the co-operative. Various factors are thought to impede external capital raising, as well as members' willingness to invest in their own co-operatives within a traditional co-operative structure. However, a variety of cases in Europe, primarily in the dairy industry, suggest opening ownership to non-member investors can become a "slippery slope" that leads to initial restrictions on share ownership becoming relaxed, or even lifted, with the eventual loss of member majority ownership and control.

Australian legislation has introduced a special financial instrument known as Co-operative Capital Units (CCUs), with aim of providing flexibility in capital raising from members and external investors whilst maintaining member control. CCUs have a role to play in alleviating some of the ownership costs of co-operatives, above and beyond the goal of financing. This report examines the merits of a CCU for a particular type of co-operative structure, the non-distributive co-operative model (NDC).

Co-operative Bulk Handling Ltd (CBH Group) is Australia's largest co-operative with $3.72 billion turnover (FY2014/15). It has a non-distributive capital structure, which means that it is not able to provide returns, dividends or share capital to members. CBH Group has a very limited member share capital ($2 share per member). This structure introduces limitations on how the co-operative can reward members.

This study uses data previously collected via a Delphi Panel and workshops with the Directors and Executive Management of co-operatives, as well as feedback from CBH Group executives to adjust our framework for CCU structures as a sub-set of non-distributing co-operatives (Mamouni Limnios *et al*. 2016).

It is noted that although this report examines the forms that CCUs may take with an NDC the analysis was not informed by or related to CBHs particular structure; such an investigation was deemed to be beyond the scope of this report. Careful consideration needs to be given to the tax consequences associated with the award, redemption and payment of a return on a CCU issued by CBH, this is particularly relevant given CBH's tax exempt status. It is recommended that comprehensive tax advice be sought before any CCU is issued by CBH

CCUs as debt instruments for NDCs- Key findings:

- <u>CCUs are unlikely to be used as debt instruments aimed at external investors.</u> CCUs have little to offer in comparison to conventional debt instruments available to co-operatives (debentures or subordinated debt)
- <u>CCUs could be a distinct category of debt used to reward member patronage</u>, which can subsequently be traded.
    - o CCUs awarded to members as a reward/repricing mechanism may need to be offered as an option to patrons against a cash payment, as it could otherwise be

considered as a compulsory loan that can only be imposed on members under certain conditions and requires a special resolution.

- Caution needs to be taken when determining the appropriate interest rate for a debt-like CCU under a NDC model. Distributing co-operatives have a lot of flexibility to reward patrons/members with hybrid instruments attracting fixed or variable returns that may be above market rates or awarded at the discretion of the board. An NDC needs to ensure an instrument passes the debt test and that it offers a risk-based, market-competitive interest rate to be certain it is not viewed as a distribution. Any CME should seek independent expert advice on these matters as they relate to their constitution and particular circumstances.

- Table 1 below outlines the most likely characteristics of a CCU issued as debt instrument in a NDC model, differentiating between the purposes of rewarding patronage or raising capital. It includes comments on the most likely ownership, market and interest structure of such instruments. This is not intended to be an exhaustive list, rather a suggestion for CCU structures fit for purpose.

Table 1. CCUs as Debt within a NDC

Purpose	Ownership	Governance	Market	Interest	Other Comments
Reward Patronage and raise capital	**Outside**	**No control**			
• Awarded to all patrons in proportion to their business with the Co-op during a defined period (could be annually) • No ties to membership or share ownership • More CCUs can be issued on years of high profitability	• Rewarded based on patronage • Transfer-able between members and non-members	• CCU holders have no representation on the Board of the co-op	• Medium to long-term maturity • Subsequent to their issue can be sold/transferred to non-members, either via private sale, in a market facilitated by the co-op or a secondary market • Can only be redeemed through retained earnings, profits or a fresh issue of CCUs	• Fixed interest rate or can vary with a money market index	• Allows co-operative to offer competitive re-pricing while raising capital under terms determined by the co-op • Risk of low liquidity for holders of CCUs as attractiveness to investors and value of the instrument on secondary markets dependent on terms of issue • May need to be offered as an option to patrons against a cash payment, as it would otherwise be considered as a compulsory loan that can only be imposed on members under certain conditions and requiring a special resolution.

	Outside	**No control**			
Raise Investment Capital • Members possibly offered first right of refusal • No ties to membership or share ownership	• Purchased by members and non-members	• CCU holders have no representation on the Board of the co-op	• Short, medium or long-term maturity • Sold in a market facilitated by the co-operative or on a secondary market • Can only be redeemed through retained earnings, profits or a fresh issue of CCUs	• Fixed interest rate or can vary with a money market index	• Investor attractiveness will determine uptake.

CCUs as equity instruments for NDCs- Key findings:

- A CCU issue as an equity instrument with a dividend attached is not an option for an NDC. This is also the case for NDCs with wholly or partly owned subsidiaries. The NDC structure does not allow partaking in the surplus created by any subsidiaries on the basis of membership or patronage with the parent- NDC, as that would constitute a distribution.

- NDCs with share capital can only issue equity-like CCUs that do not attract any dividend and are redeemed at par value. Such an instrument has limited applicability to providing seed funding or supporting a co-operative in financial distress.

- In the case of a NDC that has wholly or partly owned, for-profit, subsidiaries (either distributing co-operatives (DCs) or IOFs), it is possible those subsidiaries can reward their customers or patrons or members through an equity instrument.

    - A subsidiary is not able to distribute to the parent NDC's members.

    - A subsidiary can reward its members through, for example, an issue of an equity-like CCU or a preference share (IOF). Subsequently such entities can distribute to their shareholders or CCU-holders.

    - An IOF subsidiary deciding to issue preference shares as a reward to all users would need to do so at market value

Case studies – CCUs in Western Australia

Two case studies of West Australian co-operatives that have issued CCUs are overviewed in this document. Fruit West Co-operative Limited issued CCUs in 2012 to raise seed capital, the amount not being of significant scale. Wesbuilders Co-operative Limited introduced CCUs in 2012 to allocate part of the collective equity to members, thus rewarding their historical contribution to the co-operative. It should be noted that although the Wesbuilders model offers an innovative application of CCUs to allocate equity it would not be applicable within an NDC model.

Desktop Research Case studies- International

The case study research expanded internationally to examine the financial structures of NDCs of significant scale through a desktop review of publicly available data. The methodology applied to identify the top NFP co-operatives globally was to review the 2014 top 300 largest co-operative and mutual enterprises (CMEs), which is the most current list published by World Co-operative Monitor for leading co-operatives on a global scale (WCM, 2014).

Mutual enterprises operating in the "banking and financial services" and the "insurance" sectors were excluded, as the focus of this report is on NFP co-operatives that operate in significantly different legal and financial frameworks than these mutual entities. We were then left with 166 entries of CMEs active in the following sectors (as categorised by WCM): Agriculture and food (95); Wholesale and retail (58); Industry (7); Health and social care (4); Other services (2). These entities were individually reviewed to exclude co-operative federations or networks. This left only six (6) NFPs, including CBH Group. One of these was taken over by a consortium of for-profit and non-profit enterprises subsequent to the formation of the list. Using publicly available data the study provides an overview of the governance and capital structures of the following NFP co-operatives: Royal Flora Holland (RFH); Healthpartners Inc (HPI); Group Health Co-operative (GHC); National Cable Television Cooperative (NCTC); and Societe Internationale De Telecommunications Aeronatiques (SITA).

From the examined cases the most innovative capital structure and of relevance to the application of CCUs appears to be RFH's combination of equity-like and subordinated debt instruments with voting rights. Both instruments are rewarded to members through a set percentage of withholding from member generated revenue (possibly similar to a repricing mechanism). Subordinate debt instruments are interest bearing and follow a rotating structure with the principal being repaid after eight years. The co-operative applies performance thresholds that determine whether an interest payment can be made. A more detailed analysis of RFH's structure would require engagement with RFH.

INTRODUCTION

This paper examines the form CCUs can take in a non-distributing co-operative business model. In doing so it aims to identify how CCUs might be used to unlock member value and/or reward patronage, rather than focusing on raising third-party capital, as has been examined in previous studies. The paper aims to identify the key types of CCUs that would be applicable, the purpose each could serve and the strategic benefits and drawbacks of each option.

A co-operative is a unique type of non-government, member-owned business entity that is owned and controlled by its members. Co-operative and mutual enterprises (CMEs) are major contributors to local, national and international economies. In 2014, the world's top 300 co-operatives were operating across 25 countries with a combined annual turnover of 2.53 trillion USD (ICA 2016). CMEs generate partial or full-time employment involving at least 250 million individuals worldwide, almost 12% of the entire employed population of the G20 countries (Roelants *et al.* 2014). In Australia, there are at least 1,983 active CMEs of which 89% are co-operatives, 8.9% mutual enterprises and the remainder member-owned superannuation funds. These firms have over 29 million combined active memberships, generate more than $132.9 billion in revenue and manage over $650.4 billion in assets (Mazzarol *et al*. 2016).

Co-operatives have a long history of success in many parts of the world. The co-operative model's key difference to the investor owned firm is *a) the governance on democratic principles de-linked to investment* (one-member-one-vote) and *b) the collective ownership of capital with returns linked to patronage rather than investment*. This business model enables individuals or small businesses to come together under a common purpose, use their collective capital and bargaining power to achieve economies of scale and influence market dynamics, thereby increasing countervailing power and reducing what economists call "market contracting costs". On the other hand, the collective ownership structure carries its own challenges which Hansmann (1996) refers to as "ownership costs".

There is a commonly held view that co-operatives face challenges in raising capital to fund growth and are therefore "capital constrained" (Li *et al.* 2015). Various factors are thought to impede external capital raising, as well as members' willingness to invest in their own co-operatives. External investor disincentives include the fact that shareholder benefits are more likely to delivered via patronage (members' proportion of trade) than dividends within a co-operative (Bacchiega and de Fraja 2004; Staatz 1987).

Among the disincentives identified for external investors is the democratic nature of the governance of a co-operative. This "one-member-one vote" governance principle, as opposed to the one-share-one-vote principle, serves to dilute the authority and control of investors. Other restrictions on investor control and voting rights exist in different countries and legal jurisdictions. For example, in Australia, external investors do not have voting rights at co-operatives' AGMs.

Considerable attention has been given in the academic literature to the development of alternative ownership and governance structures that could accommodate and manage internal and external capital investment in co-operatives (Nilsson 1999; Chaddad and Cook 2004). Hybrid co-operative forms have emerged that seek to overcome some of the inherent weaknesses of co-operatives in relation to their access to capital, as well as, ultimately, member engagement and loyalty. However, in many cases, attempts to steer away from the collective capital model have led to demutualisation and no single co-operative model has emerged that alleviates such constraints.

Australian legislation has followed international trends in increasing the flexibility of capital raising within the co-operative business model. While Australian legislation in all States and Territories requires co-operatives to adhere to the "one-member-one-vote" principle; State and Territory Acts and, more recently, the Co-operatives National Law (implemented in NSW, VIC, SA, NT, TAS) have opened ownership to non-member investors. This can take place in Australia under certain restrictions through a special financial instrument termed a Co-operative Capital Unit (CCU) that does not attract voting rights, although a co-operative is restricted in terms of the source of capital that can be used to buy back CCUs.

