
Incentives in Co-operatives

by Paul Derrick

Consumers' Co-operatives in Britain grew rapidly between 1844 and 1933, but during the thirty years since the report of the Gaitskell Commission in 1958 they have been finding it increasingly difficult to compete with the huge private chains such as Sainsburys and Tesco. This is partly because Co-operatives find it harder than companies to raise the capital they need to achieve economies of scale. Some economies have, of course, been achieved through mergers and by building a substantial number of Co-operative supermarkets and hypermarkets, but many smaller Co-operative shops have been closed and the Co-operative market share has declined. The problem of raising capital arises partly because of the Co-operative principle of a limited return on capital: Co-operatives are run in the interests of their consumer, worker or farmer members, not for the profit of contributors of capital.

Return on Capital and Bonuses to Employees?

Companies, on the other hand, offer their ordinary shareholders an unlimited return on capital and an unlimited appreciation of share values if the enterprise is successful. Some Co-operators have expressed doubts about the Co-operative principle of a limited return on capital, as Lord Graham did at the Co-operative College in July 1987 and as Frank Creed of the Brighton Co-operative Society did in an article in the *Journal of the Society for Co-operative Studies* in January 1988.

On the other hand consumers' Co-operatives have had the tradition of offering their members a dividend on purchases and may also offer their employees a bonus on wages. This sharing of surplus earnings between members and employees was supported by many of the Co-operative pioneers - such as G.J. Holyoake, E.V. Neale and J.M. Ludlow - though opposed by others such as J.T.W. Mitchell of the Co-operative Wholesale Society.

In recent years, however, the "dividends" on purchases - in their various forms - of many consumers' Co-operatives have been fairly modest because societies have needed to plough back their earnings in increased investment. Many pay various kinds of bonuses to employees, which include the issue of shares, but this is not fully a form of workers' participation in the success of the enterprise because the shares do not appreciate in value. With companies such as Sainsburys and Marks and Spencers and Boots, on the other hand, the employees hold a proportion of the shares and these do appreciate in value with the growth of the enterprise. The holders participate as shareholders and

in proportion to shareholdings, not as employees in proportion to the value of work contributed.

Mondragon, Plymouth and United Co-operatives

Why should not the employees of consumers' Co-operatives share in the growth of assets in proportion to the value of work contributed, in the kind of way pioneered by the Mondragon Co-operatives with their capital credits system? A high proportion of the earnings of the Mondragon Co-operatives is invested which helps to provide new jobs; and "capital credits" are issued to members in proportion to pay which are redeemable after retirement.

In a similar way the Plymouth and South Devon consumers' Co-operative in 1971 issued its consumer members with special bonus shares also redeemable only after retirement so that they shared in the growth of assets in proportion to purchases. Members of consumers' Co-operatives can also participate in the growth of assets by the issue of "vouchers" redeemable after a period of time. There has been the recent example in United Co-operatives. Such participation in the growth of assets by the employees and by members of consumers' Co-operatives, could help to increase incentive for employees to increase productivity and incentive for members to shop at the Co-op as well as increasing investment. It would also be a further help in increasing investment by reducing tax liability.

Tax Liability of Employees?

When bonus shares are issued they are regarded for corporation tax purposes as the equivalent of distributing a cash bonus which is promptly re-invested. The issue of such bonus shares, therefore, helps to reduce corporation tax liability and if the bonus shares are issued to consumer members there is no personal tax liability because the dividends on purchases of consumers' Co-operatives are not liable to tax.

If, however, they are issued to employees they may be liable to tax. Ideal Clothiers Ltd of Wellingborough began issuing bonus shares to its employees in 1904 to enable them to participate in the growth of assets and this helped them to increase their membership to more than 600 workers. At that time fewer workers were liable to income tax than is the case today. Some of the old productive societies, such as Queen Eleanor, have issued such bonuses, but this way of enabling workers to share in the growth of assets through the issue of bonus shares was discouraged by personal tax liability.

Case for Relief -

In 1978, however, a Labour Government introduced a scheme in the Finance

Act of 1978 to enable company employees to share in the growth of assets through the issue of bonus shares free of personal tax; and this was extended by the Conservatives in 1980 and 1984. Workers' Co-operatives were, however, excluded from this tax concession in spite of amendments proposed to Finance Bills in 1978, 1980, 1981, 1984 and 1985; but in 1986 this discrimination against workers' Co-operatives was removed by the Finance Act allowing members of workers' Co-operatives to share in the growth of assets in a Mondragon kind of way by the issue of bonus shares free of personal tax.

