AGM.AND CONFERENCE 1975

Friday 4th - Saturday 5th April, 1975

This will be held at the Co-operative College beginning with tea et 16.15 hours on Friday and concluding with lunch at 13.00 on Saturday. In addition to the AGM, the occasion will include two Conference sessions, and it is envisaged that these will deal with:

1. Friday, 16.45-18.15: Societies and Inflation related to Bulletin 22 and introduced by Mr. R.A. Lee, Chief Executive Officer, Co-operative Retail Services Ltd.

2. Saturday, 09.15-10,45: Lay Leadership in Societies related to a report which is being prepared by a Working Party set up by the Education Executive and is expected to be available in January; and introduced by Mr. R. L. Marshall, Chief Education Officer of the Union.

The Annual General Meeting will occupy the session 11.15-12.45 on Saturday.

The comprehensive charge including accommodation and meals will be £8.00. Organisations in membership of the Society have, of course, only one vote at the AGM but may send more than one participant to the Conference. A limited number of bookings can be accepted for the wives or husbands of the participants at the same charge - and up to the limits of the available accommodation in double bedrooms.

A booking form is enclosed, to be returned to the Secretary and Treasurer not later than 19th March.

INTRODUCTION

This Bulletin deals with the impact of inflation on Co-operative societies and the responses they are or shoul be making. In November 1974 contributors of various experience and points of view were invited to prepare articles of about 1500 words on one or some of the following aspects of society operations:

1. Profits. Whether the term "profits", based on historical data has any meaning nowadays. Inflation accounting. Depreciation needs.

   If profits are artifically high, the implications upon corporation tax.

2. Development Programmes and the difficulties of apprais- ing capital investment projects.

3. Liquidity and cash flow difficulties.

4. Taxation. Cash flow aspects. Fiscal, e.g., in delay of payments both of VAT and corporation tax (in depreciated currency). Fiscal drag from "excessive" taxation of profits artifically inflated.

5. Buying Power. Inflation's effect on procurement and buying power. Stock level policy and valuation difficulties. Repercussions upon profits.

6. Labour Costs. Repercussions upon marginal shops and total Co-operative employment. Pension fund difficulties and implications on liabilities and profit tax.

7. Price Policies. The present situation.

8. Pension Schemes and the particular implications of inflation.

9. <u>Assets</u>. Valuation and depreciation problems. Policy for ownership, rent or leasing, etc.

10. <u>Society and the Member</u>. Share and loan capital - dangers. Interest rates. Dividend and members' bonuses.

11. <u>Co-operatives and the Effects of Government Anti-inflationary Control Methods</u>. Minimising the damage.

12. <u>Demand Factors</u>. Whether inflation has been associated with increased price-consciousness and "shopping around", or by a rush out of money and little price comparison. Effects on Co-ops.

    Effect of reduced living standards upon share and loan capital. Effect of reduced living standards upon the structure of demand, e.g., food and non-food, or packed and non-packaged food, and effects upon Co-operatives.

13. <u>Social Aspects</u>. Whether any special action is required, in addition to the Shirley Williams' "shopping basket" to relieve poverty amongst customers.

We are grateful indeed to those colleagues who accepted the invitation. Where a contributor has specified some concentration on an aspect of the subject, this is acknowledged in the title introducing the article and, more briefly, in the Contents list.

Societies and Inflation

With Particular Relation to Profits

MR. J. A. N. BAMFIELD
(Lecturer in Economics, Co-operative College)

When inflation was at low rates, it had a gentle ameliorating effect on societies' balance sheets and concealed much of the damage that was being done to Co-operative trade in the 50's and 60's. During the eight years 1962-1970, prices rose by 47%; in the four years since then, they have risen by 50%. With inflation raging at ever higher levels, it is interfering with basic management controls of societies. Hence the increased interest in this topic.

