

Financing of Co-operative SocietiesCONDITIONS OF SUCCESS

by

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All businesses, whether they be productive or distributive, whether they be sole trader, company or Co-operative, require capital for two purposes. Firstly, the day to day operations of the business need to be financed adequately; and secondly, expenditure on fixed assets to develop the potential of the business in the market in which it operates must be significant and of a continuing nature.

The supply of adequate liquid funds at a price one can afford to meet these needs is as fundamental to the success of the business as is the effective use of manpower by management in both the direct and service (indirect) categories.

The ability to generate this finance is partly dependent, of course, upon prevailing rates of inflation, the liability to pay those taxes to the State which are assessed on the earnings of the business and the proportion of Employees' Superannuation Fund moneys which it is deemed should be invested outside the business.

So far as Co-operative Societies are concerned, there are two main sources of capital, namely (a) subscribed capital (shares and Loans) and (b) the retention of earnings.

Subscribed Capital

Many years ago competition for personal savings by the general public was far less severe than it is today. The local Co-operative Society became a focal point for the community for both saving and spending. The Co-op shop usually held the Share Pass books of the members residing and trading within its immediate location. The shop manager made the entries in the Share Ledger, in the Penny Bank accounts and sometimes in the Loan Ledger. He was not merely a manager who met the day to day trading needs of his members, he was in fact regarded as a banker. Members saved at their branch of their Co-op, had their dividend transferred to their Share Accounts, and generally regarded their savings as a nest egg for a "rainy day" regardless of the rate of interest earned.

In this way, the capital needs of Societies were well taken care of at very low cost. Indeed, many Societies had surplus funds to invest outside the Society from which they were able to make very acceptable profits, and which acted as a cover to meet any exceptionally large withdrawals by their members.

It could be said that the adequacy of supply in those days and at such a low rate of cost actually caused Societies to regard the importance of liquidity as being of little or no consequence.

Today, the climate has changed.

If Societies are to acquire from their members and the public in general any significant contribution towards the daily use of funds to finance current assets (stocks, debtors, etc.) and the large outlay required on fixed assets (new shops and stores) then the share and loan facilities they offer must compete with those provided by Building Societies, Trustee Savings Banks, Joint Stock Banks, Insurance Companies, Local Authorities and even the National Government. This market is highly competitive and Societies must therefore market investments which are equal to or better than those offered by others, both from the point of view of security to the investor and the rate of return on moneys so invested.

A number of Societies have themselves entered this competitive field with purpose and through the effective management and marketing procedures adopted they have secured significant contribution towards their financial needs. The success achieved has prompted the Co-operative Union to launch nationally prepared Unit Loan Schemes in which any or all Societies may participate and success to date has been retarded only by those Societies which have chosen not to participate.

- And the Need for Marketing Investments

The marketing of investments through well designed investment centres, supported by well trained staff, is as important today as the effective marketing of merchandise in well disciplined shops. Indeed, any Society which fails to acknowledge that it has a duty to its members to move with the times in the investment field must not complain if its subscribed capital diminishes each year, thereby reducing the Society's ability to finance major development other than by the costly method of securing bank loans or mortgages.

An all out effort by all Societies to attack this market could well produce an immediate increase of some 25% on the present funds held in Share and Loan Accounts, and this could amount to no less than an additional £84 million becoming available for development purposes in the retail co-operative field. These calculations are based upon the Co-operative Union's 1977 Co-operative Statistics and the fact also that CRS, in the two years ended in January 1979, increased its Share and Loan balances by £13 $\frac{3}{4}$ million, that is by 33.3%. During this period CRS also reduced its holding of Employees' Superannuation Fund moneys by nearly £2 million.

In too many cases retail Societies are obliged to seek loan capital at excessive rates of interest simply because they have not attempted to secure funds directly themselves from consumers, many of whom shop weekly in their stores.

Traffic flow for trading purposes through Co-operative shops is surely an advantage which clearly should be harnessed and used by Societies for investment purposes. Much as one would support the Co-operative Bank in generating the flow of funds through its Handybanks in Co-operative Stores for the benefit of the Movement generally, it does seem ludicrous that retail Societies should pass over this advantage to the Bank which then loans the funds so secured at rates of interest which exceed those which Societies themselves could offer in the first place to their members. Full marks to the Co-operative Bank for acting as a banker down to shop floor level; but would it not be far better for retail Societies and the Movement generally to acquire these funds at a lower rate of cost and to invest any surplus as in years long since departed with the central federal organisation or its wholly owned banking subsidiary?