Available research is currently inconclusive in terms of whether co-operatives face challenges in accessing capital when compared to their IOF counterparts, with recent evidence provided in the 2016 World Monitor report suggesting the world's largest co-operatives are financially more solid than their IOF counterparts and less reliant on debt, with net equity being a higher proportion of their capital structures (ICA, 2016). A recent study of capital constraint in agricultural co-operatives found mixed results. As noted by the authors:

> *While cooperatives in our sample have significantly lower debt-to-asset ratios than comparable IOFs, we do not find evidence that they face financial constraints, at least in the short run. However, for financing long term assets, our data suggest that cooperatives tend to rely more on equity capital, which may reflect a constraint on borrowing.* (Li *et al.* 2015 p. 2)

Our experience in assessing some of the largest agricultural co-operatives in Australia has been that well-run co-operatives do not require external equity to grow and are able to raise debt on competitive commercial terms. Previous research on CCUs has indicated the potential of these instruments beyond the facilitation of capital investment, for the purposes of: 1) unlocking member value; 2) creating permanent capital (retain capital), and 3) rewarding patronage (Mamouni Limnios *et al*. 2016).

Co-operatives with non-transferrable member shares redeemable at par value and an inability for members to partake in equity growth, can face potential pressure for demutualisation. This is often driven by members who wish to access the co-operative's equity. This situation may be described as a drive to "unlock" member value.

Within a non-distributing co-operative business model (NDC) such pressure can intensify, as member shares are also unable to attract a dividend. Interestingly, demutualisation is commonly viewed as a failure of the co-operative model, even when it is a direct consequence of the success of the business model in building substantial equity in the business over time (Apps 2016). However, it should be noted that NDC models have tax advantages that are not available to other structures.

CO-OPERATIVE CAPITAL AND OWNERSHIP STRUCTURES

A co-operative is formed when individuals or organisations collaborate to pursue a common purpose that can be achieved more effectively through cooperative action than via other means. This collaboration via a co-operative business model enables these members to enhance their bargaining power within markets, achieve economies of scale, and minimise some of the risks associated with operating individually in a volatile environment.

The co-operative's purpose has a dual focus. While it should aim to deliver economic or financial benefits to members, it also needs to ensure that social capital is also generated and strengthened. If this does not happen the cooperative spirit within the co-operative is eroded and the business can be placed at risk of degeneration (Battilani and Schröter 2012).

Co-operatives are usually formed due to a market failure (Nilsson 2001). However, once formed and if successful, the co-operative's initial purpose will be fulfilled and the market may adjust, thereby eroding its reason for existing. This can result in the co-operative's demutualisation or failure unless its lifecycle can be extended through rejuvenation of purpose (Cook 1995).

Theoretically this has been explained as "wave theory" (Helmberger 1964), or "wind-it-up-theory" (LeVay 1983). If the co-operative becomes dominant within its market it can assume the role of a "pacemaker" (LeVay 1983). In this capacity, the co-operative will set benchmarks for pricing and service, which can engender member loyalty through keeping any competitors from offering inferior pricing or services to members.

However, the co-operative will need to ensure it can transition through its lifecycle and successfully adapt its business model from largely defensive (operational) position, to a more offensive (market-focused) strategy (Cook 1995).

A number of governance and member engagement challenges facing co-operatives have been identified as arising from the vaguely defined ownership rights that are an inherent aspect of the co-operative business model. Key issues associated with this are:

a) A lack of transferability, appreciation and liquidity mechanisms for member equity;

b) The inability to allow members to adjust their shareholding according to their risk portfolio and investment horizon; and

c) A propensity for free-riding by members and non-members that enjoy the benefit of co-operative presence in the market even if they choose not to trade with the co-operative.

Figure 1 illustrates a holistic view of the collective ownership costs associated with the business model of the co-operative. This takes into account agency and collective decision making costs. In economic terms, it assumes that members will trade with the co-operative when they perceive their individual market contracting costs to be greater than the collective ownership costs (Hansmann 1996).

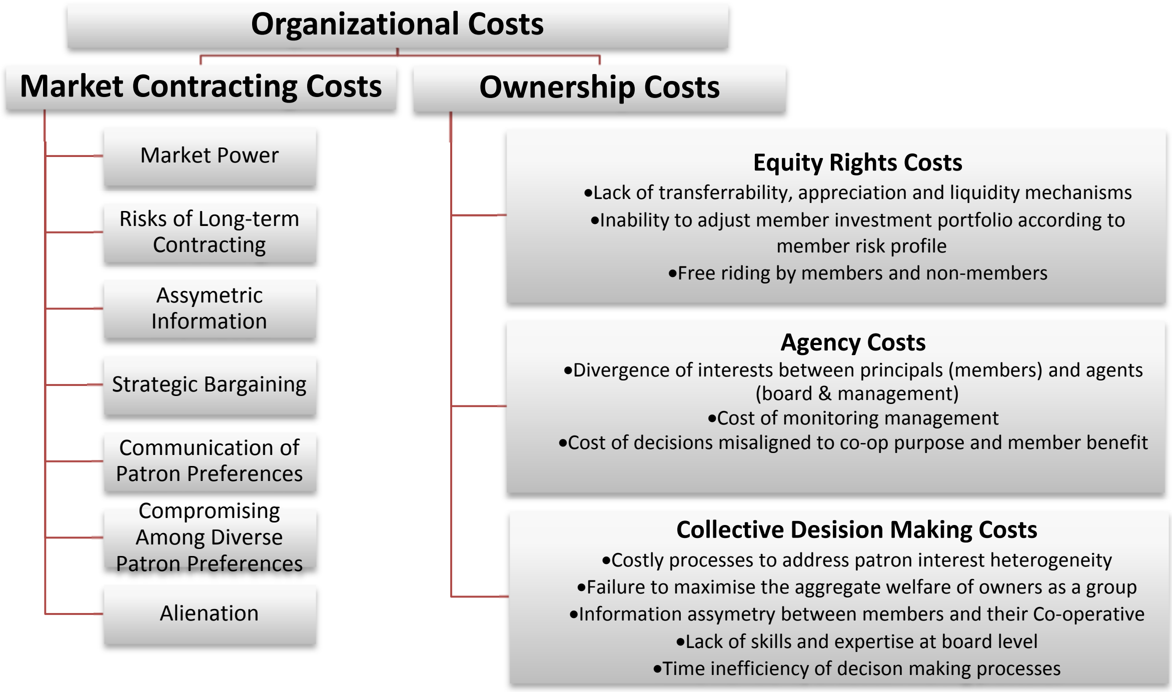

Figure 1. Organizational costs (adapted from Hansmann 1996, and Cook and Iliopoulos 2016)

Multiple ownership rights structures and hybrid co-operative models have emerged aiming to address these challenges as depicted in Figure 2. However, no single model has emerged in the literature or in practice as being superior or more sustainable in comparison to the traditional co-operative model.

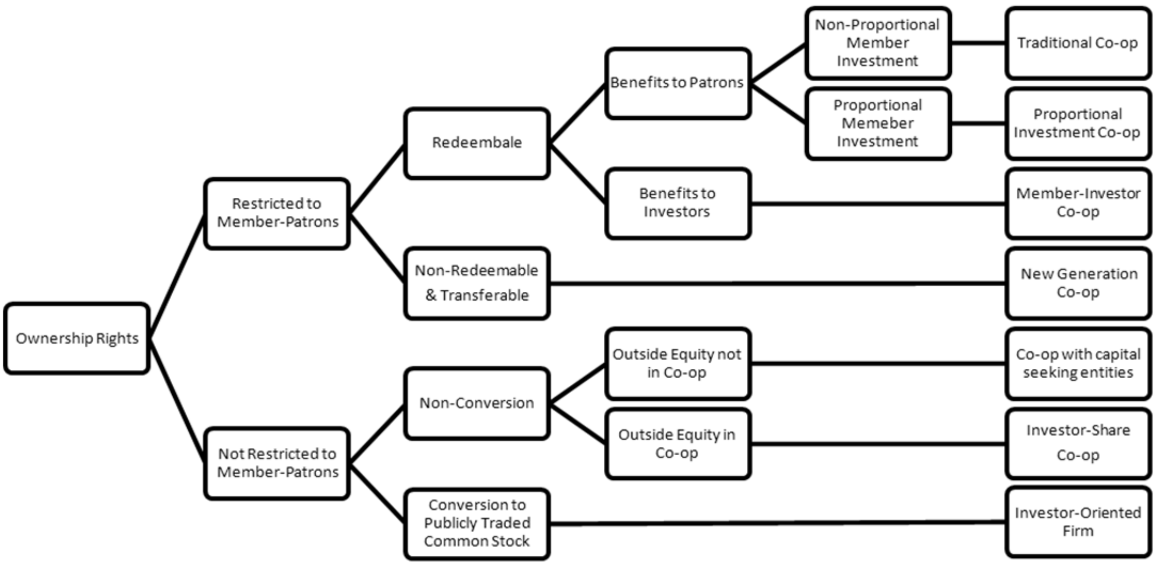

Figure 2. Co-operative ownership rights models (source: Chaddad and Cook 2004)

For example, the *New Generation Co-operative* business model (NGC) emerged in the United States (U.S.) in the 1990s to address some of the ownership challenges of the traditional co-operative business model. It offered closed membership and transferrable and commonly appreciating shares. This new business model was initially lauded as offering a solution to the generic problems facing co-operatives (Cook and Iliopoulos 1999; Katz and Boland 2002; Hardesty 2004).

However, the NGC business model has not significantly replaced the more traditional "one-member-one-vote" co-operative structure, which adheres to the democratic and collaborative principles that have underpinned the co-operatives sector since the 19th Century (Fairbairn 1994). Successful NGCs can also become demutualisation targets when their member-owned shares trade below market rate due to low liquidity. Examples of this include the American co-operatives Dakota Pasta and Golden Oval Eggs (Bekkum and Bijman 2006).

Another model is the *Investor-Share Co-operative* that has a partial listing to facilitate external equity investment. A variety of cases in Europe, primarily in the dairy industry, suggest opening ownership to non-member investors can become a "slippery slope" that leads to initial restrictions on share ownership becoming relaxed, or even lifted, with the eventual loss of member majority ownership and control (Bekkum and Bijman 2006). Even when control is maintained by the membership base, introducing external investors poses significant management challenges, as recently re-affirmed in the case of an instrument listing by Murray Goulburn, Australia's second largest co-operative.

There are multiple responses a co-operative can take to address the challenges stemming from its collective ownership structure. These include, but are not limited to, ownership, capital and governance restructures. Restructures impacting on these key elements of the co-operative business model have had detrimental effects when taken without an informed understanding of the particular problem they are trying to solve, and their impact on the wider business model.

Success and failure can be found in each co-operative model and will depend on the alignment of structure with governance, strategy and ability to deliver a member value proposition. This is reflected in Figure 3, which illustrates a model developed by Rabobank (2012) dealing with the need to balance governance, voting, capitalisation and pricing structure within the co-operative.

