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# Co-operatives in Context

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The material in this extract is drawn from *Co-operatives: Linking practice and theory* (Adderley, in press). This extract explains some of the descriptors of co-operatives, their characteristics, and their interaction with legal structures.

## Co-operatives in Context

The term co-operative is a descriptor of a type of enterprise with certain characteristics, such as the value of self-help, and principle of democratic member control — as set out in earlier chapters. This descriptor sits within a landscape populated by others, including:

- Mutuals
- Employee-owned businesses
- Charities
- Social enterprises
- BCorps
- Investor-owned businesses

These descriptors are broad and tend to be less well defined in law. For instance, in the UK, there is no overarching legal definition of the term co-operative or mutual. The outlier in the list is 'charity' — which is defined in law but is not the focus of this text. In being less well defined, the terms are open to variations in use. One person may consider something to be a co-operative that someone else does not. Some of these descriptors can also overlap, to a degree. For example, some will regard a co-operative as a type of mutual, and as a social enterprise. In seeking to understand whether something is a co-operative, or whether it sits within any other descriptors, it is important to understand the distinguishing features of the entity, and the reasons for classifying it.

Descriptors, as used here, are distinct from legal structures (sometimes referred to as legal forms or legal entities, corporate structures etc.) — such as a public limited company, co-operative society, or charitable incorporated organisation. There is an overlap between descriptors and legal structures. Generally, most businesses will be constituted using a

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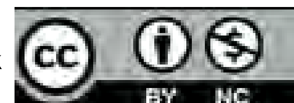

particular type of legal structure (sometimes referred to as being incorporated, registered, or chartered). Sometimes the overlap is self-evident: something registered as a co-operative society will fit within the descriptor 'co-operative'. Similarly, something registered as a charitable incorporated organisation fits within the descriptor 'charity' as a matter of law. In other instances, the overlap will be less clear: a private company limited by shares, a type of legal entity registered under the Companies Act 2006, may be a mutual, co-operative, social enterprise, BCorp, or — to some people — all of those simultaneously.

Attempts are often made to classify the economy by systems of sectors — traditionally split into the private, public, and third sector. This extract concludes by highlighting how co-operatives do not sit easily within this approach and introduces classifications such as the social economy, and social and solidarity economy.

## Distinguishing Features

It is important to start with: why? The reason for needing to find similarities or differences between organisations will change the focus. For example, if you are the state or a charitable foundation and need to ensure money you are distributing is used only for a particular purpose, you will naturally focus on the purpose for which an organisation exists. You will also want to look to other factors, such as who can benefit, and what happens to any profits (both in the life of the organisation, and on solvent closure). In other circumstances, you may be looking to facilitate engagement by people in a particular plan, in which case, how the organisation is controlled may be particularly important — is it one-member-one-vote or controlled exclusively by a founder.

Points of similarity and difference tend to be found by looking at:

| Purpose | What does the organisation exist to do? |
|---|---|
| Powers | Can the organisation do anything to pursue its purpose, or are its powers restricted in some way? Does it need to be a 'legal person' who can enter contracts in its own name and sue and be sued. Or can it be unincorporated with people appointed to hold property on trust for it? |
| Benefit | For whose benefit does it exist to do that? It could be its members, investors, the public, a particular subset of the public, people falling into categories — e.g. those who are homeless. |
| Activity | What activity does it carry out? Is it a trading business, or a grant awarding foundation, for instance. Can it carry out any activity? Is that activity regulated? |
| Ownership | Who owns it? And on what basis? Is it owned by another entity, by the government, by individuals (who, and how many). Is it owned equally, or is ownership shared based on some other formula (e.g. proportionate to the level of your investment in it). Does it have shares, or is it owned in some other way? Is ownership direct, or indirect through some kind of trust? |
| Control | Who controls the entity? And on what basis? Is it democratically controlled, and if so — is that based on equal votes or votes per share. Is it controlled by one individual, one family, etc. |
| Financing | How is it funded? Does it receive state aid or grant funding, or does it receive its income through profit from trade, or something else. |
| Profit | Does it intend to make profit, and — more importantly — how does it intend to use its profit? Can profits be distributed to anyone, and if so, who and in what proportion? |
| Assets | Can it use its assets in any way it likes, or are they restricted in their use. Is there a restriction (lock) on the use of the assets (e.g. a building must be kept), or a restriction on the use of the value of the assets (e.g. the building can be sold, but profits from the sale must be used in a particular way). Is the restriction mandatory and permanent, or voluntary and changeable, or something in between. |
| Liability | Who is financially liable for the organisation, and is that liability limited? Is it its members, and if so, to what extent? Is the state ultimately liable? Are its members liable to an unlimited amount? |
| Dissolution | What happens when it wants to solvently wind-down? Can profits go to owners, or must they go somewhere else? |

