BUSINESS COUNCIL
OF CO-OPERATIVES AND MUTUALS

Competition in Australia's Financial System inquiry

Submission from Business Council of Co-operatives and Mutuals to the Productivity Commission inquiry into Competition in the Australian Financial System

September 2017

Competition in Australia's Financial System inquiry
Productivity Commission
GPO Box 1428
Canberra City ACT 2601

15 September 2017

Dear Commissioners

Submission to the Productivity Commission inquiry into Competition in the Australian Financial System

The Business Council of Co-operatives and Mutuals (BCCM) welcomes the opportunity to make a submission to the above inquiry.

The BCCM represents Co-operative and Mutual Enterprises (CMEs) operating in all sectors of the Australian economy. CMEs operating in the financial system include credit unions, mutual banks, building societies, member-owned superannuation funds, mutual insurers and friendly society funds. The customer-owned ADI sector alone has assets of more than $100 billion, and collectively is one of the most significant competitors to the big four banks.

The BCCM strongly believes that the unique structure and purpose of member-owned financial institutions serves to increase the resilience and level of competition in our financial system. However, legislative action to create a level playing field is needed if the CME financial institutions are to continue adding to the level of diversity and competition in our financial system into the future.

Our submission outlines these points in more detail as follows:

1. About the BCCM
2. About Co-operatives and Mutuals
3. BCCM supports diverse corporate ownership
4. The business purpose of co-operative and mutual enterprise aids competition and choice
   - 4.1 CMEs provide competition and choice for consumers
   - 4.2 CMEs contribute to corporate plurality and diversity
   - 4.3 CMEs promote economic resilience and sustainability
5. Action to increase competition from the CME sector
   - 5.1 CMEs need more flexibility in accessing working capital
   - 5.2 In many countries, mutuals do not face the same restrictions on raising capital as in Australia
   - 5.3 The Federal government should legislate to improve corporate law for Australian CMEs
   - 5.4 CMEs should have the option of legal protection from hostile takeover
6. Appendices

The BCCM welcomes the opportunity to provide additional information or comment on any aspect of this submission at any further hearings the Commission may hold.

Yours faithfully

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1 About the BCCM

The BCCM is the peak body for Australian co-operatives, mutuals and member-owned enterprises. The BCCM represents a diverse range of enterprises operating in sectors including agriculture, finance and banking, insurance, superannuation, motoring services, health services, aged care, disability employment, education, indigenous services, housing and retail.

The BCCM advocates for recognition of the sector and for measures that create a level playing field between co-operatives and mutuals and other businesses, including implementation of the recommendations of the Senate Economics References Committee report into Cooperative, mutual and member-owned firms.[1]

2 About Co-operative and Mutual Enterprises

Co-operative and mutual enterprises (CMEs) are important Australian owned businesses: 8 in 10 Australians are members of at least one CME and annual turnover of the top 100 CMEs (excluding member-owned superannuation funds) reached $30.5 billion in FY2014/2015.[2] Together with mutual superfunds, it is estimated that the CME sector contributes 6 per cent of GDP.

The distinguishing feature of all CMEs, regardless of what legal form they use, is that they are owned by their members and operate for member benefit. Member benefit can mean a wider range of social or non-financial benefits compared with the financial returns enjoyed by a shareholder. Membership is tied to contributing to or making use of the CME's services; this ensures the co-operative or mutual is made up of people who share its common purpose.

Broadly speaking, there are three types of CME – customer-owned, worker-owned and producer-owned.

Customer-owned: The objective is service, quality and price, rather than profit maximisation. Examples of these businesses exist in financial services (such as CUA, Heritage Bank, P&N Bank), insurance (HCF, RT Health), food retail (The Co-op - Barossa), health (National Health Co-operative) and motoring services (RACQ, NRMA, RAC WA).

Worker-owned: The objective is high quality employment that properly rewards employees, provides workplace democracy and shares wealth. An example is design and engineering firm Arup Group.