Accountancy seems to be based on a series of conventions to ensure that assets are not paid out as dividend and that shareholder capital is retained intact. The whole system assumes that money retains its value. However with inflation, merely to observe past conventions and add up the figures thereby produced does not guarantee that the society is maintaining its value, or that the profits so procured actually exist.

Boosting of Profits

The task of accountants is to value Revenue flows and identify the expenses connected with them. Many expenses, of course, occur at a time earlier than the Revenue flow. Where there is nil inflation this causes little problem. With high levels of inflation however, the gap between expenses and revenues will widen in money terms, even though in real terms it may stay the same. Because expenses (including stocks) occur in period 1 whilst the inflated revenue comes in period 2, an extra profit is produced, created simply because the payments and receipts are differently timed. If the rate of inflation is accelerating, then the gap between the costs of revenue and the revenue itself will widen even further (as it has). Therefore a society earning a respectable rate of net surplus in money terms may not be making a profit at all in real terms - as would be obvious if inflation were to end tomorrow.

Profits can be boosted by inflation in other ways as well.

(a) The increase in the value of stocks and similar assets can create additional profit which may be taxable.

(b) Depreciation according to rule may mean insufficient is being retained so that the value of the business may be falling. The various functions of depreciation are well-known, but none of them will be met if the replacement value of assets is increasing rapidly whilst depreciation levels remain constant. In this situation the size of the profits will partly be an indicator of the shrinkage in the value of the business assets - though I would not wish to bring this forward as a proposition.

Many societies, of course, make extra provision through accelerated retentions and special depreciation. To many though, activity of this sort smacks of over-enthusiasm. The 1973 Co-operative statistics indicate that although a sizeable amount of the increased surplus stayed with societies, it was only a small percentage of the total assets used in trade. This implies that in 1973 the value of the business did not remain intact - real Co-operative profits did not increase, but they fell. Even in the best of all possible Co-operative worlds, to declare paper profits and then retain most of them breeds a complacency that can only be damaging.

(c) Wages also boost profits, especially if inflation is increasing. Wages have usually been negotiated annually, or once every two years. This has produced a sharp jump in wage costs, which in money terms then remain static for the rest of the year. Revenues, of course, rise in money terms throughout the year. If the inflation rate is increasing then the relation between money wage costs and revenues is wider at the end of each successive year. Employees seem to have two options: to have their wages continually topped-up (e.g., by threshold agreements or indexing) or to obtain substantially higher awards in annual agreements. To some extent, they have been able to do both recently, and the problems thereby caused show the extent to which the see-sawing of real wage costs has helped profits.

Measuring the Real Position?

Recent academic discussion has made it difficult to decide whether inflationary profits are real or not. However most academics agree that real or not, it would be difficult to turn these profits into cash in order to meet tax bills. Thus if we keep to the conventions of accountancy and the limits set by the Inland Revenue, then tax payments can be minimised but the business will not necessarily be protected. So there is certainly a case for a society having its own private accounts to check that (a) the society is actually making real profits, and (b) the extent to which the value of the business is being maintained. In time, public tax rules may well catch up with private inflationary tax rules: Chancellor Healey's concessions on stock appreciation could well be the start of a wider refashioning of the tax system as it affects companies.

In principle, one would urge the indexing of all items in a profit and loss account to show how much profit comes from inflation and how much from trade. New accounting practices for stock, valuing all stock at the most recent price (Last In, First Out) will also show this up. The system is widely used in the USA, no doubt encouraged by the fact that it also enables them to reduce their tax liability.

Depreciation presents many problems. In principle, appreciating assets need not be depreciated. But such intellectual rigour will certainly increase tax charges. Where items such as plant and machinery, fixtures, fittings and transport are depreciating rapidly and will need to be purchased again within, say, five years, the private depreciation rate could well be at the replacement cost value rather than the historic cost. This will at least ensure that projects are making enough profit to cover their costs (in real terms) and provide for their continuance into the future.