Sometimes these features will be enshrined in law. For example, the objects of a credit union (a type of consumer co-operative) are prescribed in legislation (Section 1(2A), Credit Unions Act 1979) — thus restricting its purpose. In other instances, a feature may be voluntary. For example, an organisation may say it donates a percentage of its profits to good causes, but the questions is whether it is legally required to do so or if it is a decision voluntarily taken which could be reversed.

Some of these features vary from one co-operative to another and can generally be determined by looking at the rules (also known as the constitution, articles of association, etc.) of the individual co-operative. For example:

- Profits: some co-operatives will distribute profits to their members through a dividend on purchases, as in the case of a consumer co-operative. In a worker co-operative, it may be done through some kind of bonus to workers. Some co-operatives may not pay any form of dividend.

- Dissolution: some co-operatives will have all funds dissolving to their own members on solvent dissolution (often referred to as co-ownership). Others will have rules specifying the funds must go to some other organisation, like a similar co-operative. This tends to be referred to as common ownership.

In setting up a co-operative, understanding each of these features will help to determine the legal form, and the sort of clauses to include in the rules.

## Descriptors

This section briefly explains the following descriptors through the lens of their relationship to co-operatives: mutuals, employee-owned businesses, charities, social enterprises, BCorps, and investor-owned businesses.

## Mutuals

There are different descriptors that place co-operatives and mutuals together. Birchall (2022a) popularised use of the 'member owned business' (MOB). Mazzarol et al. (2018) prefer 'co-operative and mutual enterprises' (CME). Much less commonly, Parnell (2018) uses 'self-help enterprises' (SHE) as a collective term. Most recently, the term 'inclusive and democratic business models' (IDBMs) has been used to group together businesses with democratic ownership. Mcinroy (2024) uses IDBMs to:

> … refer to social enterprises, employee-owned businesses, worker co-operatives, co-operatives, Development Trusts and other forms of democratic ownership models. These are referred to as the Social and Solidarity Economy, Social Economy or Inclusive and Democratic Enterprises in other countries and academia. In using the term IDBMs, we are not diluting individual elements but augmenting by giving them more collective strength. Furthermore, whilst there are distinctions between the different types of IDBMs, they are not mutually exclusive and there is crossover and bleed between these forms. (p. 7)

There is no legislative definition of 'mutual' in the UK. The term mutual is often used in a broad sense, to cover a range of organisations including co-operatives, friendly societies, building societies, and other organisations. For example, Parliament used 'Mutual Societies' to refer to the function given to the Financial Conduct Authority under The Financial Services Act 2012 (Mutual Societies) Order 2013. In its loosest definition, a mutual is an organisation owned by its members, and democratically controlled by them. Birchall (2022b) articulates this at a high level as follows: "Mutuals are part of a class of organisations (also including co-operatives and associations) that have one common feature — they are membership-based" (p. 135).

Some say that "all co-operatives are mutuals, but not all mutuals are co-operatives" (Nuttall, 2012, p. 74). Birchall (2011), however, articulates in more detail three common distinctions between co-operatives and mutuals. The first is that the term 'mutual' is usually applied to member owned businesses operating in financial services. Their purpose is to raise funds from their customers to provide them with services including savings and loans, and insurance. This is usually done "through recycling money within a closed system that does not include — or need — outside investors" (Birchall, 2011, p. 6). Second, different stakeholders can take part in governance — providing the example of building societies with customers as savers, borrowers, or both. Finally, "mutuals insist that customers become members, while co-operatives often have dealings with customers who are not members" (Birchall, 2011, p. 7). This includes consumer co-operatives.