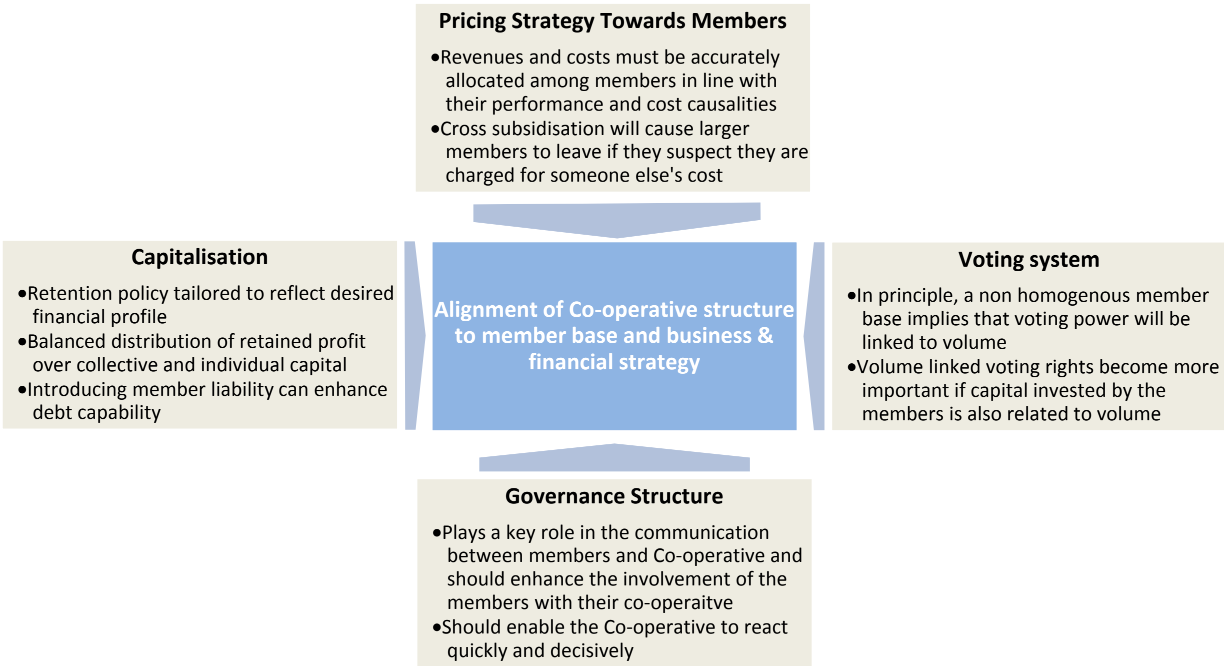

Figure 3. Rabobank conceptual model (communications 2012)

It should be noted that Australian legislation requires co-operatives registered under State and Territory or National Co-operatives Law to adhere to the "one-member-one-vote principle". As a result, the voting system parameter in the Rabobank (2012) framework is not applicable for Australian co-operatives, unless they are registered under the Corporations Act. However, even in this case, care must be taken to ensure asymmetrical voting power among members does not trigger a degeneration into demutualisation.

An even more holistic view is provided by Mazzarol *et al.*'s (2014) co-operative business model framework, which is shown in Figure 4. In this framework, the co-operative business model elements include purpose, governance, profit formula and share structure, but also operational processes and resources. Underlying this framework is the assumption that all of these elements are inter-related and need to be configured to sustainably deliver a member value proposition (MVP), while addressing challenges emanating from external socio-economic environments and generating economic and social capital outputs.

The delivery of an MVP needs to recognise and address the tensions that the four roles that members play. These are their role as patrons, investors, owners and members of the community of purpose for which the co-operative exists. These four roles or "hats" that the influence members' loyalty and commitment to the co-operative.

Traditional approaches to how members engage with their co-operatives have highlighted the often-competing relationship between the "patron" and "investor" hats (Nilsson 2001). Where these come in conflict the mutuality of the co-operative can be placed in jeopardy. Much of the analysis and discussion over the trade-off between non-distributing and distributing co-operative business models, and the level of equality between members has focused on the nexus between these two "hats".

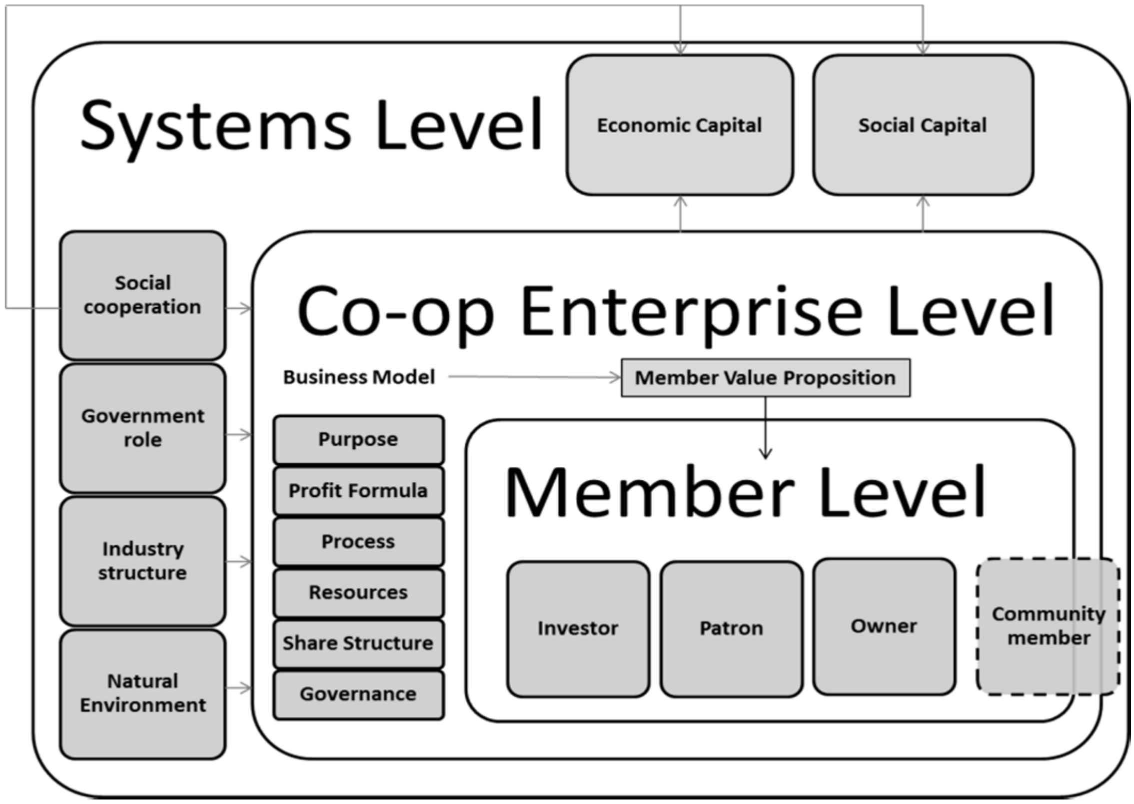

Figure 4. Co-operative Enterprise Framework (source: Mazzarol et al. 2014)

However, members' roles as owners and members of a community of purpose also need to be considered. For example, Birchall and Simmons (2004) suggested a "mutual incentives theory" in order to better understand member's motivations to participate in mutual businesses. They combine individualistic motivations (commonly the sole focus of economists) with collectivistic motivations; the latter including shared goals, shared values and a sense of community. The importance of the emotional aspects of the relationship between a co-operative and its members has been highlighted in the literature (Oczkowski *et al*. 2013). In particular, there is a recognition of the importance of "affective commitment" (Allen and Meyer 1990), which is a member's sense of belonging and emotional commitment to a co-operative. This has been identified as a key factor in alleviating the generic problems challenging Co-operatives (Jussila *et al.* 2012).

Further, a co-operative's strategy will be influenced by the external market environment and, in turn, this will determine appropriate business structure configurations that, for example, are related to the potential strategic need for scale, aggressive growth and, hence, capital. It also relates to the wider socio-economic environment and the existence of social capital, as well as cultural elements that directly influence co-operatives' sustainability. Societies characterised by individualism (e.g. U.S., Ireland, Australia, New Zealand, Nordic countries, Netherlands) have seen a progression from collective capital to strong individual member claims and demutualisation, as compared to countries with strong societal awareness that view co-operative as a collective business model (e.g. Italy, Spain, Portugal, Latin America, France, Canada, Belgium).

While this discussion was limited to an examination of capital unit structures in relation to the purposes they can serve, the appropriateness of any capital structure for a particular co-operative can only be assessed with a full view of its business model at macro, meso and micro levels.

CCU Legal Definition and Requirements

This study took place within the context of the Co-operatives Act WA (2009) and the Co-operatives National Law (CNL)[1], which has been adopted by New South Wales, Victoria, South Australia, the Northern Territory and Tasmania[2]. Legal reforms of Co-operatives Legislation since the early 1990s and through the 2000s, have resulted in the gradual introduction of CCUs in State and Territory laws.

Prior to the introduction of CCUs no State or Territory legislation allowed co-operatives to raise capital from non-members other than through the issue of subordinated debt or debentures. CCU provisions are provided in the Co-operatives Act WA (2009) and the CNL. CCU provisions provide an instrument for raising capital as a hybrid security (that has debt and equity-like characteristics). This can be issued to members, and non-members under certain restrictions, designed to maintain control within the active membership base and that is believed to protect the sustainability of the co-operative. Additional purposes CCUs can serve have emerged, including an ability to unlock member value, create permanent capital (retain capital) and reward patronage (Mamouni Limnios *et al.* 2016). A Co-operative Capital Unit (CCU) is defined as:

> *"An interest issued by a Co-operative conferring an interest in the capital, but not the share capital, of the Co-operative."*
>
> (Co-operatives Act 2009 (WA), Division 2, s257(1))

Therefore, a CCU holding does not have the rights of co-operative membership. A CCU can be structured as debt or equity and can be issued to members and non-members. In order to issue such an instrument, a co-operative must have rules that authorize and govern the issue of CCUs. CCU requirements have minor differences between the various State and Territory legal jurisdictions. However, for the purpose of this report, we adhere to the CCU requirements introduced by the Co-operatives Act WA (2009). The rules of a co-operative must contain the requirements outlined in section 261 of the Act as a minimum, namely:

> *Each CCU holder is entitled to one vote per CCU only at a meeting of CCU holders;*
>
> *The rights of CCU holders may be varied according to their terms of issue with the consent of at least 75% of the holders;*

[1] The Australian Uniform Co-operative Laws Agreement (AUCLA) entered by all states and Territories in February 2012 allowed for any state or territory the option of adopting legislation that was consistent with the CNL as an alternative to the model template. Western Australia and Queensland have not adopted the CNL, with Queensland in addition withdrawing from the AUCLA from the 30th of January 2015.

[2] Refer to Co-operatives (Adoption of National Law) Act 2012 (NSW), Co-operatives National Law Application Act 2013 (Vic), Co-operatives National Law (South Australia) Act 2013 (SA), Co-operatives (National Uniform Legislation) Act 2015 (NT), and Co-operatives National Law (Tasmania) Act 2015 (Tas).

The holder of a CCU has none of the rights or entitlements of a member of the co-operative; and

A CCU holder has the same rights as the holder of a debenture in respect to receiving notice of all meetings and other documents.