The inflation of fixed assets (land and buildings) will also affect management policy - perhaps perversely. As assets are depreciated, they could well be twenty times as profitable at the end of their working life as they were when new. And an older fixed asset will obviously have lower internal charges to set against profit than will a new store. In real terms, at their current market valuation there may be no difference in profitability between old and new stores; but in money terms, opening a new store may well seem to depress profitability. Therefore, if management is not to distort its trading policy by excessive deference to historic expenses, private comparisons of investment appraisal should be conducted in relation to current valuations rather than old valuations net of depreciation.

Much of the foregoing has been urged with all the misplaced enthusiasm of youth, and it can be objected that the views represent an over-reaction to the situation. But greater reality must come when either (a) the inflated profits are taxed, or (b) inflation slows to new low levels. The first course has virtually been ruled out by the Chancellor - the second must eventually happen (in a sense the longer it is postponed the more inevitable it is). As inflation slows down, the profit multiplier goes into reverse, and societies which are making only paper profits will start to make paper losses. In this stage, high costs will not disappear under the impact of inflated money revenues, and the faster the rate of deceleration, then the greater the paper loss which will become apparent. If in addition, a return to normal rates of inflation is accompanied by heavy deflation on the 1969 model, which seems likely, then real profit margins will be under pressure as well.

In this context, a studious attention to the reality behind the 'money illusion' of false profits would prove the best investment in the future for the manager if he is to avoid the worst consequences of what Byron described as:

> "Dreading that climax of all human ills,
> The inflammation of his weekly bills."

Societies and Inflation

With Particular Relation to Development Programmes and Capital Investment Projects

MR. G. W. CALCROFT
(Chief Executive Officer,
Leicestershire Co-operative Society)

Inflation, with its effect upon all facets of our daily lives, having been with us for all time, is no new difficulty for us to deal with when appraising development programmes. Nevertheless, the current much higher than usual rate of inflation, its many causes and subsequent effects, now give rise to the attendant difficulties of development programme appraisal being much more broadly based and worthy of even more serious concern and study.

Appraisal problems now of necessity being more broadly based, still give rise for accepting at the onset, certain basic principles; for instance, that under all circumstances few developments, large or small, can be regarded as gilt edged.

Secondly and also without reservation, at the time of any development plan appraisal, the plan itself must be soundly based. Weakness on this score makes the exercise of appraisal pointless and, therefore, any doubt as to the thoroughness of research into the scheme, must essentially first be satisfied.

Conditions for a Sound Development Programme

What, therefore, makes for a soundly based development programme?

It is suggested that it must be based upon detailed research into all the factors which can affect progress of the plan and the end result of the programme on completion.

Such detailed research whilst at first being technical in detail as to design, construction, ultimate customer throughput and profitability, must also provide for the problems arising from the activities of the environmentalists, changing retailing techniques, money supply, cash flow, fluctuating interest rates and the broadly based legislative powers of the local authority planners, all or any of which if inadequately researched and planned for, can seriously affect both the timing and cost elements of the plan.

From the above it will be seen that any development plan must essentially be flexible and capable of adjustment - hence the need to accept, whatever the difficulties, that however efficient the appraisal might be, subsequent changes to the plan will certainly emerge.

Any development plan large or small, long-term or short-term, even though soundly based upon an acceptable standard of research, must essentially provide information in two main parts:-

1. The facts as they are at the time of preparation.

2. The forecast as to what the end results should be when the plan is completed.

The main appraisal difficulty, therefore, is to accept that whilst the facts may be correct, the forecast must inevitably contain some element of crystal ball gazing. Who, for example, can forecast with reasonable confidence, such matters as the outcome and effect of the following?

(a) Present inflation trends, will they worsen, slow down or level out?

(b) What ratio of future gross profit earnings will be taken up in personnel costs or occupancy costs?

(c) Will present legislative controls upon rates of gross and net profit margins remain stable?

(d) What effect upon our fortunes will peace or war in the Middle East bring about?

(e) Will the world population explosion worsen our ability to obtain supplies?

(f) Will taxation in all its forms remain unaltered?