Taking a historical approach, Laville (2023) explains that during the second half of the 19th century, "co-operatives were distinguished from mutuals, with the former becoming a type of capital company focused on production or consumption, while the latter focused on providing assistance" (p. 69). This explanation sees mutuals focusing on areas linked to state protection. This could be seen in the case of friendly societies in the UK, who focused heavily on providing insurance for sickness and health.

The term mutual is often used precisely within Europe. Within the European Union, mutuals account for around 25% of the insurance market and are described as:

> … enterprises providing life and non-life insurance services, complementary social security schemes, and small value services of social nature. Their primary purpose is to satisfy common needs while not making profits or providing a return on capital. Mutual societies are managed according to solidarity principles between members who participate in its corporate governance. They are intended to be accountable to those whose needs they were created to serve. (European Commission, n.d., para. 1)

For statistical purposes, the United Nations articulate the difference as follows: "Mutual societies differ from cooperatives, however, in that they are mechanisms for sharing risk, either personal or property, through periodic contributions to a common fund" (United Nations Statistics Division, 2003, p. 22). In contextualising co-operatives, mutuals and other types of organisations, the United Nations explain that they would not generally class co-operatives and mutuals as non-profit institutions and would instead include them in the commercial sector, but notes they operate in a "gray area between the non-profit sector and either the corporate or government sectors" (United Nations Statistics Division, 2003, p. 22).

Further articulation on the differences is given elsewhere:

> The main difference in behaviour between co-operatives and mutual societies is that the mutuals operate with own funds which are collective and indivisible, rather than with a capital represented by shares that are bought by the members. The members of mutuals pay a fee rather than acquiring shares, whereas share purchase is obligatory in the co-operatives. In the mutual societies, member and policy-holder are totally and exclusively one and the same, whereas it is possible for some co-operatives to have (a minority of) non-user members. Another point is that there is no undistributable equity in mutual societies, whereas this is a possibility for co-operatives in many countries. (Barea & Monzon, 2006, pp. 46-47)

Others have articulated the main difference as the fact that, unlike co-operatives, "mutuals are not established through the provision of capital provided by members" (Sanchez Bajo & Roelants, 2011, p. 127). Defourny and Develtere (2009) highlight that in a mutual, profits tend not be distributed to members but are instead kept within the business. Though many UK friendly societies operate a 'with profits' fund, with members able to participate in profit distribution.

Within the UK, building societies and friendly societies tend to be seen as mutuals.

Credit unions are often seen as financial co-operatives rather than mutuals, even though individuals *must* become a member to benefit from their services, and their services (loans and

deposits) are only provided to members. Credit unions in the UK have never been able to divide profits among the members on solvent dissolution and are capitalised through share capital (which is held as deposits) rather than through the purchase of policies. Building societies and friendly societies have, by contrast, been demutualised with money going to members, and do tend to be financed — particularly in friendly society insurers — through the purchase of policies. For further detail, in relation to friendly societies, on the legal nuances of members as policy holders, and members as members, see Financial Conduct Authority (2014).

Credit unions are, however, often included within the descriptor 'mutual'. Explained in the context of a framework for National Accounts within the EU:

> Only the savings and credit co-operatives and insurance co-operatives are placed with the mutual societies in institutional sector S12 (financial corporations). All the other co-operatives are classified into the non-financial corporation sector (S11). In all other respects, the operating principles of co-operatives and mutual societies are similar. (Barea & Monzon, 2006, p. 47)

This would suggest that the differences can at times be hard to see, and that despite best attempts at definitions, there is an inevitable degree of overlap.