Producer-owned: The objective is the viability of small businesses in markets that would otherwise be dominated by large investor-owned firms. Co-operatives enable small primary producers to combine their efforts to compete. Well known examples of producer co-operatives are Co-operative Bulk Handling (CBH Group), Capricorn Society and Murray Goulburn.

[1] http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Cooperatives/Report

[2] Business Council of Co-operatives and Mutuals, National Mutual Economy Report 2016, 17. http://bccm.coop/wp/wp-content/uploads/2016/11/BCCM-NME-Report-2016.pdf

The vast majority of CMEs are incorporated and regulated under one of two legislative regimes: the State/Territory-based Co-operatives National Law (the CNL)[3] or the Commonwealth Corporations Act. CMEs providing financial services are generally registered as companies. A company under the Corporations Act is a co-operative or mutual if it adopts a co-operative or mutual constitution.

3 BCCM supports diverse corporate ownership

Among policymakers, a new awareness has emerged of the importance of spreading risk in economies by ensuring the presence of a plurality of business types. Along with listed investor owned firms and family owned enterprises and charities, co-operatives and mutuals have an important part to play in the biodiversity of our economy.

A vibrant economy requires businesses of all types to be able to compete, regardless of corporate form. This means that appropriate legislative frameworks are required that do not restrict particular types of firm from being able to access the finance capital that they need to facilitate their growth and development.

4 The business purpose of co-operative and mutual enterprise aids competition and choice

CMEs exist when groups of individuals come together to achieve an objective that they could not achieve alone. They are a rational alternative to investor-owned business models when the objective is different from that of maximising return to shareholders.

CMEs often come about as a response to the failure of a market to adequately serve the interests of groups of customers, workers or producers, such as where services and products are unavailable or otherwise not accessible to groups of people.

The point of a CME is different from investor-owned businesses. It is focused on delivering its mission, rather than maximising return to shareholders.

Because the CME business purpose is different, these firms behave differently, pursuing business plans that aim to secure long term success for their members. As a result, they positively affect the markets in which they operate, often by restricting the profit taking of investor-owned firms that must compete with them.

4.1 CMEs provide competition and choice for consumers

Because of their different ownership structure and purpose, co-operatives provide extra competition and choice in the market place. They frequently offer products which differ from those of their competitors and can focus on different parts of the market. For example, mutual ADIs like Heritage Bank and Regional Australia Bank provide choice to regional communities.

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[3] Co-operatives National Law has been adopted in all States and Territories except Queensland. Western Australia has adopted consistent legislation.

4.2 CMEs contribute to corporate plurality and diversity

The member ownership of CMEs creates corresponding diversity in forms of:

- corporate governance;
- risk appetite and management;
- incentive structures;
- policies and practices; and
- behaviours and outcomes.

Because of their ownership structure, CMEs pursue business strategies aimed at long-term sustainability, contrasting with listed companies that require shareholder-led, short and medium-term business strategies.

CMEs actively contribute towards corporate diversity because their reason for existence – their business purpose – is different to that of publicly listed businesses.

All businesses exist to serve their owners. The difference with CMEs is that their owners are their members, who may be customers, workers or those with shared interests. This means that CMEs can focus on the needs of their members instead of the demands of external investors.

4.3 CMEs promote economic resilience and sustainability

The evidence from the global financial crisis is that CMEs have generally been more resilient than listed firms.

During the financial crisis of 2007/2008 and the following years of economic turmoil, CMEs in the financial sector have not faced the levels of difficulty encountered by the banking sector and by certain other insurers.[4]

Australian CMEs play an essential role in the global economy, especially in times of crisis, by:

- combining profitability with solidarity;
- creating high-quality jobs; and
- strengthening social, economic and regional cohesion.

5 Action to increase competition from the CME sector

Whilst CMEs remain a strong component of the Australian economy it is clear that in an increasingly competitive global environment mutuals need to ensure they are equipped to compete in the future.