These, and many other problems of a similar nature, whether they be local, national, international or world-wide, will inevitably bring forth new difficulties of appraisal, in that the actual end product, of the development programme itself, usually is planned to last many years. Thus difficulties of forecasting with reasonable accuracy, turnover, profits, cash flow and the like, must be accepted.

The Moment of Decision

The problem of estimating long-term viability in a development programme in the light of uncontrollable or unforeseeable future circumstances, even if the programme is soundly based and even if capital investment and growth are essential to the future success of the organisation, poses the inevitable central issues. The questions then are:-

1. Should we go ahead with the programme or wait a while?

2. Should we readjust the programme to one of consolidation?

3. Must the programme essentially be short-term?

To go ahead with the programme regardless of the future outcome could, it is suggested, be irresponsible and foolhardy.

The difficulty of indecision or delayed decision is still with the appraisers. However, this not unknown dilemma of appraisal, can be overcome and should automatically lead to the asking of a few simple but important questions, or possibly the adoption of a wider field of appraisal.

Dealing with the latter, the process of development planning appraisal unfortunately too often is specialist in nature and usually deals only with the development plan itself. Thus it provides little regard for the extensive other internal plans being developed within the organisation, all of which in any event, play some part in the organisation's future trade growth and efficiency standards - for example, the sales promotion plan, the merchandising and marketing plan, the refurbishing and replacement of existing fixtures plan, the staff training plan. It is, therefore, possible, though somewhat difficult, that a balancing together of the development plan alongside the various other plans, could provide future growth needs and concurrently to some extent an even greater degree of flexibility in the overall strategy of the organisation, plus improved safeguards against the unforeseeable future.

Questions to be Asked

The simple questions to be asked should in any event have been provided for in any well-balanced property development plan. However, their repetition would do little harm:-

1. Has the programme taken full account of our competitors' collective development activities, and if so, are they going ahead with development or are they consolidating or doing nothing at all?

2. Having decided our market, what is our share of that market? Will the development plan or lack of it maintain that share, improve upon it, or cause us to lose ground?

3. Is the full programme or any part of it so large that the success or failure of the new capital investment can make or break the whole organisation if any, or all, of the imponderables should ultimately come upon us?

4. If the programme is short-term, say, one to three years, is it flexible enough to provide an acceptable growth sufficient to meet our rising costs?

Having answered the above points or questions, is there really a difficulty or appraisal as to the acceptance or otherwise of the development programme?

Assuming for instance that despite the problems of the imponderables, national growth and financial prosperity is to be ours in the future, then under those circumstances growth and development of our organisation must proceed along with that growth and prosperity.

Secondly, should stalemate in growth and a static standard of living be the order of the day, then without doubt some organisations will go to the wall, but others will progress or remain reasonably profitable, and some in fact may gain in prosperity. Surely, therefore, those organisations with a soundly based development programme, coupled with high standards of efficiency in all other aspects of their activity, will be those for whom prosperity will emerge.

Alternatively, should the forecasters of doom ahead be proved to be right, again only the most efficient and best in each field of operation, will survive. In fact a soundly based programme thoroughly appraised must surely be the best form of survival and defence in circumstances of our adversity.

Societies and Inflation

With Particular Relation to its Effect on Consumer Demand

MR. ROBIN W. GAGE

(Mr. Gage is a senior member of the staff of the CWS Retail Management Services Group. The views expressed are, of course, his own and not necessarily those of the Group or the Society.)

In this brief contribution on the likely effects of inflation on the sales levels of retail societies, it is not the intention to make any fundamental analysis of the causes, or the likely outcome, of the inflation that currently grips the British economy. Indeed, the question both of the cause, and likely outcome, of the inflation is still the subject of debate amongst economists, and, frankly, to accept any one set of arguments at the present time is to give the economists more credit than they deserve. The best among them admit they cannot fully understand the situation. Instead of a generalised discussion, what has been attempted is to construct a practical guide, given certain basic assumptions, as to the likely effect on consumer demand for the major categories of goods sold by Co-operative societies.