Mutuals also use a range of legal structures — including building society, friendly society, co-operative society, credit union, company limited by guarantee, and company limited by shares. In proposing a definition of a mutual in Australia, where there are commonalities with UK mutuals, Apps (2019) suggests:

> A 'mutual company' is a company whose dominant purpose is to provide economic and/or social benefits to satisfy the common needs of its members as the recipient of its services and whose constitution provides that each member of the company has no more than one vote at a general meeting of the company. (p. 564)

For tax purposes in the UK, there is greater specificity. Mutual Trading Status is a particular type of tax treatment afforded to mutuals providing they meet certain criteria (HMRC, 2024, section BIM24020):

- Complete identity, as a class, between the contributors to the mutual surplus and the participators in it.
- Arrangements which ensure that the surplus ultimately finds its way back to the contributors and no arrangements for it to go to anybody else.
- A reasonable relationship between the amount a person contributes to the surplus and the amount distributed to them on winding up.
- Arrangements that entitle the contributors to the common fund to control it.

This recognises a tax principle that a person cannot trade with themselves. This definition is however only relevant where the organisation is claiming mutual tax status from His Majesty's Revenue and Customs (HMRC) in the UK.

For completeness, we also saw use of the term mutual in the context of public service mutuals (Department for Culture, Media and Sport, 2017). The term mutual was however given a broad interpretation that does not provide clarity (Birchall, 2022b). Public service mutuals are a contested concept, beyond the scope of this work.

By way of summary, a mutual, in taking an approach that differentiates it from a co-operative, could be defined as follows: "A mutual is a business owned and democratically controlled, equally, by its members, who fund it through the purchase of products or services it provides exclusively to them, with profits generally retained." This is a definition proposed by this author to synthesise the main characteristics from earlier referenced definitions. That co-operatives and mutuals can be differentiated should not distract from the fact they have much in common, including a purpose to benefit members, member-ownership, and member democratic control. Mazzarol et al. (2018) provide an overview of definitions. In most circumstances, co-operatives and mutuals can be combined under a single descriptor.

### Employee-Owned Businesses

As may be expected, employee-owned businesses (EOBs) are businesses owned by their employees. The Employee Ownership Association (EOA) estimate there are more than 1,400 employee-owned businesses in the UK (https://employeeownership.co.uk/). They argue that EOBs are more productive and create more jobs than conventional businesses (EOA, 2023). John Lewis Partnership, and Scott Bader are examples of EOBs.

There is no legislative definition by which something is definitively employee-owned, though there is specialist legislative treatment — including tax treatment — for particular types of employee ownership, such as employee ownership trusts through the Finance Act 2014. The UK's *Nuttall review of employee ownership* (Nuttall, 2012) defined employee ownership as a business in which the employees have a "significant and meaningful stake" (p. 20). For the stake to be meaningful, it is said to require that the organisational structures promote employee engagement. It has been noted that while this figure can be as low as 25% employee ownership, the majority of UK EOBs are majority or 100% employee owned (Pendleton et al., 2023).

The nature of ownership varies. Shares in the EOB are held either directly by employees, indirectly through a trust for the employees, or in some hybrid arrangement combining the two. In the USA, employee stock ownership plans (ESOP) are popular, with more than 10m employees involved, across more than 6,500 companies (ESOP Association, n.d.). In this model, an employee trust acquired shares to then hand over for individual direct ownership by employees. In the USA, this tends to be on retirement — so the ownership is indirect for a long period of time before becoming direct. The employee trust is often some kind of company, such as a company limited by guarantee, holding shares on behalf of the employees. Indirect ownership, through an employee ownership trust is the most prolific form of employee ownership in the UK, especially since gaining legislative recognition and specialist tax treatment in 2014 (Pendleton et al., 2023).

Worker co-operatives are generally businesses directly owned by their employees i.e. their employees individually hold the shares in the business. To this extent, worker co-operatives can be said to be a form of EOB. Unlike worker co-operatives, EOBs need not be controlled by the employees. Employees in EOBs may have rights to elect the directors of the employee-owned trust, but this varies and can be distinguished from employee control on the running of the business itself. For instance — in 94% of instances, worker co-operatives enabled employees to vote on strategic decisions, compared with 47% of EOBs structured with trusts, and only 35% of directly employee-owned businesses (EOA, 2023).