The Industrial Common Ownership Movement has rightly argued that this tax concession should also apply to the issue of loan stock by workers' Co-operatives to their members as many of their Co-operatives are companies limited by guarantee without a share capital. *But it should also apply to the issue of bonus shares by consumers' and agricultural Co-operatives to their employees to enable their employees to participate in the growth of assets in the same way as company employees.* For them to be excluded is discrimination against Co-operatives and the Working Party on Taxation, under the auspices of the Co-operative Development Agency, should make this very clear to the Government.

- And Ending Other Forms of Discrimination

There are also other forms of tax discrimination against Co-operatives. For example in 1972 the classic system of corporation tax was replaced by the imputed system which avoided double taxation i.e. personal income tax as well as corporation tax on the same profits. As Co-operatives gained nothing from the imputed system a Conservative Government allowed them to pay at a special rate.

Companies gained considerably from the imputed system so the rate had to be raised for them in order to maintain revenue. The special rate for Co-operatives was abolished in 1984 without explanation from the Government.

There is a strong case for allowing Co-operatives special tax treatment because they find it harder than companies to raise capital. Between 1844 and 1933, consumers' Co-operatives did not pay tax on their trading surpluses because Conservative and Liberal Governments recognised that the exemption of dividends on purchases from tax made it logical to exempt retained earnings too. The success of the Mondragon Co-operatives was helped by a ten year exemption from corporation tax, followed by payment at half the rate paid by companies. Agricultural Co-operatives in France are exempt from corporation tax, as are some in Britain, but there is tax liability when earnings

are distributed. In 1985 when Mr John Moore was Financial Secretary to the Treasury he expressed interest in the suggestion that workers' Co-operatives should be exempt from corporation tax to help them to accumulate capital out of earnings.

The Co-operative Union has long argued that there should be tax concessions in respect of interest on Co-operative shares in order to encourage investment in Co-operatives. In 1969 the Co-operative Party urged that there should be a special tax concession on all investment incomes of less than £100 in order to encourage small savings and investment in Co-operatives. Between 1907 and 1920 earned and investment incomes were taxed separately, an arrangement which provided scope for encouraging small savings. The present Government, however, has preferred to help large investment incomes, as by abolishing the Investment Income Surcharge in 1984 and by tax changes in 1988.

Investment and Incentive

There are many tax changes which could be used to help consumers' Co-operatives to reduce prices to consumers and help to control inflation at a time when the Government appears to prefer to try to tackle growing inflation by raising interest rates and increasing the danger of higher unemployment. The crucial thing for consumers' Co-operatives is, however, for them to be able to increase investment to compete more effectively with the private chains and to increase incentive for employees to improve efficiency and for consumer members to shop at the Co-op. In the old days substantial dividends on purchases were possible, but in the 1990s it could be useful if consumers' Co-operatives were to enable employees to share in the growth of assets in proportion to work contribution and for consumer members to share in the growth of assets in proportion to purchases by share accounts being credited in an appropriate way.

In an age of computer technology this should not be too difficult and should encourage more customers to become members. It could, however, be important for special share accounts to be used, as with the Plymouth Society in 1971 and as with the Mondragon Co-operatives so that the shares are not redeemable until the member reaches retirement age or leaves the district. The withdrawal of share capital in the early 1970s was an embarrassment to the Co-operative Movement. In some countries, such as Austria and Japan, share capital is less easily withdrawable than in Britain.

But No Sharing of Residual Assets

If it is important for members and employees of consumers' Co-operatives to share in the growth of assets when earnings are ploughed back it is also

important that they should not be entitled to share in the residual assets of their Co-operatives. This is prohibited by law in many countries, such as France and Italy and Spain, as a matter of Co-operative principle. Otherwise Co-operatives could become increasingly threatened by take over bids, as agricultural Co-operatives have been in countries such as Australia, when there is a substantial gap between share values and asset values. The point is that there is a real need for employees and members of consumers' Co-operatives to share in the growth of assets to increase incentive but that does not mean sharing in residual assets.

The raising of share capital by the Co-operative Wholesale Society by the issue of preference shares, in spite of the doubts of the Registrar about Industrial and Provident Societies other than agricultural Co-operatives issuing such shares, should help the financing of consumers' Co-operatives. The main source of finance for consumers' Co-operatives, however, as for companies, should be retained earnings from successful trading. The prospects of such successful trading should be improved if employees and consumer members share in the growth of assets as investment increases.

The Author

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