Decline in Consumer Expenditure

For practical purposes the assumptions implied in the consideration of demand outlined below are those which are made by the Government, and most reputable independent economic forecasters, covering the next eighteen months or so. Without going into great detail these forecasts predict a decline in consumer expenditure (in real terms) of around about 1 - 2% from current levels. This is arrived at generally by predicting an overall price inflation of around 19%, wage increases of something rather more than this, but total personal income being cut back behind the rate of price increase by a combination of unemployment - probably around the one million mark - and possibly Government measures (either to restrict wage increases or to take a bigger tax revenue). In other words the prediction is for a rather less affluent but essentially very similar economic situation to the current one. In practice it makes little difference to the purpose of this paper whether these forecasts are worthy of acceptance or not, for unless something very similar to this happens, the changes in our economic situation are likely to be so great that it is, literally, almost anybody's guess what will happen.

On the other hand, on the basis of this type of development we can make some fairly confident predictions, in broad terms of what is likely to happen to consumer demand, in terms of the goods sold by retail societies, as a direct result of the predicted 1 - 2% decline in real purchasing power. (For the purposes of the comments below we have assumed a 2% decline.) These predictions take account only of spending power, not of any other market trends.

The forecasts of the effects a cut in living standards (or real wages) are likely to have on purchasing patterns are based on the "income elasticity of demand" for the various commodities and products. This is in fact a fairly complicated economic statistic. It is arrived at by a lengthy comparison of the relationship of income and consumption at a single point in time, and when finally calculated it shows, approximately, how much consumption of a particular product is likely to be affected by a 1% change in income level. The actual figures used in the comparison are drawn from Government publications - The Family Expenditure Survey for non-food, The National Food Survey for food.

Effects on Dry Goods?

Across the board, a 2% decline in purchasing power is likely to lead to a decline in expenditure on food of 0.5%, and on dry goods (durables, clothing and footwear, hardware and other non-durable household goods) of slightly over 2% - about 2.1%. In the field of dry goods the product categories most likely to suffer from a decline in real wealth are:-

Menswear
Children's wear
Soft furnishings and household textiles
Furniture and floorcoverings
Miscellaneous dry goods (hardware, toys, jewellery, etc. combined as one category)

In all these categories, consumer spending is likely to contract at a greater rate than purchasing power. All these categories are likely to suffer a real decline of around 2.5% - 3.5% in terms of cash sales (excluding the effect of inflation) because of spending power being reduced.

The non-food categories which will be least affected by a decline in spending power are:-

TV rental
Ladies' wear
Footwear
Other clothing (hats, gloves, piecegoods, etc.)
Electrical appliances

In all these categories we would expect that there would be rather less impact - ranging from practically no measurable effect on TV rental, to a decline of about 1 - 2% on the other categories.

In terms of the most recent experience available these are the effects that a decline in real spending power is likely to have on consumer expenditure. Of course, it must be remembered that the level of spending power is only one of the influences on market trends. There are other factors which may well influence the market - such as Government credit restrictions, supply difficulties, and basic market trends (i.e., a product going out of fashion) which will affect market demand. These predicted changes are not therefore in fact market forecasts for 1975; they are factors which should be used to take account of the likely changes in real income levels, when making forecasts (so that, for example, if based on market trends one expected sales in 1975 of £100,000 in both TV rental and menswear, then because of the predicted change in purchasing power these should be modified to £97,000 for menswear, and remain basically unchanged for TV rental).

Effects on Food Trade?

In the area of food trade sales we can make rather fuller predictions, using the same elasticity technique, because there are more available statistics relating purchasing patterns to income levels.

Of itself a 2% decline in real income will make very little difference to the demand for cigarettes and tobacco. Liquor sales, however, will be more responsive and should decline by about 2.5% (although again this is in total, and may well be more than offset by the trend to higher home consumption, so that the 2.5% decline again should only be applied to the expected value for 1975).

