Community Shares

Recovery Share Offers

Guidance in response to the COVID-19 crisis

June 2020

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Background

The COVID-19 emergency has had a massive impact on all businesses, regardless of age, scale, sector or type. Government measures to support businesses during this emergency are well publicised and generally available to co-operative and community benefit societies along with other types of business.

Community shares give community businesses additional solvency, compared with other businesses that are more reliant on debt finance. Your community and your members have a vested interest in the purpose of their societies, and will support measures to protect its employees, volunteers, assets and share capital.

The purpose of this guidance is to support societies to use community shares to improve their solvency as part of their response and recovery to the current crisis.

It is the duty of directors to act in the best interests of the society and to care for its employees, volunteers, customers, suppliers and creditors. The health and safety of these stakeholders must come first, and the society must act to safeguard these people.

It is paramount that you act early by anticipating problems that may threaten the survival of your society and involving your members in your response to these problems. This means continuously assessing the society's "going concern" status and protecting against the dangers of insolvency which would result in the legal obligation to wind-up the business.

Maintaining going concern status: solvency and liquidity

Solvency and liquidity are central to the financial health of any business.

Solvency means the society's assets exceed its liabilities. Put another way, it means that the society could in theory pay everyone it owes money to, including long-term lenders, and still have something left over. If there is a risk that the society could not pay all it owes, then the society may be insolvent. In such circumstances the directors have a duty of care for the society's creditors and must wind-up the business unless there are reasonable grounds for thinking that it can return to solvency in the short to medium term future.

Liquidity means having the cash to pay bills as they fall due. It is an immediate and short-term matter. Can we pay employees, suppliers and other creditors? Will the bank honour our payments? Will those who owe us money pay it on time? To answer these questions, we need to look at the society's cash flow, the timing and amount of money coming in and going out of the business.

Solvency and liquidity may sound similar and they are connected, but not always in a straightforward way.

For instance, a society might be solvent but illiquid. This might be the case for a society that has lots of its money tied up in fixed assets, like property or equipment, but it has run out of cash because it cannot continue to trade in the current emergency. It is reasonable for a society to ask members for new share capital, or to borrow money, as long as it is confident that it will not incur losses that will threaten its solvency before it can return to profitability and solvency. In such circumstances, raising additional share capital through a **recovery share offer** will improve solvency whereas loans will undermine it.

More problematically, a society might be liquid but approaching insolvency. Even though it has the cash to pay bills, the society is making a loss and building up liabilities it will not be able to meet in the future. These might result from strategies to improve short-term liquidity, without sufficient regard to future profitability, such as encouraging customers to prepay for goods or services, or deferring payment of rent, rates and taxes. The society might also face contingent liabilities such as redundancy costs or bad debts caused by the insolvency of its customers. Monitoring and forecasting future profits and losses is vital in anticipating the threat of insolvency.

The worst-case scenario is that the society is both illiquid and insolvent. It has run out of cash and has no reasonable hope that it can one day become a profitable business. It may be that the society was already making losses before the current crisis, which has acted as the final blow. In such circumstances, the directors' balance of care shifts to doing their best by their creditors. They may have an immediate duty to wind-up the business, and not incur any further liabilities. But if a society has been monitoring its solvency, it can explore various other options before it is too late.

If there is any threat that your society may be approaching insolvency you must suspend share withdrawals and notify members of this action. This should include a notice to members and ex-members who have recently withdrawn share capital that they remain liable for the debts of the society, up to the value of their shares, for up to twelve months after they have withdrawn their capital.

We recommend you read Co-operatives UK's guidance for Societies facing up to financial strife to learn more about liquidity, solvency and steps to avoid insolvency.

Recovery share offers

The Community Shares Handbook does not currently provide best practice guidance on this type of emergency call for additional share capital to improve a society's solvency so we have written these **10 best practice principles** to supplement the guidance in the Community Shares Handbook. This guidance should be used in conjunction with professional advice and support from a Community Shares Practitioner.

1. All members must be formally and fully informed.

The proposal by the board to run a Recovery Share Offer should be communicated with existing members at an Extraordinary General Meeting (EGM) and all members should be given due notice of the proposal in advance of the meeting (normally at least 14 days' notice). This meeting could also be used by the board to explore other proposals such as the options to amalgamate, merge or transfer engagements to another entity, and the society's solvent dissolution.

Support on using technology to engage with your membership and running virtual AGMs is freely available through the Co-operatives UK website. Opportunities for members to feedback on the proposal should not be restricted just to the general meeting, with the usual communication channels open as usual.

