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Social but still business

Cooperatives like CBH Group and Capricorn Society are big businesses with wider goals. Page 8



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Mobile 0401 733 291

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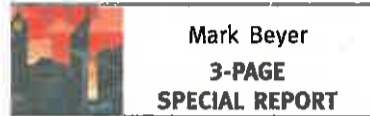


AUSSIE PORTABLES

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International co-op experience combines

Member-owned businesses such as CBH Group and Capricorn Society are constantly fighting for legitimacy, despite a long track record of success.



Mark Beyer
3-PAGE
SPECIAL REPORT

IN 1970, 12 Golden Fleece petrol station operators were having a social drink when they started comparing notes about the cost of their supplies.

One boasted that he was getting a much better price for tyres, another was getting a better price for spark plugs, and so on.

They decided there and then to establish a buying cooperative, so they could all benefit from the best available prices.

Fast-forward 40 years. The Golden Fleece brand has disappeared but that buying cooperative has become a highly successful business.

Capricorn Society has 12,000 members across Australia, South Africa and New Zealand and its members make annual purchases of more than \$850 million.

Chief executive Trent Bartlett reckons Capricorn has a great business model and he wants more people to know about it.

That's why he has established Social Business Australia, which represents what he calls the fourth sector – cooperatives, mutuals, credit unions and other member-owned businesses.

SBA faces a big task lifting recog-

inition of the so-called fourth sector, which includes some of the state's major businesses – CBH Group, RAC, HBF and dozens of cooperatives (see table).

Its members tend to get lumped in with the 'third sector' (charities and philanthropic organisations).

And many people have concluded that mutuals and cooperatives are anachronistic in the modern business world.

That's why WA businesses such as Home Building Society and Statewest Credit Society chose to demutualise.

The same thing has occurred on the national stage – two of the country's largest mutuals, AMP Society and National Mutual (now AXA), chose to corporatise and now trade on the stock exchange.

In all of these cases, the corporatisation process produced large windfall gains for long-term members; but whether the business and its members have gained long-term benefits is debateable.

This debate is continuing today inside one of the state's largest businesses – grain handler and marketer CBH Group.

CBH has traded successfully for 77 years as a member-owned cooperative, yet many of its members want change because they believe it could achieve even more with a different corporate structure.

Just this week, a bloc of dissatisfied grower shareholders requisitioned an extraordinary general meeting to propose changes to CBH's board structure and elections.

Mr Bartlett is hoping that SBA will bolster the standing and growth of a sector he believes does not get due recognition.

Internationally, he says there is wide support for the concept of social business, which marries the best of market efficiency with social outcomes.



MODEL PERFORMER: Trent Bartlett wants more people to know about Capricorn's business model, and has established Social Business Australia to achieve that end. Photo: Grant Currall

In contrast, he says the social enterprise movement in Australia has been captured by a narrow charity-driven definition of not-for-profit activity.

"We don't get talked to as a true business, but we don't want to be treated as a charity," he said.

Mr Bartlett said a social business was one that traded for a social purpose and applied its profits or surpluses to a social benefit.

As such, SBA was open to a wide range of businesses.

"We are just asking people to

cooperate and come together. It's whether they identify with the sector," he said, adding that ownership was one criterion.

"Wherever members are the owners, you've got the basis of a social business."

But it's not restricted to cooperatives or mutuals.

In fact, Capricorn itself has changed its legal status from a cooperative to a public company, to facilitate its expansion and shift into financial services.

The group established Capricorn

Mutual in 2003 to provide insurance services to its members.

It has since established a Sydney-based joint venture with UK-based Regis, to help other groups establish and run self-insurance schemes.

Its financial services arm has also expanded into equipment finance, for motor vehicles and other capital equipment.

Mr Bartlett insists Capricorn's commitment to cooperative values is undiminished by its growth and new legal status.

Health fund HBF is another WA

Abesque provides a multi-discipline engineering service to the resource sector with extensive design and construction capabilities for processing facilities and the associated infrastructure. Abesque offers a full suite of services across all of the project development stages, from the pre-feasibility studies through to the plant commissioning.

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market efficiency with social outcomes

business that seeks to marry its commercial activities with broader goals.

"We've clearly made a decision to stay not for profit," chief executive Rob Bransby said.

He believes this status provides a competitive point of difference, ensuring HBF retains a genuine commitment to wider community goals.

However this does not lessen the need to focus on growth and efficiency.

"While we're not-for-profit, we're not for loss either."