(Co-operatives Act 2009 (WA), Part 10, Division2, s.261)

Importantly, CCU redemption requirements include the following:

The redemption of CCUs is not to be considered to be a reduction in the share capital of the Co-operative.

CCUs may only be redeemed out of profits; or the proceeds of a fresh issue of shares, or an approved issue of CCUs, made for the purpose of the redemption.

Any premium payable on redemption is to be provided for out of profits or out of the share premium account or an account created for that purpose.

(Co-operatives Act 2009 (WA), Part 10, Division2, s.264)

The terms of issue of a CCU must be approved by the Registrar (section 261) and must include details of entitlement to repayment of capital, entitlement to participate in surplus assets and profits, entitlement to interest on capital including whether interest is cumulative or non-cumulative, details of how capital and interest on capital are to rank for priority of payment on a winding-up, whether there is a limit on the total holding of CCUs for non-members of the co-operative and what that limit is (section 262).

The Act allows for the conversion of CCUs held by an active member of the co-operative into shares of the co-operative, if there is such a provision (section 266). CCUs are not to be issued unless the terms of issue are approved by a special resolution of the co-operative and the Registrar, who is not to approve the terms of issue unless satisfied that they will not result in a failure to comply with co-operative principles and are not contrary to the rules of the co-operative or the Act (section 262).

CCUs were first introduced in NSW in 1992. The NSW Act at the time stated that a non-distributing co-operative could only redeem CCUs using proceeds from a fresh issue of shares, or a new issue of CCUs made for the purpose of the redemption. The WA Act does not have the same limitation, with WA non-distributing co-operatives able to use profits to redeem CCUs. This has also been adopted by the NCL.

Further, the 1992 NSW Act restricted voting to one vote per holder of CCUs at a meeting of CCU holders. The WA Act reflects voting entitlement to investment holding, prescribing that "each holder of a CCU is entitled to one vote per CCU held at a meeting of the holders of CCUs" (Co-operatives Act 2009 (WA), Part 10, Division2, s.261). Subsequently, the NCL allows for either (as specified in the rules): (i) each holder of a CCU is entitled to one vote only at a meeting of the holders of CCUs; or(ii) each holder of a CCU is entitled to one vote per CCU held at a meeting of the holders of CCUs.

There is no provision for issuing CCUs in the Queensland legislation (Co-operatives Act 1997 (QLD)), and currently no indication that Queensland will adopt the CNL, as the State withdrew from the Australian Uniform Co-operative Laws Agreement (AUCLA) in February 2012. Western Australia will also maintain the Co-operatives Act WA (2009).

Arguably the CNL has failed to streamline all Australian legal jurisdictions and AUCLA has been criticized as being compromised from the beginning by the inclusion of a provision that allowed States and Territories the option to adopt an alternative to the model template, as long as it was "consistent with the CNL" (Apps 2016). Co-operatives in Australia can also be registered under the Corporations Act (2001), including the second largest co-operative in Australia, the dairy co-operative Murray Goulburn.

In light of the unlikely adoption of the CNL across all Australian legal jurisdictions, and the ability of co-operatives to be recognised as such even when registered as a corporation, we would raise the question as to whether the sector would be better served by the inclusion of a sub-division within the Corporations Act and abolishment of the CNL and the State Acts.

There is an argument for maintaining a distinct co-operative identity through separate legislation (Apps 2016), which is in line with international trends in Europe and other jurisdictions. However, it could be argued that the benefit is lost in Australia, as following the State or National Co-operative Law there is an option to register as a corporate entity under the Corporation's Law.

We would argue the benefits of enforcing consistent, simplified legislation throughout Australia as an amendment of the Corporations Act would outweigh any benefits provided by a segmented co-operative legislation. Registration through a subsection of the Corporations Act would increase the visibility and awareness of co-operatives as an alternative business model and would enable the efficient measurement of the sector's performance through a single registry, as well as allow benchmarking against other sectors.

However, it would be important to include many sections of the CNL (in particular the definition of the unique nature of a co-operative enterprise and the issues relating to "purpose" and "identity"). This is noted in reviews of international practices in the design of co-operative laws in which identity, purpose, the democratic principles of "one-member-one-vote" and the distribution of profits are specifically stipulated:

> *"Stipulating the cooperative identity and preserving their distinguishing features should therefore be considered the primary objective of cooperative law."*
>
> Cracogna, Fici and Henry (2013, p. 18)

Non-Distributing Co-operatives- Legal Definition and Requirements

A non-distributing co-operative (NDC) may or may not have a share capital and under the Co-operatives Act WA (2009), and mirrored in CNL, is defined as:

> *"A non-distributing Co-operative is a Co-operative whose rules prohibit it from giving returns or distributions on surplus or share capital to members, other than the nominal value of shares, if any, at winding-up."*
>
> (Co-operatives Act 2009 (WA), Part 2, Division 1, s14(1))

Effectively, while a NDC can conduct commercial activities, it is a not-for-profit prohibited from distributing surplus funds to members from profits, asset revaluation or on winding up. Non-distributive co-operatives are more commonly used to provide social, cultural and recreation services to members.

There are some differences in the active membership requirements of distributing and NDCs that allow more flexibility for the definition of active membership in a non-distributive co-operative. While an active member of a distributing co-operative is required to use an activity of the co-operative, a NDC may provide for a regular subscription fee as a requirement to establish active membership. The active membership provisions are:

> *The only active membership provisions that are permitted to be contained in the rules of a <u>distributing Co-operative</u> are —*
>
> *(a) provisions requiring a member <u>to use an activity of the Co-operative</u> for carrying on a primary activity specified in the provisions to establish active membership; and*
>
> *(b) any other active membership provisions that the Registrar may approve.*
>
> (Co-operatives Act 2009 (WA), Part 6, Division 2, s.116)

> *Active membership provisions for a <u>non-distributing Co-operative</u> may provide that the payment of a regular subscription by a member of the Co-operative, to be applied to a primary activity of the Co-operative, is sufficient to establish active membership of the Co-operative. A member of a Co-operative who would, on payment of the subscription, be an active member of a Co-operative is taken to be an active member until the subscription is payable.*
>
> (Co-operatives Act 2009 (WA), Part 6, Division 2, s.117)

Finally, additional restrictions are imposed on non-distributing co-operatives at winding up:

The rules of a non-distributing Co-operative must provide —

(a) that there must be no return or distribution on surplus or share capital to members other than the nominal value of shares, if any, at winding up; and

(b) for the way of distribution of the surplus property at winding up.

The rules of a non-distributing Co-operative that has operated as a mutual may provide that —

(a) surplus funds are payable only to members who have paid contributions to the Co-operative and have a credit balance in their member's ledger; and

(b) the payment of surplus funds is limited to the return of the contributions paid by the member to the Co-operative and the nominal paid up value of the shares, if any.

(Co-operatives Act 2009 (WA), Schedule 1, cl. 3).

CBH GROUP- A LEADING NON-DISTRIBUTING CO-OPERATIVE

The grain industry is one of Australia's oldest and largest agribusiness sectors. Grain growing commenced with the first European settlement in 1788 and has continued ever since (Donath 1953; Hancock 1957; ABS 2006). Today there are nearly 12,000 grain growers in Australia who produce a variety of crops, such as wheat, coarse grains (e.g. barley, oats, sorghum, maize and triticale), oilseeds (e.g. canola, cottonseed, soya beans) and Legumes (e.g. peas, chickpeas, lupins and other lentils).

Structure of the Australian grains industry

In 2015/16 wheat comprised around 54% of all grains produced, followed by coarse grains (26%), oilseeds (13%) and legumes (7%). Together these grains generated a revenue to the sector of $13.8 billion, including $9 billion in exports. Over the past five years the grains industry has grown annually by around 2.3% and the outlook for the next five years is for annual growth of around 2.4% (Tonkin, 2016a).

The geographic distribution of grain producers is dependent on the availability of suitable broad acre farmland and the industry is highly susceptible to the impact of environmental forces, such as drought, as well as fluctuations in global grain prices. NSW has the largest concentration of grain producers with around 32% of the national total. In second place is WA with 27% of all grain producers, followed by South Australia (16%), Victoria (14%), Queensland (10%) and Tasmania (0.2%) (Tonkin 2016a).

Australian grain producers predominately operate family owned farms that employ small, usually casual and seasonal, workforces. To remain competitive, grain producers must have access to suitable land and enjoy growing conditions that have appropriate levels of rainfall at the right time of the year. In addition, they need to invest in state of art production systems, such as precision farming and the adoption of the latest technologies and crop varieties. There is also an increasing need for economies of scale, with fewer producers now owning and operating larger farms. Major costs include the purchase of fertilisers, irrigation water and fuel, of which the cost of fertiliser is probably the most significant (Tonkin 2016a).

The supply chain for grain in Australia is dominated by a small number of large firms that undertake bulk grain handling and storage, as well as grain wholesaling. Grain wholesaling is a $16.5 billion industry that has enjoyed an annual growth rate of 4.2% over the past five years. There are around 363 firms operating in this sector, but five companies control just over 60% of the market. The two largest by market share are Glencore Grain Pty Ltd, which has 19.2% market share, and the CBH Group, with 19% market share. In third place is GrainCorp Ltd with 11% market share, followed by Cargill Australia Ltd with 7% market share, and finally Emerald Grain with a 6% market share (Tonkin 2016b).

Bulk grain storage, handling and wholesaling

There are at least 116 bulk grain storage and handling businesses operating in Australia. However, the same five organisations dominate the market. The CBH Group is the most significant player with 17% market share, followed closely by GrainCorp (16% market share), Cargill Australia (9% market share), Glencore Grain (7% market share), and Emerald Grain (1% market share) (Tonkin 2016c). Of these five, only CBH Group is a co-operative. GrainCorp is a publicly listed Australian company employing over 3,088 people with annual revenues of more than $4.1 billion and assets of $3.7 billion (IBISworld 2015). The other firms are foreign-owned subsidiaries. Glencore Grain is a wholly-owned subsidiary of the Swiss-based commodities trader Glencore International AG. Cargill Australia is a wholly-owned subsidiary of the US-based Cargill Incorporated, and Emerald Grain is a wholly-owned subsidiary of the Japanese trading company Sumitomo Corporation.

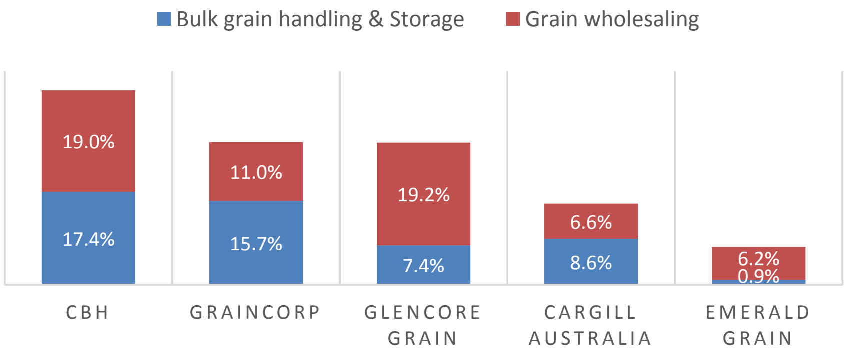

Figure 5: Bulk Grain Handling, Storage and Wholesaling Market Shares of the Leading Organisations in 2016 (Source: IBISWorld)

The competitive success of these five major agribusinesses is their ability to offer efficient, integrated services that include bulk grain handling and storage, as well as grain wholesaling and trading. As shown in Figure 7, CBH Group has a good balance of both functions and is a fully integrated business that receives and stores around 90% of the WA grain harvest.