The fact that the Co-operative Bank is able to finance its Handybank operations in retail stores must surely convince senior Society officials that there is a market for the retail Society itself in its own shops which has not been tested and which could provide much needed capital at a lower rate of cost than secured loans and bank overdrafts.

Retention of Earnings

The Co-operative Union has produced special bulletins on this subject, the most recent being in June of this year; and these circulations are perhaps the most important statements of policy issued to date on the financing of Co-operative Societies.

After one has accepted that stocks should be maintained at optimum levels, that credit trading accounts should be managed effectively in order to reduce bad and doubtful debts to the minimum, that creditors should not be paid before due dates of settlement to secure maximum discounts and that depreciation rates are adequate to amortise individual assets over their anticipated active life-time, one must seriously examine the effects of inflation upon the replacement of assets both current and fixed.

A business which does not retain sufficient liquid funds from its trading revenue to meet increasing replacement costs must sooner or later seek capital from other sources at a higher rate of cost. This means that future developments must incur a higher rate of cost on the capital so invested and this itself reduces the ability of the business to maximise its net trade earnings from which retentions for future developments must be sought. It becomes a cycle of events which often results in insolvency.

Capital which is borrowed is always more costly than capital which has been retained from revenue surplus, and this presupposes that capital in the quantity required will be available.

In this connection the rate of issue of dividend stamps is very important. It must be accepted that stamp issues are really a declaration of dividend in advance of profits having been generated. Unfortunately, there are those who regard stamps as being an integral part of management, a promotional tool which is sure to generate more sales and net earnings. This is not borne out by the facts. Indiscriminate issues of dividend stamps merely aggravate liquidity shortfall. They are not a substitute for good management. Indeed, good management regards dividend stamps for what they really are - a distribution of surplus in advance, so that caution should be exercised to ensure that after such distribution adequate surplus remains to finance future asset development.

The subject of retention is not simply a problem to be solved by Co-operative Societies. Our historical accounting methods practised for so many years have been put severely to the test by the prolonged period of inflation throughout the world.

Attempts have been and continue to be made to evolve a new system of accounting which will more clearly and accurately define the real net profit and net worth of

a business after taking into account the impact of inflation upon earnings. Whatever system may emerge, if any, the existing accountancy procedures do not prevent the required steps being taken to ensure that earnings, however stated, are not dissipated regardless of the need to conserve resources to meet future replacement costs of all assets, current and fixed.

It is not so much a new accounting system to which all should conform which is required as a realistic interpretation of what should be retained in the business to meet enhanced costs of the future. After all, if a new system produces a revenue loss on paper this does not itself conserve any resources.

The impact of inflation is first revealed in increased monetary sales, provided volume is maintained. Operating costs, in amount, will also increase in sympathy with sales. The science of the exercise is to ensure that the rates of sales increase, the rates of operating costs to those increased sales and the ultimate rate of net profit are all kept in balance. An increase in sales of 20% coupled with a maintenance of the rate of net profit to those sales must mean a 20% increase in net profit and hence a maintenance of revenue resources on trade account at the pre-increase purchasing power.

This is perhaps an over-simplification of the subject because replacement costs, operating costs, and price increases do not always increase at the same rate at the same time. However, for the purpose of prudent accountancy, without creating exceptionally detailed calculations, the fundamental acceptance of "rate" maintenance as opposed to "amount" maintenance will prove to be adequate.

If net profit "rates" are maintained then the advice of the Co-operative Union, if implemented, will provide sufficient retention to meet current needs. If depreciation is added back to surplus and if taxation charges are deducted from total surplus, then Societies should aim to retain some 65% of the adjusted surplus. This should correspond to some 50% retention of surplus before adjusting for depreciation and tax.

General

However one may address oneself to the problem of the financing of retail societies, the first requirement must be that management must be efficient in both the financial and trading fields.

One must accept that capital acquisition from the public and revenue earnings from trading operations both belong to intense fields of activity and competition. Today, effective management of assets and people is the only way to succeed. No systems, no formulae and no words of advice will produce the liquidity

or the revenue earnings which a thriving business requires. Action alone produces the means and the resources from which the future gains sustenance. Debates on how such resources should be employed may be endless but in the first place the generation of surplus and liquidity is the essential ingredient for financial success and self-supporting operations in the years ahead.

The Movement has the opportunity to succeed. Will retail Societies make the best of that opportunity or will they allow somebody else to show them how to do it?