Mr Bransby acknowledges the main constraint facing HBF is the lack of access to external capital.

This is a perennial issue for many not-for-profit, or member-owned businesses.

At the same time, many of these businesses that are commercially successful face the inverse problem – how to efficiently return value to their members.

CBH Group is a case in point. After nearly a decade of sometimes-acrimonious debate over its structure, it recently completed a survey of its grower members.

The survey found members want to retain its cooperative principles and for it to be grower owned, particularly its core grain storage and handling network.

They also want to ensure CBH can provide value to growers sustainably.

Specifically, they want to see more tangible and transparent value from CBH's investments in grain- and food-processing businesses, including the potential for direct ownership.

CBH is currently evaluating a range of potential ownership models, and plans to present a shortlist to its members in September.

To assist this process, it has engaged agricultural cooperatives

expert Fabio Chaddad from the University of Missouri.

Professor Chaddad said many people mistakenly assumed there were just two choices facing cooperatives – to stay as a member-owned entity or become a company with shares.

In practice, he said there were many different models around the world.

Two of the largest farmer-owned businesses in the US are examples of the 'grey' structures between a traditional cooperative like CBH and a corporate like Viteira.

CHS Inc (formerly Cenex) is the largest agricultural cooperative in the US with diversified energy, grains

"Cooperatives can be very creative in their capital structures, without losing farmer ownership and control."

- Fabio Chaddad

and food operations and annual turnover of \$US26 billion.

"What is interesting about their structure is that they have about \$US280 million worth of (non-voting) preference shares issued to outside investors, about 10 per cent of their total equity, in addition to joint ventures with Cargill and Mitsui," Professor Chaddad said.

Another example is Dairy Farmers of America Inc, the largest dairy cooperative in the US with turnover of about \$US8 billion.

It has a base capital plan that requires members to hold shares in the cooperative in proportion to their milk delivery.

It also has several joint ventures

and contractual alliances with private milk processors across the country.

"The bottom line is that cooperatives can be very creative in their capital structures, without losing farmer ownership and control, and creating mechanisms to deliver value to their owner-members," Professor Chaddad said.

A third example closer to home is New Zealand's largest exporter, dairy cooperative Fonterra.

After a contentious and long-running debate, its 11,000 owners have voted in favour of changes that provide a much more flexible capital structure.

Last year they approved changes that increase the percentage of shares each farmer can own relative to their production.

"Many of our shareholders have made it clear that they want to retain 100 per cent farmer control and ownership of their cooperative and they have indicated they are prepared to support Fonterra's ongoing growth by providing additional capital to fund profitable business opportunities" Fonterra chairman Sir Henry van der Heyden said at the time.

The latest step, approved last month, will allow share trading among farmers.

The new system, in which farmers will be able to buy and sell shares from each other through a market, rather than through the co-op, was designed to remove redemption risk – the need for Fonterra to pay cash out to those farmers leaving or reducing milk supply.

"We knew when Fonterra was formed nine years ago that we would need to evolve our co-op's capital structure and develop a durable solution to address redemption risk," Sir Henry said last week.

"Trading Among Farmers will ensure Fonterra remains farmer controlled and owned, and that our loyal shareholders have an incentive

MAJOR SOCIAL BUSINESSES IN WA

Company	Turnover
CBH Group	\$1.55bn
HBF	\$1.02bn
Capricorn Society	\$850m
RAC	\$399m
Geraldton Fishermen's Co-op	\$207m
Ravensdown Fertiliser Co-op	\$169m
WA Meat Marketing Co-op	\$108m
Police & Nurses Credit Society	\$67m
Travellers Choice	\$39m
Cooperative Purchasing Services	\$35m
Mount Barker Cooperative	\$25m
Wesbuilders Cooperative	\$17m

Source: Cooperatives WA and company reports, ranked by annual turnover

to hold Fonterra shares and put more equity into our co-op."

UWA Business School Tim Mazzarol (see next page) has identified at least five funding options employed by cooperatives.

The first is internally traded shares that allow the member to realise capital growth from their initial investment. This is like the Fonterra model.

A second is externally traded subordinate bonds, which allow the co-op to raise external capital without diluting member control.

A third is for co-ops to establish a subsidiary company, the co-op may be the sole shareholder, or its members may be able to buy shares.

A fourth is the issue of preference shares, which may be listed on an exchange. CHS Inc's preference shares, for instance, are traded on

the Nasdaq exchange in the US.