Threats to CBH Group's mutuality

Despite its success, CBH Group has had to face pressure from external and internal forces to demutualise. In 2000, a minority group of members, with the backing of third-party interests sought to demutualise the co-operative. This went to an AGM vote but failed to secure sufficient support from the membership. More recently (2016), CBH Group experienced a challenge from a minority group of members known as Australian Grain Champions (AGC). With the backing of GrainCorp and former directors, AGC sought to have CBH Group demutualised and listed on the Australian Stock Exchange (ASX). This saw the co-operative's board and senior management engage for several months in an education and consultation program with its members, exploring possible options for the co-operative's business model. In September 2016, the AGC GrainCorp group formally withdrew their bid in the face of a rejection by the Board and the membership.

CBH Group is governed by a board of 12 directors, of whom nine are grower members elected by the membership from five regional zones, while three are independent directors selected on the basis of their expertise. According to the directors of CBH Group, the recent demutualisation campaign provided an opportunity for the co-operative to enter into a major review of its purpose and member value proposition. It required CBH Group to review how it could more effectively communicate with members to help them understand CBH's corporate structure and governance. This was undertaken within the co-operative principle of "education, training and information" and was designed to provide an awareness of the purpose and value of the co-operative to both members and the wider community.

Member surveys, undertaken by CBH Group during the protracted discussions over the AGC-GrainCorp demutualisation bid, found 78% of members agreed with the board's decision to reject the offer. Upon conclusion of the member engagement and education process, final member survey results and board resolutions were released in December 2016, it was noted that:

- *Almost 8 out of 10 growers support the co-operative model, with 58 per cent of growers preferring a non-distributing co-operative. The CBH Board has therefore unanimously resolved CBH will remain a non-distributing co-operative and will explore further enhancements to how value is returned.*
- *The results also showed that 70 percent of growers want CBH to introduce a mechanism to protect the collective equity for future generations, so the Board will explore this concept in more detail.*
- *Only 14 percent of growers supported external parties investing in storage and handling, and only 12 percent supported a publicly listed structure for CBH.*
- *Structural preferences were consistent across grower tonnage, age and geographic segments. CBH Group 2016)*

In many ways, the AGC-GrainCorp bid offered the CBH Group board another opportunity to explain the benefits of the co-operative business model and compare it to a range of alternative business models, including full demutualisation and public listing. This recent experience of CBH Group responding to the AGC-GrainCorp demutualisation bid also highlights the importance of CMEs fully understanding their purpose and using this to help remind members of the roles they play and the benefits mutuality can offer. The "degeneration" that may result in a CME demutualising has been attributed to the inability of the business's board and management to keep focused on its purpose (both social and economic). For example:

Degeneration involves deviation from the social purposes of co-ops...Through this process, co-ops can become similar to or the same as investor-owned enterprises. This process can be internally controlled when co-ops decide to change their character...or uncontrolled when democratic voting just gradually disappears. Indeed, democratic engagement has emerged as the Achilles' heel of many co-ops. In many cases members were content and did not bother to vote. This of course is an open invitation to management to do what it wants. In several cases managers decided to demutualize the respective co-op, and during the process acquire through their insider-knowledge the best pieces for themselves as private *property. Lack of democratic practice is a long-term threat to all co-ops. (Battilani and Schröter 2012, p. 5)*

THE "KEYSTONE" ROLE OF CBH GROUP

Explaining the competing alternative business models is challenging and there are many variables that must be considered. However, CBH Group has survived another significant challenge to its mutuality and the Board and its members have had an opportunity to fully assess the costs and benefits of the co-operative business model. The final decision to remain a co-operative keeps CBH Group as a major player within the Australian grains industry with no other purpose than to work for the benefit of its members.

CBH's foundation in 1933 at the height of the Great Depression came at a time when the cost of the jute bag and subsequent handling and storage was worth more than the grain inside. Without the co-operative, WA grain farmers may not have survived. While fewer in number today, the WA's grain industry remains one of the nation's most important export industries and a vital source of jobs and economic growth for the WA rural sector.

CBH Group is not only Australia's largest CME by annual turnover; it is also one of the most significant agribusiness firms in the nation and a major player in the grains industry. In 2014/15 CBH Group and its members contributed an estimated $2.98bn in gross value-add to the WA economy. CBH Group accounts for approximately $0.73bn of this total contribution, while its members make up around $2.25bn. The direct contribution component of both CBH Group and its growers – $1.1bn – equates to 25% of the entire gross value-add of the agricultural, forestry and fishing industries in WA in 2014-15.

CBH Group invested about $1.2 billion in capital projects from 2009 to 2015, including an $880 million upgrade of road and rail transport systems across the 300,000-square kilometre wheat growing areas of the State, which also benefitted local communities. CBH Group also spends $1.5 million on an annual basis for sport and recreation, health, safety and the arts through its Community Investment Program. A further $600,000 has been donated in the past four years to charitable organisations such as the Royal Flying Doctor Service, the WA Country Football League, Ronald MacDonald House, Hockey WA and Music Aviva (Deloitte Touché Tomatsu 2016).

Since its emergence in the depths of the Great Depression, CBH Group has played a "keystone" role in keeping the WA grains industry competitive. Such a "keystone" role occurs when a large firm becomes the centre of a wider network or "business ecosystem" and uses its power to help keep the system vibrant and healthy. It may, as in the case of CBH Group, provide smaller "niche" firms, such as grain producers, an opportunity to secure access to supply chain infrastructure, services and support that might otherwise be unavailable to them at a competitive price (Moore 1993; 1996). Large co-operatives, such as CBH Group, help protect smaller "niche" members and enable them to survive and remain sustainable. They also protect these smaller firms from "dominator" firms that typically come from overseas and take over an industry and reduce competition, often forcing smaller "niche" firms to become price takers (Iansiti and Levien 2004).

It should be noted that the formation of co-operatives from the mid-1800s to the mid-1900s was internationally supported by governments through the establishment of enabling legislation that created co-operative monopolies against the interests of existing merchants. Australia's bulk grain storage and handling systems emerged during the 20th Century with the active support of State governments. The passing of the Bulk Handling Act 1936 (WA) provided Co-operative Bulk Handling Ltd with a 20-year monopoly to create a state-wide system of bulk grain handling and storage (Ayris 1999). The South Australian Co-operative Bulk Handling Ltd was established much later (1955) (Payne and Donovan 1999). In many cases governments went to the extent of providing significant financial support and tax incentives. The process was developed to transfer agricultural profits from merchants to the agricultural sector, which would not have happened had co-operatives not been enabled.

When CBH Group secured its tax exemption in 1970 it required an amendment to the State legislation that governed the co-operative's operations. Under a new constitution, rebates were not permitted and, in the event the business was wound up, the distribution of any assets owned by the co-operative was to be made at the discretion of the State Government. The argument put in favour of this governance and share capital structure was that it would allow CBH Group to accumulate surplus profits and reinvest them into the resources needed for future growth (CBH Group 1970). Major expansions of infrastructure took place in the 1970s, with CBH Group raising a bank loan of $42 million (the largest bank loan ever issued in Australia at the time) in 1970 to build the Kwinana grain storage and shipping terminal (Ayris 1999). When opened it was the largest facility of its kind in the world (Planner 1988). The Kwinana grain port facility was built without increasing tolls or levies to growers (CBH Group 1970). It is unlikely CBH Group could have been built the terminal today under current legislative and market conditions.

CCU Analysis and Recommendations

The analysis provided in this section relates to the issue of CCUs under the Co-operatives Act WA (2009) unless otherwise stated.

Methodology

Exploring alternative CCU structures is a complex task due to their broad legal definition and the diverse purposes these instruments can serve. This study approached the problem using a mixed method methodology, which allowed an examination of not only what but also why and how some structures are preferable over others (Wright 2004). The data used were previously collected through the formation of a Delphi panel of experts that was asked to evaluate how co-operatives could use CCUs to raise, but also retain capital; the latter being more relevant to this paper's aim.

The analysis also draws on the findings of a workshop and focus groups held in 2012 that considered the Delphi panel findings and the characteristics of CCU structures in terms of ownership, governance, market facilitation and distribution options. We revisited this data and complemented that information with the author's own views and understanding of the Co-operatives Act WA (2009), as well as the views of Co-operatives WA (discussions in 2016) and that of UWA accounting and finance experts in order to adjust previous findings and frameworks to the NDC business model. We also interviewed CBH Group executives, who provided feedback on earlier versions of this report.

Debt Instruments for NDCs

NDCs can issue subordinated debt or debentures. Corporations legislation applies to the issue of debentures with modifications that in summary relate to: referencing to a co-operative instead of a corporation and the Registrar instead of ASIC (Co-operatives Act 2009 (WA), Part 10, Division 1, s.250); disclosure statement provisions if a debenture is issued solely to members of the co-operative, or members and employees (Co-operatives Act 2009 (WA), Part 10, Division 1, s.252) and other provisions that prescribe how the rate of interest payable is to be determined, these however allow flexibility to the co-operative board and in accordance to each co-operative's rules.

There are five essential elements required to satisfy the debt test in relation to an entity, as per The Board of Taxation's interpretation of Division 974 of the Income Tax Assessment Act 1997:

- *there must be a 'scheme', which is very broadly defined as an arrangement or any scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise;*
- *the scheme must be a 'financing arrangement';*
- *there must be a financial benefit that is received, or will be received by the issuing entity or a 'connected entity' of the issuing entity, under the scheme;*
- *the issuing entity, or its connected entity, must have an 'effectively non-contingent obligation' to provide a future financial benefit; and*

> - *it must be substantially more likely than not that the value of the financial benefit to be provided will at least be equal to or exceed the financial benefit received, and the value provided and the value received must not both be nil.*
>
> *(The Board of Taxation, 2015)*

To reflect the economic substance of an arrangement better, the debt test adopts the concept of an 'effectively-non-contingent obligation', that the pricing, terms and conditions of the scheme are such that there is in substance or effect a non-contingent obligation to take that action, for example, make that payment (The Board of Taxation, 2015).

It should also be noted that both the debt and the equity tests involve a number of additional rules and that a hybrid scheme (or a set of related hybrid schemes) is classified by the ATO as either entirely debt or entirely equity. If an interest satisfies both debt and equity tests, a 'tiebreaker' rule takes effect and the interest is treated as a debt interest (The Board of Taxation, 2015).

A co-operative can enforce members to lend funds

A distinct difference to the Corporations Act is the ability of a co-operative to require members to lend money, with or without security, to the co-operative, in accordance with a proposal approved by special resolution of the co-operative and in accordance with provisions in Part 10, Division 1, s.255 (Co-operatives Act 2009 (WA)), including that the proposal cannot require a loan to be for a term of more than 7 years or another term prescribed by the regulations of the co-operative.