EOBs tend to start life as privately-owned companies that get converted to employee ownership, often as part of a succession plan enabling the owner to retire (Erdal, 2011; Pendleton et al., 2023). While this can be true of worker co-operatives, the worker co-operative model is also well suited for the establishment of new businesses.

There is a degree of overlap between the EOB descriptor, and co-operative (especially worker co-operatives). Previous versions of Co-operatives UK's (2021, 2023) co-operative economy report have included some employee-owned businesses within the statistics for the co-operative movement. Of the distinguishing features listed, the main differences centre on ownership (direct vs indirect) and control.

## Charities

Unlike other descriptors here, whether something is a charity is a matter of law. Charities must exist for a charitable purpose delivered for the public benefit. Examples of charitable purposes include: the prevention or relief of poverty, the advancement of education, the advancement of amateur sport, and the relief of those in need because of youth, age, ill-health, disability, financial hardship or other disadvantage. An organisation that has a mix of charitable and non-charitable purposes is not a charity (see for instance s1(1)(a) of the Charities Act 2011

— 'established for charitable purposes only'). For there to be public benefit, there must be identifiable benefit that outweighs any harm, and the benefit must be for the public in general, or a sufficient section of the public. Any personal benefit to individuals (other than in delivering the charitable activity e.g. a homeless person receiving housing) must be incidental (Charity Commission, 2014).

Co-operatives exist to meet the economic, social, and cultural needs, and aspirations of their members. It is difficult to reconcile this with a requirement for charities to exist for public (rather than member) benefit, for the advancement of a particular charitable purpose. It is generally therefore the case that co-operatives cannot be considered charities, and vice versa.

## Social Enterprises

There is no overarching legislative definition of social enterprise in the UK. Organisations may therefore call themselves a social enterprise and operate in a significantly different way to other organisations using the same descriptor. Social Enterprise UK estimate there are 131,000 social enterprises in the UK, with a GDP generation of £60bn (Social Enterprise UK, n.d.). The UK Government used the following definition of social enterprise in *guidance* (not a legal requirement):

> The term "Social Enterprise" describes the purpose of a business, not its legal form. It is defined (by Government) as "a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners" (Department for Business, Innovation and Skills, 2011, p. 2).

Other definitions of social enterprise exist, and the descriptor has changed over time. Comprehensive analysis of social enterprise definitions, and how they have changed over time, are well documented (see Ridley-Duff & Bull, 2019).

Earlier definitions included expectations to democratically involve members in the governance of the enterprise (Pearce, 2003). An early and co-operative-based definition of social enterprise is provided by Spreckley (1981): "An enterprise that is owned by those who work in it and perhaps reside in a given locality, is governed by registered social as well as commercial aims and objectives and run co-operatively may be termed a social enterprise" (p. 3). Later definitions have evolved from collective definitions to ones that are more individualistic. It has been argued the evolution of the definitions have resulted in convergence toward the lowest common denominator of trading for social aims (Ridley-Duff & Bull, 2019).

Social enterprises may be democratic, but they need not be in the sense that there is no legal or definitional requirement requiring them to be. Many advocates, including Spreckley (2021) still, recently, argue for democracy as a core principle of social enterprise. They may be owned by one individual (the social entrepreneur) who has executive control or owned in other ways. Social enterprises may retain all their profits for social objectives, or they may distribute a lot of the profit to their owner(s).

A wide range of legal structures are used by social enterprises — including 'community interest companies', 'companies limited by guarantee', 'companies limited by shares' and 'community benefit societies'. As to whether a co-operative is, or sees itself as, a social enterprise will depend entirely on both the definition of social enterprise being used, and the features of that individual co-operative.

## BCorps

The BCorp descriptor emphasises businesses making a positive society and environmental impact. The concept of the BCorp grew out of the USA, where it focuses on for profit entities. A different approach for the UK has been adopted because of the UK's legal environment, which

is very different to that of the US, and has an established social enterprise movement (B Lab United Kingdom, n.d.).