A fifth option is to demutualise and convert into an investor-owned company, like Home Building Society and, more famously, Westralian Farmers Cooperative, which morphed into Wesfarmers.

In 2007, Fonterra proposed a partial demutualisation that involved splitting its cooperative business from its other business activities.

The co-op would have owned two-thirds of the new business, 15 per cent would be distributed to farmers and the remaining 20 per cent traded on the stock market.

This proposal sparked strong debate and ultimately led to a major rethink that culminated in the restructuring outlined earlier.

CBH Group will be hoping it is able to reach an equally peaceful solution with its grower members.

Forge Focus



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Federal grant to fund study into coops



Mark Beyer
3-PAGE
SPECIAL REPORT

THE global cooperative movement employs about 100 million people and the top 300 cooperatives turn over \$US960 billion per year, yet the sector has been largely ignored within mainstream economic and management studies for the past 60 years.

UWA Business School professor Tim Mazzarol is aiming to rectify that situation, having just secured a \$260,000 federal government grant for a three-year study into the sector.

Cooperatives WA, which has 70 members, and three of its largest businesses – Capricorn Society, CBH Group and Ravensdown Fertiliser Cooperative – are also backing the study.

Cooperatives WA chairman Chris Enright said his group has been working with Professor Mazzarol to lift awareness and understanding of the cooperative business model.

“The grant will allow that work to go to a new level,” said Mr Enright, who also chairs the Mount Barker Cooperative.

Most of WA’s cooperatives have a rural focus, including major operations like CBH and Ravensdown.

Others focus on specific industries, like the Geraldton Fishermen’s Cooperative and Challenge Dairy Cooperative, while others service farmers in particular regions, like the Mt Barker and Cunderdin cooperatives.

The sector also features several centralised buying groups, such as Capricorn, which services the automotive trade, Travellers Choice, Cooperative Purchasing Services, which has 500 members, primarily in the hardware trade, and Wesbuilders Cooperative.

Caxton Cooperative is the state’s newest. It was set up in 2004 by five Snap printing franchisees, who pooled their resources to buy printing equipment they couldn’t afford or justify in their own businesses.

Osborne Park-based Caxton has a traditional cooperative structure – each shareholder has one vote, while financial contributions and rewards are linked to print volumes through the production centre.

The UWA research partnership coincides with completion of the WA Cooperatives Act, a complete rewrite of legislation governing the sector, which is due to be proclaimed this year.

Mr Enright said the new act would create both challenges and opportunities for cooperatives.

The opportunities will include the ability to raise capital from non-members by issuing ‘cooperative capital units’.

A CCU may be a debt instrument like a debenture or an equity instrument like a redeemable preference share, but holders will not have voting rights.

This will provide a potential solution to one of the major constraints facing cooperatives – how to raise capital to fund their growth.

Professor Mazzarol said the issue of shareholder power lay at the heart of many of the strengths and weaknesses of coops.

“The inability of any one group to concentrate power through their accumulation of share ownership ensures that the coop will not be easily taken over or have its democracy eroded,” he wrote in a recent report.

“However it also makes the ability of the coop to raise capital difficult as investors will not willingly provide money without influence.”

The new WA legislation will also put clearer responsibility on cooperative members to be active, or else face being expelled.



TARGETED: Challenge Dairy Cooperative focuses on a specific industry, while others service farmers in particular regions, such as the Ravensthorpe Fertiliser Cooperative.

Professor Mazzarol believes cooperatives can play a very important role in the economy.

“They can have particular value helping smaller entities, like farmers, to help them grow and take on larger corporate entities. In that way they can help to maintain competition,” he said.

Professor Mazzarol’s study of the sector has shown that cooperatives are mostly driven by commercial goals rather than altruism.

“At the end of the day they want to make money for their members, they want to lower costs or lift

their (selling) prices,” he told *WA Business News*.

However one of the major challenges facing coops is the ability to demonstrate value to members.

In contrast to a listed company, where the share price and dividend payments provide a clear measure of value, the benefits of being in a coop are usually derived from patronage.

Professor Mazzarol said ‘new generation’ coops in the US were tackling this issue by allowing more open membership.