CCUs are unlikely to be used as debt instruments aimed at external investors

The Delphi panel view was that the issue of CCUs as debt aimed at external investors would be unlikely, as they felt CCUs would have little to offer in comparison to conventional debt instruments available to co-operatives (Mamouni Limnios *et al.* 2012). It was also noted that when debentures or subordinated debt is issued to debtors other than co-op members and employees, the term CCUs could cause unnecessary confusion and reduce the uptake of the instrument.

CCUs as debt instruments to reward patronage

Some experts are of the view that CCUs could be a distinct category of debt used to reward member patronage, which can subsequently be traded. Co-operatives generally rebate a portion of fees as a means of rewarding patronage. This commonly takes the form of a cash payment, in particular in the agricultural sector. In some cases, the reward is in the form of preference shares (not available as a reward mechanist to NDCs). The patronage reward is regarded as a "repricing" mechanism (Co-operatives WA 2016), meaning the initial price issued is tentative and only finalised at the end of the financial year. It should be noted that, while most distributing co-operatives provide goods and services only to active members, NDCs can or may, indeed, be required to service members and non-members alike, in which case a trading rebate would be paid to all patrons irrespective of membership status.

It should also be noted that CCUs awarded to members as a reward/repricing mechanism may need to be offered as an option to patrons against a cash payment, as it could otherwise be considered as a compulsory loan that can only be imposed on members under certain conditions and requires a special resolution.

Table 1 outlines the most likely characteristics of a CCU issued as debt instrument in a NDC model, differentiating between the purposes of rewarding patronage or raising capital. It includes comments on the most likely ownership, market and interest structure of such instruments. This is not intended to be an exhaustive list, rather a suggestion for CCU structures fit for purpose.

Table 1. CCUs as Debt within a NDC

Purpose	Ownership	Governance	Market	Interest	Other Comments
Reward Patronage and raise capital	**Outside**	**No control**			
• Awarded to all patrons in proportion to their business with the Co-op during a defined period (could be annually) • No ties to membership or share ownership • More CCUs can be issued on years of high profitability	• Rewarded based on patronage • Transfer-able between members and non-members	• CCU holders have no representation on the Board of the co-op	• Medium to long-term maturity • Subsequent to their issue can be sold/transferred to non-members, either via private sale, in a market facilitated by the co-op or a secondary market • Can only be redeemed through retained earnings, profits or a fresh issue of CCUs	• Fixed interest rate or can vary with a money market index	• Allows co-operative to offer competitive re-pricing while raising capital under terms determined by the co-op • Risk of low liquidity for holders of CCUs as attractiveness to investors and value of the instrument on secondary markets dependent on terms of issue • May need to be offered as an option to patrons against a cash payment, as it would otherwise be considered as a compulsory loan that can only be imposed on members under certain conditions and requiring a special resolution.
Raise Investment Capital	**Outside**	**No control**			
• Members possibly offered first right of refusal • No ties to membership or share ownership	• Purchased by members and non-members	• CCU holders have no representation on the Board of the co-op	• Short, medium or long-term maturity • Sold in a market facilitated by the co-operative or on a secondary market • Can only be redeemed through retained earnings, profits or a fresh issue of CCUs	• Fixed interest rate or can vary with a money market index	• Investor attractiveness will determine uptake.

CCU interest rate under a NDC model

Caution needs to be taken when determining the appropriate interest rate for debt-like CCUs in an NDC model. Distributing co-operatives have a lot of flexibility to reward patrons/members with hybrid instruments attracting fixed or variable returns that may be above market rates or awarded at the discretion of the board. An NDC needs to ensure an instrument passes the debt test and that it offers a risk-based, market-competitive interest rate to be certain it is not viewed as a distribution. Any CME should seek independent expert advice on these matters as they relate to their constitution and particular circumstances.

CCUs as Equity Instruments for NDCs

A CCU issue as an equity instrument with a dividend attached is not an option for an NDC. This is also the case for NDCs with wholly or partly owned subsidiaries. The NDC structure does not allow partaking in the surplus created by any subsidiaries on the basis of membership or patronage with the parent- NDC, as that would constitute a distribution.

Although there is a view that a NDC cannot issue equity-like CCUs, the authors have explored the applicability of an equity-like CCU for NDCs with share capital that does not attract any dividend, and is redeemed at par value. Such an instrument would obviously not be an attractive investment for external investors, but it could be taken up by members that benefit from the services of their co-operative. Such an instrument could be effective in raising seed capital or financial support to a NDC in financial distress. It is unlikely such an instrument would be offered as a reinvestment mechanism as part of repricing (rebate). Table 2 outlines what the authors deem to be the most likely characteristics of a CCU issued for this purpose.

Table 2. CCUs as Equity within an NDC

Purpose	Ownership	Governance	Redemption	Distribution
Raise (limited) equity	**Inside**	**No control**		
• Offered to members and prospective members/ beneficiaries • Potentially structured as a requirement to gain or retain membership	• No restriction on ownership but unlikely to be attractive to external investors • Past members and their beneficiaries can retain their holdings	• CCU holders have no representation on the Board of the co-op	• Redeemed at par value by the co-operative upon member application and at board discretion • Can only be redeemed through retained earnings, profits or a fresh issue of CCUs	• No distribution- Zero dividend

Equity Instruments for NDC Subsidiaries

In the case of a NDC that has wholly or partly owned, for-profit, subsidiaries (either distributing co-operatives (DCs) or IOFs), it is possible those subsidiaries can reward their customers or patrons or members through an equity instrument. It is stressed that a subsidiary is not able to distribute to the parent NDC's members. However, it can reward members through, for example, an issue of an equity-like CCU or a preference share (IOF). Subsequently such entities can distribute to their shareholders (CCU-holders).

An IOF subsidiary deciding to issue preference shares as a reward to all users (non-shareholders) would need to do so at market value, a process that would require the issue of appropriate documentation and external valuations for making an offer to the market. In this event, it would be strongly recommended that the subsidiary has a separate board of governance to that of the parent NDC. If the subsidiary is a distributing co-operative (instead of an IOF) it could issue equity-like CCUs to its members, a process that may attract less compliance costs when compared to an IOF issue of preference shares. Issues of transfer pricing and governance will need to be carefully considered in either case.

Table 3 outlines the likely characteristics of a CCU issued by a DC, depending on the purpose this instrument aims to serve. We differentiate between aiming to reward DC patronage and unlock member value, versus the need to raise investment capital. The latter is more likely to attract some governance control mechanism to increase investor attractiveness. It is stressed that the below suggestions are not an exhaustive list of options, rather scenarios that our research suggested would be likely to serve co-op, member and investor needs in each case.

Table 3. CCUs as Equity within a Distributing Co-operative subsidiary

Purpose	Ownership	Governance	Market facilitation	Distribution
Reward patronage & unlock DC members' value	**Inside** • Rewarded based on patronage • The buyer must be either a qualified member of the Co-op (past members and their beneficiaries can retain their holdings) or the Co-op itself **OR** **Outside** • Subsequent to their issue (and build-up of critical mass) transferrable between members and non-members	**No control** • CCU holders have no representation on the Board of the DC **OR** **Some control** • CCU holders nominate a predetermined number of independent directors to the Board of the DC (to be approved by members)	**Coop** • Sold in a market facilitated by the DC **OR** **Third Party** • Sold on a secondary market operated by a third party	**Variable** • Variable dividend as determined annually by the DC's Board **OR** **Combined** • Dividend with a fixed component (fixed or referable to market rates) and a variable component (at Board discretion or performance related)
Raise investment capital	**Outside** • CCU ownership open to members and non-members, with members possibly offered a first right of refusal • Mother co-op members may be also offered first right of refusal	**No control** • CCU holders have no representation on the Board of the DC **OR** **Some control** • CCU holders nominate a predetermined number of independent directors to the Board of the DC (to be approved by members) OR • CCU holders to elect a	**Coop** • Sold in a market facilitated by the DC **OR** **Third Party** • Sold on a secondary market operated by a third party	**Combined** • Dividend with a fixed component (fixed or referable to market rates) and a variable component (at Board discretion or performance related)

	predetermined number of independent directors to the board of the DC	

Risks and benefits associated with opening ownership to members or investors in distributing subsidiaries should be carefully considered. If a sub-set of members of the parent NDC co-operative has an interest in subsidiaries of the co-operative this could lead to portfolio and influence cost issues, as some members (and board members) would have a stronger investor hat than others in different sub-entities. If such equity issues are of significant value it is likely to increase governance complexities, costs and associated risk.

The recent experience of Murray Goulburn's MG Unit Trust listing on the ASX highlighted that opening co-operative ownership to external investors can complicate management and governance decisions. With or without ownership rights an investor is an important stakeholder that shifts the dynamics of a member-owned business to that of a dual ownership model.

In addition, while a distributing co-operative may issue equity to members so as to unlock member value and avoid horizon problems and demutualization pressures, it may find itself under greater pressure instead. As noted in the literature review, successful co-operatives can become demutualisation targets when member-owned shares trade below market value due to low liquidity.

CCU ISSUES IN WESTERN AUSTRALIA

The previous analysis illustrates the complexities associated with the application of CCUs in the non-distributing co-operative model. Case studies of debt and equity instruments applied by distributing co-operatives are likely to be inappropriate for a non-distributing co-operative, but could be relevant to its subsidiaries. Two cases of CCU issued in Western Australia were identified and are analysed below.

FRUIT WEST CO-OPERATIVE LIMITED - RAISING CAPITAL

Fruit West Co-operative Limited (FWCL) was founded by Western Australian fruit growers in 2012 to secure marketing rights to tree fruits covered by plant breeder's rights (PBR) and trademark protection. It manages an integrated supply chain on behalf of growers. The co-operative holds the Head Licence to commercialise the Western Australian bred PBR protected "Bravo" apple variety with growers requiring a licence from FWCL to grow the tree. The licence requires growers to deliver all Bravo variety fruit to the co-operative or the co-operative's licensed packers, marketers and subcontractors. This structure allows the co-operative to control the quality and timing of fruit to market and is termed a "closed loop" managed supply chain by the co-operative's management.

The Western Australia Agriculture Authority is the Head Licensee (owner of plant breeder rights and trademarks) and has ensured growers do not need to be members to apply to FWCL for a licence to grow the variety. While only a Western Australian grower can be a member of FWCL, the co-operative's varietal development plan is to have the variety grown Australia-wide. Co-op members have influence through FWCL's governance structures, whereas non-members do not. According to the board, there has not been a shortage of licences thus far and therefore there is no need for restrictions or selection criteria. The current requirement for the provision of services to non-members has the potential to introduce free-riding issues, although in other co-operatives with similar structural requirements in WA this has not been a major concern.

The capital structure of FWCL has shares and IDUs (Industry Development Units) held by members. Share capital is redeemable on exit; thus it is a non-permanent form of capital. FWCL has a limited share allocation ($10per member) to limit their exit liability. The rules (constitution) of FWCL allows for classes of member shares depending on the fruit type/industry in which a grower is engaged. Currently, FWCL has one class of member shares, as they are only active in the apple industry. The co-operative has been trading since 2014, while the rules allow for distribution of surpluses the co-operative has not yet paid rebates against patronage or member shares. In line with Western Australian co-operatives legislation FWCL operates under the 1-member 1-vote principle.