There is a certification process by a private body that a business must go through before being able to use the trademarked term BCorp. There are several requirements including:

- That it is a business. Charities are not included. The criteria look to whether most of the revenue is generated from trading and competing in a competitive marketplace.
- A business impact assessment, that looks to the social and environmental impact of an organisation. They set out five key areas: governance, workers, community, environment, and customers.
- Legal requirements (see B Lab United Kingdom, n.d.):
    - with wording to include in company articles including a commitment to have a material positive impact on (a) society and (b) the environment. This utilises section 172(2) of the Companies Act 2006 to expand the objects of a company beyond that of serving its members
    - aligning the director duties to that object; and
    - producing an annual impact report.

While template wording for co-operatives has not been provided, the BCorp legal criteria reference co-operatives. Co-operatives could therefore choose to apply for certification as a BCorp. There are co-operatives, and building societies, who have achieved BCorp certification in the UK. BCorp designation focuses on the external impact being had by a business, rather than its ownership, control, or use of profits. As to whether a co-operative meets the criteria of a BCorp will vary.

## Investor-Owned Businesses

A business is generally a broad term (which could include companies, sole traders etc), with firm (or enterprise) being a subset of it to cover legally constituted bodies — such as companies. Both terms would generally include co-operatives within them. There is scope for confusion when talking about companies. In British English, the term company is often used in the same way American English uses corporation (Kay, 2024). This has changed over time. Historically, in Britain a ‘company’ was a group of people who then formed a corporation. In referencing usage until the early 19th century “society, association and company were used interchangeably to describe the unincorporated unit” (DuBois, 1938, p. 139).

In the UK today, the term company most accurately refers to an entity registered under the Companies Act 2006 — such as a public limited company or a private limited company — whether limited by shares or guarantee. However the term is often unhelpfully used interchangeably with business, or firm. This should be avoided, because there are a wide variety of businesses registered as companies — including charities, co-operatives, mutuals, social enterprises, EOBs, and investor-owned businesses (IOBs).

‘Investor-owned’ would generally denote that the business is owned by private individuals (i.e. not the state) — who are businesses (such as private equity firms etc.) or individuals. Most typically, these IOBs would use the public limited company (plc) legal structure — being a type of company whose shares are available to be bought and sold. Often a plc will be listed on a stock exchange, enabling their shares to be readily bought and sold (i.e. publicly traded). These fall clearly within the common use of the descriptor of IOB. There are however other types of business that, like a plc, generate profit to pay investors based on their shareholding, including family-owned businesses (with the ‘investors’ in this sense being the family members)

and private-companies who may only have one or a small number of owners, with shares not available to other parties.

As to whether these businesses are included within the descriptor IOB (or investor-owned firm (IOF)) will vary from one author to the next. Co-operatives are generally not considered to be IOBs, because they are owned by members, with profits shared equitably based on a member's participation in the business activity of the co-operative. This is the case even where co-operative members invest capital into the co-operative, or where the co-operative has external investors (i.e. investors who are not using the services of the co-operative).

Many co-operatives use the company legal structure. They would tend to be constituted as private limited companies — either by shares, or by guarantee. Though using the company structure, they tend to make alterations to the standard articles (constitution) of a company — by changing the voting to 'one-member-one-vote' rather than one-share-one-vote. They would also tend to change the way profits are distributed – to an equitable formula based on member-participation in business, rather than share-ownership. Those adaptations mean they will generally not be classified as IOBs. It is therefore important to look not just at legal structure, but also the underlying characteristics. All IOBs are considered to be part of the private sector — because they are not owned by the state and make profits for private individuals. This distinguishes them from the public sector (i.e. the state).

## The Author

Ian Adderley, a Chartered Secretary and Fellow of the Chartered Governance Institute, was called to the Bar in England and Wales in 2010 and has worked for the UK's Financial Conduct Authority in their role as the registering authority for mutual societies for over a decade. He is on the board of IUS Cooperativum, trustee and Vice Chair of the Co-operative Heritage Trust, and a trustee of the UK Society for Co-operative Studies — which he chaired for five years. He writes in a personal capacity, with views expressed not necessarily reflective of any of the organisations mentioned here.

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