For instance, they offer greater voting rights to members who trade

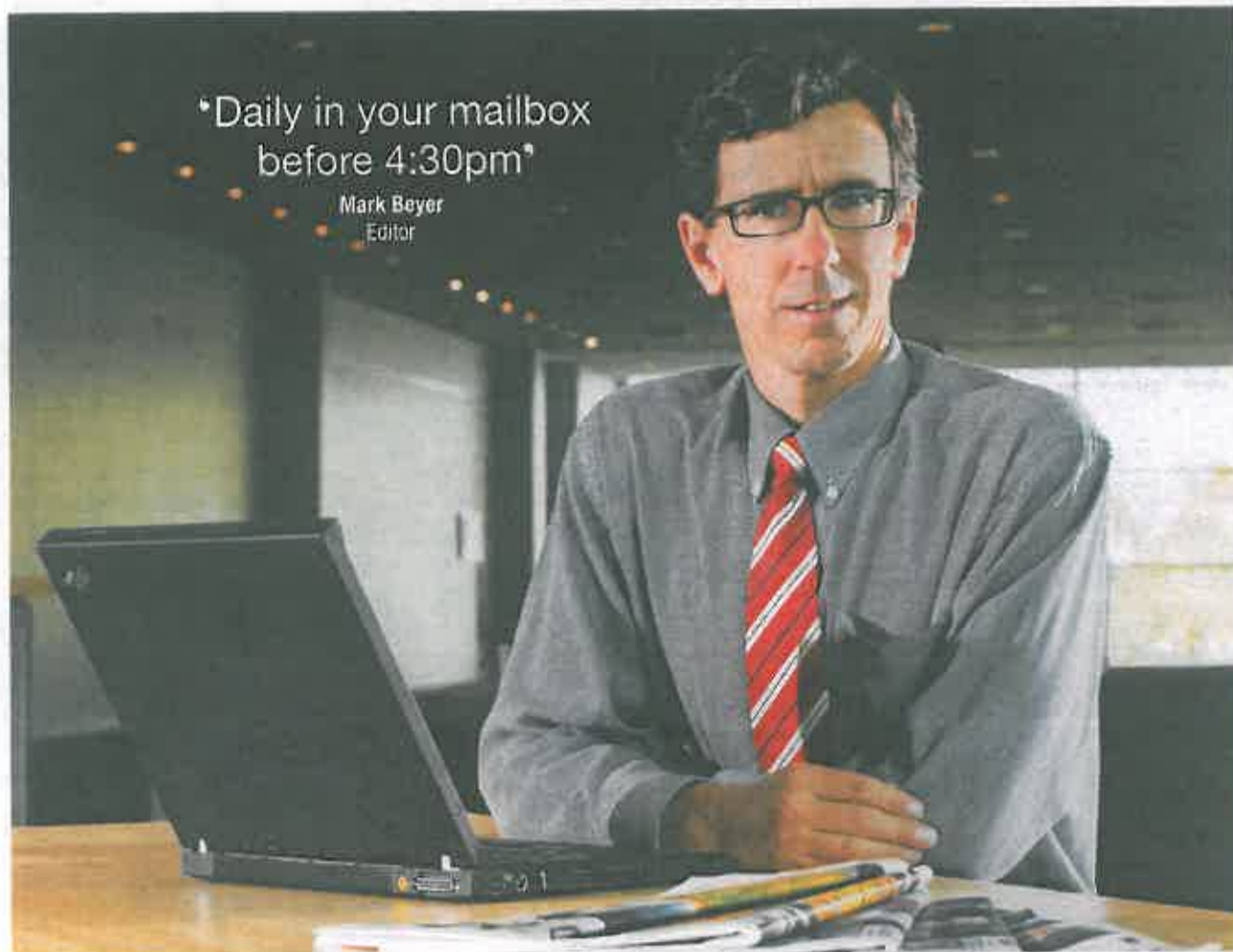
more with the cooperative.

Despite their limitations, Professor Mazzarol has found that the financial performance of coops is similar to investor-owned companies.

His upcoming study aims to identify international best practice, so coops can employ it in future.

It will also examine why some have abandoned the cooperative business model and become investor-owned companies.

A related question he will examine is how do cooperatives measure and communicate true value to their members.



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Mark Beyer
Editor

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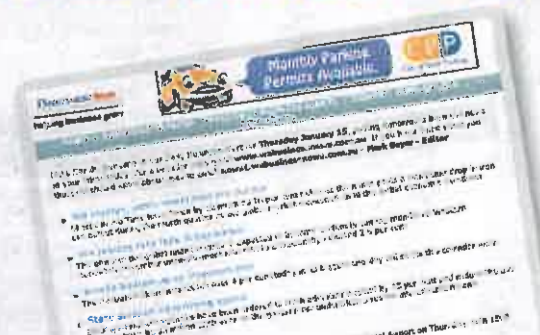
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