IDUs, on the other hand, take the form of permanent capital, redeemed only at board discretion if a buy-back scheme is decided. They are issued as a CCU under the Co-operatives Act 2009 (WA), and do not carry any rights to ownership (no voting rights at a meeting of members). IDUs are to be issued only to members as an entry requirement to FWCL. They were introduced in 2012, at which time the requirement was for a 1,000 IDU holding per member (at $1 per unit). Some were partly paid (members having a liability towards their co-operative) and, subsequently, the co-operative reduced the holding requirement to "up to 1,000 ICUs" for new members. ICUs can pay a distribution linked to the share dividend, however as noted above FWCL has not made any distributions to members thus far, this also applies to ICU holders.

The purpose of the ICU issue has been to raise seed funding for co-operative formation and operations. FWCL operates with a low-cost structure with minimal assets and capital needs. The IDUs structure has allowed the co-operative to raise and retain funds, minimising their liability upon any fluctuation of membership numbers.

Wesbuilders Co-operative limited - Allocating Collective Capital

Wesbuilders Co-operative Limited (WCL) was formed in 2004 as a supply co-operative for Western Australian residential home builders. They started with 13 members and membership has grown to 120 members that include new home, extension/renovation and light commercial builders. They have a strong network of over 100 preferred suppliers and aim to provide members with access to the most up to date product designs, product specifications and installation methods in the building industry. They reported member activity through the cooperative in excess of $33 million in 2014/15FY.

WCL was formed as a traditional co-operative, each member has one vote and holds an allocation of 100 member shares, shares are redeemable at their nominal value of $1.00 per share. Dividends can be paid on shares but none has been paid thus far, as the holding value is very low. The co-operative pays an annual cash rebate if surplus allows, which is in proportion to members' patronage. The rebate is called "trading bonus" and has been paid annually over the last seven years.

In 2012 WCL introduced Growth Capital Units (GCUs) into their capital structure, moving away from a traditional co-operative model. GCUs are issued as CCUs under the Co-operatives Act 2009 (WA). These equity-like instrument were introduced to allocate a portion of unallocated reserves that were building up on the co-operative's balance sheet and being held as collective equity. The allocation of GCUs was in proportion to members' patronage and was on the order of $1.25 million ($1 per 1 unit).

GCUs are transferrable between members, to non-members and can continue to be held by former member on leaving the co-operative. However, their liquidity is low. They attract a dividend at the board's discretion. They are redeemed only at liquidation or on the determination of the Board. A partial voluntary redemption offer was made under a 3-year capital adequacy management plan that aimed to: 1) continue to increase the trading bonus (regular, patronage-based, cash rebate), 2) pay market based GCU dividends and 3) provide further redemption opportunities when the co-op balance sheet reached a certain level (commercially confidential information).

The Managing Director and Board of WCL feel the GCU issue has been successful in achieving its goals. Effectively the capital growth on GCU's was paid out as a fully franked dividend (7% dividend in 2015 and 5% in 2016). The redemption scheme was offered to members in 2016. It was voluntary and resulted in a buy-back of about 25% of the GCUs on issue at the time.

WCL keeps detailed records of member patronage which they relate to the co-operative's collective equity, effectively knowing how much each member has contributed to the collective equity. These records allowed for the allotment of GCUs and could be used for any future issues. This GCU structure and distribution policy (capital gains) has strengthened members' ownership hat, rewarding those who have historically contributed to building the balance sheet; some of whom may not be ongoing users (patrons). The challenge of entrepreneurial co-operatives of this type that steer away from the traditional co-operative model is to balance the "Four Hats" of members; in this case the patron hat is rewarded by repricing and direct cash rewards while the owner hat is rewarded through capital gains distributed through GCUs.

GCUs were initially allotted with the intention to grow the business, potentially diversify and to fund this growth partially through common equity and partially through GCUs; providing an opportunity for members to take direct ownership stakes in those investments. If such plans were to be actioned, GCUs would have the potential to also strengthen the investor hat of members. This innovative structure has the potential to create further member incentives, noting the need to monitor and manage any portfolio issues that may arise.

NFP Co-operatives Internationally- Highlights of Capital Structures

The identification of Australian NDCs of considerable size with an interest in issuing debt or equity is challenging. Mutual enterprises operating in the health, insurance and finance sectors can be of significant size in Australia and a number of these follow not-for-profit structures. Credit unions, for example, are not-for-profit cooperative financial institutions, owned and controlled by members. Similarly, some health funds are not-for-profit mutual entities. Most of these not-for-profit entities have membership structures that reward patronage through competitive rates for products and services. Financial, insurance and superannuation mutual enterprises are regulated by different legislation and are overseen by the Australian Prudential Regulation Authority (APRA). The capital structures of NFP mutual enterprises have been excluded from this report as their legislative environment differs significantly to that of co-operatives nationally and internationally.

Methodology

The World Co-operative Monitor (WCM) publishes annual reports on the impact of the top 300 co-operatives and mutual enterprises on a global scale. WCM is a collaboration between the International Co-operative Alliance (ICA) and the European Research Institute on Cooperative and Social Enterprises (EURICSE). This project is the successor to the former Global 300 project, which published the top 300 list from 2004 to 2008. Whilst there is a 2016 edition of the WCM, that does not include a top 300 update. Therefore, our analysis based on the 2014 top 300 list, which remains the most current list for leading co-operatives on a global scale.

The methodology applied to identify the top NFP co-operatives globally was to review the 2014 WCM top 300 by turnover (WCM 2014). We excluded mutual enterprises operating in the "banking and financial services" and the "insurance" sectors, for the reasons already noted, namely the focus of this report was on NFP co-operatives that operate in significantly different legal and financial frameworks than these mutual entities. We were then left with 166 entries of co-operatives and mutual enterprises active in the following sectors (as categorised by WCM): Agriculture and food (95); Wholesale and retail (58); Industry (7); Health and social care (4); Other services (2). These entities were individually reviewed to exclude co-operative federations or networks. This left only six (6) NFPs, including CBH Group. One of these was taken over by a consortium of for-profit and non-profit enterprises subsequent to the formation of the list. An overview of these co-operatives is provided below. The analysis is based on publicly available information from third party publications and the organizations' own websites, including where possible sourcing their articles of incorporation and bylaws.

Royal Flora Holland (RFH)

Overview

Royal Flora Holland, legally Koninklijke Coöperatieve Bloemenveiling Royal Flora Holland U.A., is a Dutch co-operative of florists. It is one of the largest auction companies in the world, described by Forbes as

"Holland's Wall Street for flowers", in which more than half of the world's flowers move from grower to distributor (Karabell, 2016). RFH is headquartered in Aalsmeer, with locations in Naaldwijk, Rijnsburg, Eelde and Bleiswijk. RFH is the outcome of a 2007 merger between Flora Holland and Aalsmeer Flower Auction. It has a long history of local co-operative and association formations and mergers that goes back to 1911. RFH have operations and offices in Kenya, Ethiopia, Germany, Spain, Italy and Colombia (Royal Flora Holland 2015).

In 2015 RFH had 4,413 members (grower-suppliers), of which 638 were located outside the Netherlands. Kenya and Ethiopia account for 67% of RFH's imports. Most important export countries are Germany, England, France, Italy and Russia. They also had 1,740 non-member suppliers. RFH employed over 3,000 employees, of whom 48% worked full time. Collectively RFH employees worked a 2,437 FTE (Full-Time-Equivalent) a 5% reduction on the previous year. RFH reported a turnover of €4.6billion (1.4% increase to 2014), revenue of €392million, and profit after tax of €12million (Royal Flora Holland 2015). RFH was listed in the top 300 as n.93 with a reported turnover of US$6.02 billion in 2014 (WCM 2014).

The RFH auction system works in reverse, rather than bidding up the price, Royal Flora Holland's auction bids down. The bidding system is based on a clock that runs backwards. Bidding starts at 1 Euro and goes down; buyers stop the clock at the price they want to pay and then advise how many plants they want. The average price for flowers between 2011 and 2014 was 22 cents; for house plants about 1.60, and for garden plants 93 cents (Karabell 2016).

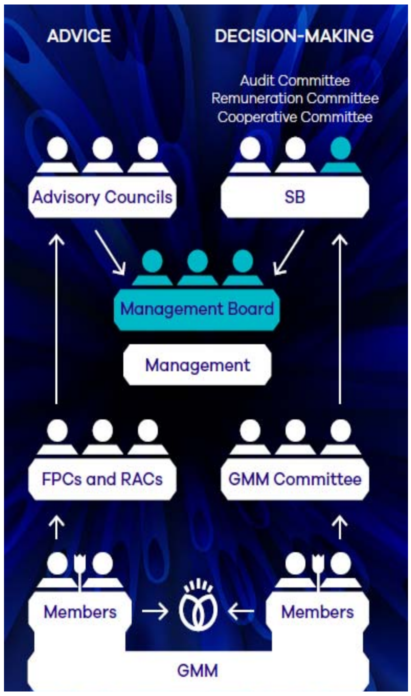

Figure 6: RFH Governance (Source: RFH Annual Report 2015)

Governance Structure

The senior management team of RFH includes the CEO and CFO (Management Board) and six division managers underneath them. RFH has a complex governance, advice and supervision structure that includes a Supervisory Board (SB), but also Advisory Councils, Royal Flora Holland Product Committees (FPC) and Region Advisory Committees (RAC). In addition, RFH set up a Customer Platform in 2015 with representatives of directors and owners of various categories of trading companies. The most senior decision-making body of the co-operative is the General Member's Meeting (GMM).

Capital Structure

A new capital structure was approved on the 2nd June 2016 GMM and was implemented from 1 January 2017. Previously members financed the co-operative through a participation reserve (understood to be an equity contribution redeemed at par value) and a members' loan that was supplemented each year by withholding 1% from member revenue (referred to as liquidity contribution). The latter was a rotating debt instrument, attracting an interest and the principal returned after eight years. If the co-operative made a loss this was to be covered from the members' liquidity contribution, reducing members' entitlement.

The new capital structure no longer uses member's capital to cover losses. Members' loans and the participation reserve were converted into Certificates A and B. The 1% withholding from member revenue is retained. Members initially accumulate Certificates A of up to €20,000 that are registered in their names and remain within the co-operative for the duration of their membership (equity-like instrument). Once the Certificate A has reached the desired threshold members will then accumulate Certificates B. These are also registered by name, but are interest bearing (subordinated debt instrument with voting rights) and follow the previous rotating structure, the principal being repaid after eight years.

If the cooperative's risk-bearing capital falls below a threshold of 45%, distribution is not permitted and no payment on Certificates A and B can be made. This is intended to maintain the cooperative's capital position at an appropriate level, while the members retain their entitlement to their capital. If the equity rises above 55%, the Management Board may propose to pay out additional Certificates B to members.