2. Identify your audience

It will be crucial to identify the key audiences of your recovery share offer and how that will affect your message and channels of communication:

- **Existing members** should already know and understand the society and through previous investments will have a vested interest in the survival of the business, welfare of its volunteers and employees, and in preserving their existing share capital
- **New members** may be loyal customers or stakeholders and have a vested interest in the survival of the business, but by not being involved in earlier share offers will require further information on the society's governance and financial position to date
- **Institutional investors** may be existing members or stakeholders who have other reasons to have a vested interest in your survival (e.g. existing funders, local authorities, suppliers, customers).

3. Standard Mark for Recovery Share Offers

We understand that timing and resources may not allow for a society to work with a practitioner to undertake a full Standard Mark assessment of a Recovery Share Offer, which is why we have developed this additional guidance to sit alongside the existing Standard Mark assessment framework for open offers.

Co-operatives UK's Booster Programme (and other support programmes) may be able to provide additional grant funding to develop a Standard Mark compliant Recovery Share Offer. Please contact us to find out more: communityshares@uk.coop.

4. Similarities to open offers

If the society is planning new capital expenditure to seriously change the business model, it should instead consider a new time-bound share offer. Recovery Share Offers are more similar in scope and should look to the Standard Mark requirements for Open Offers summarised in the following key content areas:

- **Purpose** and brief description of the aims, objectives and purpose of the society, reasons for making this new offer of investment, how the money will be spent to safeguard the future of the society
- **Return on investment**: summary of interest paid, withdrawals and impact of the society to date to indicate track record under 'normal circumstances'
- **Capital position**: description of the society's capital position, level of share capital, reserves and any long term liabilities. (see section below of writing down the value of existing share capital)
- **Supporting documents**: links to any further information, governing documents, annual accounts, original share offer documents etc.

On top of these, due to the circumstances surrounding a Recovery Share Offer, we recommend the following additional requirements.

5. Full financial disclosure

In keeping with the principles of transparency and openness, societies should make a full financial disclosure to members, to show that the society is currently solvent but under threat. It should provide an outline plan of how it intends to survive through the emergency, the amount of additional share capital it is seeking, and any additional debt it plans to obtain to improve its liquidity, but may weaken its solvency.

6. Minimum targets

A minimum target for a Recovery Share Offer should be set if the society has or is forecast to have negative reserves exceeding 50% of its current share capital, or a simple solvency ratio between 0 and -0.5 (reserves (accumulated profits/losses divided by share capital). The minimum target in such cases should be at least the amount required to increase the simple solvency ratio above -0.5.

As with a time-bound offer, arrangements must be in place to protect applicants' investments until the minimum target has been reached (within a reasonable timeframe). If the minimum target is not reached, applicant funds should be returned, less any administrative charges (ensure to state this clearly in the offer).

7. Maximum targets

There is no requirement to set a maximum target for a recovery share offer, but a society may choose to do so if it already has positive reserves and is concerned it may become over-capitalised.

8. Capital-at-risk warning

The Recovery Share Offer document should make it absolutely clear that anyone buying community shares could lose some or all of the money they invest, without the protection of the government's Financial Services Compensation Scheme, and without recourse to the Financial Ombudsman Service. This warning should be expressed in plain English.

In addition, it should be clear that share interest payments and the withdrawal of share capital are suspended for the foreseeable future.

9. Suspending withdrawals

Most Model Rules (excluding Plunkett Foundation's) allow for the board to write down or reduce the value of the existing share capital. This can enable share liquidity (withdrawals) but is not a long term solution to addressing insolvency.

Running a Recovery Share Offer **while suspending withdrawals** enables a society to raise additional share capital. In communicating to members, it should be made clear that by raising additional share capital **and** suspending withdrawals for a period time, the society is aiming to preserve the value of their existing share capital.

If possible, financial forecasts should be prepared in line with the planned recovery of the business which indicate a future when interest payments and withdrawals may be available again. Co-ops UK have a webinar on cash flow and business re-forecasting here.

10. Members remain liable for debts up to 12 months

All members (existing and new) should be reminded clearly that they remain liable for the debts of the society up to the value of the share capital they have held in the society during the past twelve months, even if they have withdrawn that share capital.

Other maintenance matters

Regular board meetings

Regular board meetings are vital during this period as a record of the board continuing to act in good faith and in the interests of the society. There is plenty advice on using online platforms if required to ensure regular communication. Minutes of these meetings should be taken as usual and made available to members on request.

General Meetings

The Co-operatives UK governance webpages have lots of advice on managing general meetings, including specific guidance on running an online general meeting to ensure effective engagement and representation of all members at this crucial time.

Annual accounts and returns

The FCA has confirmed that societies can postpone their submission of their annual accounts and returns by up to three months, further advice on the Co-operatives UK governance webpages.

Good practice with employees

Looking after employees at a time of crisis is crucial, for more support see the Co-operatives UK HR webpages.