[4] See generally the International Labour Organization report 'Resilience in a Downturn: The power of financial cooperatives', available at http://www.ilo.org/empent/Publications/WCMS_207768/lang--en/index.htm

5.1 CMEs need more flexibility in accessing working capital

Like all businesses, co-operatives and mutuals need access to working capital to fund their growth and development. However, the way that their capital is raised - through retained earnings - presents particular challenges to their ability to operate as flexibly as their investor-owned competitors do.

This is a function of the lack of legal options available for federally registered co-operatives and mutuals; the Corporations Act does not currently provide for them to issue securities to investors without risking their mutual status.

5.2 In many countries, mutuals do not face the same restrictions on raising capital as in Australia

Although facing the same natural limitations on raising capital as Australian mutuals, mutuals across the world raise additional capital in a variety of different ways. Some types of capital raised in Europe exhibit equity-like features and are available to institutional investors, whilst others are raised directly from members.

We can give examples of successful international businesses that have, for many years, been permitted to raise funds from their members and investing institutions, because this is permitted in the jurisdictions in which they operate.

In the UK, where similar barriers have existed to those in Australia, new legislation has been passed to enable CMEs to issue securities that are within the ethos and purpose of these mutually owned businesses.

5.3 The Federal government should legislate to improve the corporate law for Australian CMEs

Currently, the only mention of mutuals in the Corporations Act 2001 refers to how they may be demutualised.

There is no statutory definition for a mutual in Australia[5]: those businesses that describe themselves as mutuals do so voluntarily as an expression of their business purpose; it is not a statement of legal form.

As such, mutuals will typically register as a company under the Commonwealth Corporations Act 2001. This means that mutuals may be a public company limited by shares, a company limited by guarantee, or a company limited by shares and guarantee.

By amending the Corporations Act to define an 'Incorporated Mutual Company,' and creating a new capital instrument for mutual businesses that currently have no permanent investment capital, the Federal Government would enable them to attract additional working capital to fuel the development of their businesses.

[5] The legislative environment for CMEs is also discussed in the final paragraph of section 2 above.

5.4 CMEs should have the option of legal protection from hostile takeover

There is an important difference between the legislative frameworks prevalent in most EU states and Australia in relation to the principle of 'disinterested distribution'. A 'disinterested distribution' or 'asset lock' requirement acts as a legal barrier to demutualisation by removing the incentive for current members to cash out the value of the business. In effect, on a solvent winding up, assets and reserves in a mutual entity may only be transferred to another body that observes the disinterested distribution principle and has similar aims. The assets cannot be transferred to, for example, a for-profit company, or distributed to members.

This type of 'disinterested distribution' provision is commonly applicable to co-operatives across many EU jurisdictions, but is not available through legislation to Australian CMEs.[6] As a consequence, mutuals and co-operatives have constructed sometimes elaborate defences against demutualisation.

Demutualisations that have occurred in the UK have been brought about by current members seeking to cash out the value of the organisation (or a proportion of its value) against its intended purpose. Demutualisations, particularly in the financial services sector, have had negative effects on competition, choice and value. Such events have been avoided in other EU countries by the consistent application of the principle of disinterested distribution.

[6] State/territory-registered non-distributing co-operatives have a legislative restriction on distributions to members. However, there are two issues with this legislative restriction. Firstly, there is no legislative restriction on conversion from non-distributing to distributing status for co-operatives (so there is merely an extra step involved in order for members to "cash out" the value in the co-operative). Secondly, and more importantly, there is no option to combine periodic distributions of surpluses to members with a restriction on access to the capital of the co-operative in a demutualisation.

Appendices

- BCCM publication - Raising New Capital in Mutuals: Removing the barriers to competition and choice
- BCCM Submission to the Treasury consultation on Reform for cooperatives, mutual and member-owned firms