In 2015, interest on members' loan was paid at a rate of 1.4% (2014: 1.6%). It is unclear to the authors how the interest rate is determined. Furthermore, in 2015 the total amount of the withheld liquidity contribution (1% of members and non-members' sales) was €46.0 million (2014: €44.8 million). The previous structure allowed for voluntary member's loans that attracted a higher interest (1.9% in 2015; 2.1% in 2014), it is not clear if voluntary member loans are part of the new structure. Finally, supplier loans with various repayment terms were also part of the old structure and have transitioned into Certificates D.

It should be noted that the capital restructure is concurrent with a strategic target to reduce co-op running costs by one third and a streamlining of the types of membership that used to differ depending on the legal structure of member-grower. The new structure did not affect voting proportions, according to which members can obtain additional voting rights depending on their Certificate A and B holdings.

For more information, readers are directed to RFH publications (Meskers 2016; Royal Flora Holland 2015, 2016) that have informed this analysis.

HEALTHPARTNERS, INC. (HPI)

Overview

HealthPartners is an integrated health care organization providing health care services, health plan financing and administration, and medical research and education. HPI was listed in the top 300 as n.104 with a reported turnover of US$5.51 billion in 2014 (WCM 2014). HPI was founded in 1957 as Group Health Plan, Inc., a non-profit co-operative, governed by member-consumers who formed the board of directors. In 1992 Group Health merged with MedCenters Health Plan to form HealthPartners. On January 1, 2013 HealthPartners merged with Park Nicollet Health Services of St. Louis Park.

HPI is the largest consumer governed, non-profit, health care organization in the USA, serving more than 1.5 million medical and dental health plan members nationwide. The HPI care system includes a multispecialty group practice of more than 1,700 physicians that serves more than 1.2 million patients. HealthPartners employs over 22,500 people, has won multiple industry awards for the quality of their services, their physicians and as a leading employer. In addition to their clinics and hospitals, HPI operates twenty on-site health clinics for several organisations, an Institute for Education and Research and an online clinic with certified medical professionals who can diagnose and treat over 60 health problems online. In 2015 HPI's total cost of care was for the fifth year in a row lower than the regional and national benchmarks (17% lower than Minnesota costs, 7% lower than regional costs, 2% lower than national costs). (HealthPartners, Inc. 2015)

Governance

Membership

HPI has one class of members and each member is entitled to one vote. A member shall be a) a contract holder who holds a health maintenance contract for health care services issued by HPI, or (b) any contract holder who receives health care services through a self-insured contract administered by HPI or one of its related organizations if so designated. Proxy voting and cumulative voting are prohibited, mail voting or voting by electronic communications is the only methods used for voting by the members on any matter (Amended and Restated Bylaws od HealthPartners, Inc.).

Board of Directors

Since 2016 the Board is composed of fifteen members as follows: eight Member-Elected Directors, three Member-Elected Directors of Group Health Plan, Inc., and four Provider Directors. As a care system, HPI recognises that the voice of physicians is very important. In order to have this voice in the organization, the Board appoints four physicians as voting directors (called Provider Directors). The Chief Executive Officer is a nonvoting ex officio member as is the Care Group President (Amended and Restated Bylaws of HealthPartners, Inc.).

The Governance Committee nominates candidates for Member-Elected Directors after soliciting input from members and providing at least two weeks' notice prior to the nominations. A set of requirements is listed in the co-op bylaws, including that at least forty percent of the total number of directors must be either covered by a health maintenance contract of HPI or covered under an employer-insured contract administered by HPI or one of its related organizations assigned by the Governance Committee. Election of Member-Elected Directors is valid only when 250 of the Members entitled to vote cast a ballot (Amended and Restated Bylaws of HealthPartners, Inc.).

Capital Structure

The precursor of HPI, Group Health Plan, was founded under the Minnesota Non-profit Corporation Act (Minnesota Statues Chapter 317A) on a “membership basis without capital stock”. All of its income was to “be devoted to the furtherance of its purposes on a non-profit basis” and “shall not afford pecuniary gain, incidentally or otherwise, to its members, officers, or directors” (Articles of Amendment Amending and Restating the Articles of Incorporation of Group Health Plan, Inc.).

Group Health Co-operative (GHC)

Overview

Group Health Co-operative (GHC), was listed in the top 300 (WCM 2014) as n.142 with a reported turnover of US$3.68 billion in 2014. Group Health was founded in 1945 as a non-profit organization with members, it was originally named Group Health Cooperative of Puget Sound, the “of Puget Sound” was dropped in 1955. Group Health along with other non-profit insurers was criticized by the Seattle Times (Ostrom 2012) for building up their reserves whilst their rates were increasing. In December 2015, it was announced that Kaiser Permanent would acquire Group Health (Evans 2015). The acquisition of Group Health and its subsidiaries took place on 1st February 2017 (Kaiser Permanente 2017) following endorsement by Washington State regulators. The acquisition further led to the formation of Group Health Community Foundation, a non-profit entity that does not have any members (Articles of Incorporation of Group Health Community Foundation, Bylaws of Group Health Community Foundation).

Kaiser Permanente is a consortium of for-profit and non-profit organisations, offering health insurance and medical care in the USA. Kaiser Foundation Health Plan (KFHP) is one of the largest non-profit organisations in the USA. KFHP and its regional operating subsidiaries, Kaiser Foundation Hospitals, do not have members with the power to appoint or elect board members, meaning that the board itself nominates and appoints new members.

Kaiser Permanente and Group Health Community Foundation are therefore not co-operatives and were not investigated further.

Acquisition structure

Little information is publicly available on the capital and ownership structure of the former Group Health Co-operative. However, from the acquisition details it can be inferred that members owned capital stock that was repaid at par value upon member exit.

The acquisition of Group Health was agreed at US$1.8billion, allocated as follows (Group Health Cooperative 2017):

- $1.724 billion for the establishment of the non-profit Group Health Community Foundation

- $1.2 million to refund Group Health members one-time refundable membership fees or "dues" that they paid to become voting members (or members may choose to donate their refund)

- $75 million set aside to pay "any potential indemnification obligations that may arise under the Agreement". Any unclaimed amount will be released after 15 months and paid to the Group Health Community Foundation.

National Cable Television Cooperative, Inc. (NCTC)

Overview

National Cable Television Cooperative, Inc (NCTC) is listed in the 2014 top 300 as n.184, reporting an income of US$2.78 billion (WCM 2014). It is a non-profit organisation that according to Bloomberg "operates as a programming and hardware purchasing organization for its member companies who own and operate cable systems in the United States and its territories. The company offers marketing support and memberships, as well as access to discounted services, including billing, negotiating, and training services to cable networks, cable operators, content providers, and hardware companies. It also collects and pays the hardware invoices on behalf of its member companies. The company was founded in 1984 and is based in Lenexa, Kansas." (Bloomberg 2017)

Unfortunately, very little information is publicly available on NCTC, their official website is not accessible without a log-in, no annual reports or other official documentation on their ownership, governance or financial structure. is made public.

In 2003, the US Department of Justice provided a positive response to NCTC's request for review of their business with a particular focus on a new proposed set of procedures. The new process would see members wishing to participate in a new master contract with a program supplier to state their reserve prices before negotiations and be required to participate in the contract if the contract price equals or falls below the members' reserve price. Members would still be able to participate in the contract if they did not state a reserve price. It was advocated that the previous procedure could not guarantee any volume participation in a contract, thus hindering NCTC's ability to negotiate volume discounts achieved by large multiple systems operators (their competitors). (Pate 2003)

Société Internationale De Telecommunications Aeronatiques

Overview

SITA is a co-operative association, owned and operated by and on behalf of the Air Transport Community. It was incorporated in Belgium on the 23rd of February 1949. For over 50 years it has been providing network, communication and related IT based application services for its members on a not-for-profit basis. SITA seeks as its primary objective "to foster all telecommunications and information processing required in the operation of the air transport industry with the aim of promoting in all countries safe and regular air transport;" (Articles of Association Art. 3, SITA 2000).

SITA is owned and governed by more than 400 air transport industry members. It has a global presence in over 200 countries, more than 1,000 airports and supports more than 30 governments in border management. It is listed in the 2014 top 300 as n.266, reporting an income of US$1.69 billion (WCM 2014). SITA provides services in two broad categories: managed global communications (including infrastructure, cloud and outsourcing services) and services for airline commercial management. The latter includes passenger operations, flight operations, aircraft operations, air-to-ground communications, airport management and operations, baggage operations, transportation security and border management, cargo operations and others. They have strategic partnerships with Motorola, Orange Business Services and Riverbed amongst others and have won multiple awards in the IT and Aviation Industries.

Governance

SITA has three governing bodies, the SITA Board, SITA Council and SITA Secretariat (SITA 2017a).

The Board is composed of 14 directors (including the CEO), the term of office for elected members being three years with one third of the seats being available for re-election on an annual basis. The Board has two standing Committees: The Audit and Risk Management Committee and the Remuneration Committee. (SITA 2017a)

The SITA Council is a member representative body that is consulted on matters having material impact on services provided to SITA members and has the final approval over matters relating to high-level direction of SITA. The SITA Council has two standing committees. The Nomination Committee nominates SITA Board Directors and SITA Council President and Deputy President for appointment by the General Assembly of Members. The Membership Committee addresses membership policy and rules, as well as member admissions and expulsions. The SITA Council is further an important communication instrument between SITA and their member that is further required to gather views and report back to the community on Council actions. (SITA 2017a). The association recognises the challenge of "providing a meaningful and representative governance structure" to the air transport community of their members, as it is dynamic and global with diverse interests from large computerized reservation systems that serve airlines and their travel agents around the world to small regional airlines with limited needs (SITA 2000). This is addressed by the composition of the SITA Council which has up to 34 representatives, 20 from SITA's top 20 customers, 10 airline geographical group representatives and four industry-specific group representatives (SITA 2017a). This structure aims to provide "flexibility, stability and a spread of expertise, experience and regional knowledge, mixed with addressing the interests of both large and small users. It is also neutral (SITA 2000)". The SITA Secretariat is the body responsible for observing and executing statutory governance functions and requirements. It further organizes the statutory meetings, including the Annual General Assembly, manages the Shareholder Registry and all membership matters.

Membership

"Any company, group or organization operating aircraft for the transport of passengers, mail or cargo, or any company, group or organization whose primary business is related to the air transport industry (an "ATI member"), or any eligible institution may request admission to the membership of SITA SCRL if they already are, or intend to become, a customer of SITA" (SITA 2017b).

An "eligible institution" in the above definition is either "an international organization, which forms part of, is an agency of, is affiliated to, is associated with, or is deemed by the SITA Council to have a role similar to the United Nations in terms of its mission and global reach" or "any governmental or non-governmental, national or international regulatory agency, which governs or supports the activities of the air transport industry" (SITA 2017b).

Capital Structure

SITA membership requires the purchase of one share valued at 5 euros (SITA 2017b). Members receive "rebates on not-for-profit network services", amongst the other benefits of membership communicated as: having a voice in shaping the industry of tomorrow, participation in the Board or Council, and free admission to the Air Transport IT Summit (SITA 2017c). The extent and structure of rebates is not public knowledge. In a submission to ICANN (Internet Corporation for Assigned Names and Numbers), SITA notes that shares in the association are allocated annually, based on percentage of use (Articles, Chapter II, SITA 2000). Further details on SITAs capital structure is not publicly available.

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