As stated above, in terms of actual food products, by which we mean food for in-home consumption, not confectionery or meals out, etc., the general effect will be considerably less than for most non-food products - a real decline in expenditure of under 1% is predicted. By and large, as will be the case also for non-food items, the decline in spending will be a combination of reduced quantities purchased and of "trading down" within a product. The products which appear most likely to see noticeable "trading down" are:-

Beef and Veal	Onions
Mutton and Lamb	Apples
Bacon and Ham	Soft Fruit (fresh other than grapes)
Cooked Meats	Dried Fruit
Chicken and Poultry	Cakes and Pastries
Fresh Fish	Plain and Chocolate Biscuits
Canned Fish	Breakfast Cereals
Quick Frozen Fish	Rice
Potatoes and Other Root Vegetables	Pickles and Sauces
Fresh Green Vegetables	Salt

For all these food products we would expect there to be a movement towards cheaper cuts or quality, or brands. These are the products where reduced income levels should have a noticeably greater effect on the money spent, rather than on the actual quantity bought. For all other food products it seems likely that quantity and expenditure are likely to be affected equally. The following are the products whose volume sales are most likely to be affected by the decline (2%) in spending power.

Decline in Quantity	Products
about 3% - 5%	Quick frozen fruit, shellfish, fresh coffee.
about 2% - 3%	Yoghurt, Q.F. chips and potato products, all quick frozen vegetables, cooking oils, fruit and vegetable juices.
about 2%	Nuts, fresh fat fish, Q.F. peas, Q.F. beans, ice cream and mousses, cream.
about 1% - 2%	Rabbit and game, Q.F. fish (white), wholemeal and wholewheat bread, mushrooms, spreads and dressings.

about 1%	Cucumber, lettuce, canned potatoes, poultry other than broilers, crispbread, QF meat, all fresh fruit (other than rhubarb and possibly apples).

<u>Increase in Quantity</u>	<u>Products</u>
about 1% - 2%	Coffee essence, pre-packed "old" potatoes (Jan-Aug), canned milk puddings.
about ½% - 1%	Beef sausages, canned peas, flour, pre-packed main crop potatoes (Sept-Dec).
under 1%	Large white sliced loaf.

Very few foods are in fact likely to gain any substantial benefit from a generally reduced spending power.

<u>Many Other Factors</u>

Apart from the products itemized above, the quantities of products sold are not likely to be affected substantially by a reduction in real spending power of the order predicted. Again, however, it must be stressed that we have here considered the effect only of a change in spending power upon consumption patterns. There are, of course, many other factors involved in setting the pattern of consumer spending - the changing nature of consumer tastes and needs, changing patterns of product supply or product innovation or noticeable disparate changes in the relative price of competing goods, for example. All these factors can be expected to be again present in 1975. For this reason the figures given above cannot be regarded as actual predications of market changes in 1975. They are solely an estimate of where, and to what extent, a reduction in spending power is most likely to have an influence. For example, the heavy representation of frozen foods in the list of products does <u>not</u> mean we are predicting an actual decline (of about 2%) as implied in the above lists, in the frozen food market. What we are in fact saying is that consumption of these foods will be depressed in 1975 (by about 2%) from the level we might otherwise have expected, due to a reduction in real spending power. However, the strong trend to increased frozen food consumption - due to changing food preparation habits, consistent product innovation, increased availability of refrigerators, and so on - that we have seen over recent years will still be present. We therefore expect 1975 to show a continued increase in frozen food expenditure (due to the established market trend) but a very much slower rate than in recent years (due to lower real spending power).

In conclusion, it may be worth re-emphasising that the whole of this examination of likely influences depends very much on the economy being kept on a reasonably even keel, and thus allowing consumption patterns in broad terms, to follow past experience. At least we might draw some encouragement from the fact that all current indicators are reasonably hopeful for Co-ops, at least from the sales side, if not from the profitability aspect. There is no evidence of any basic changes in shopping or consumption patterns as yet, and contemporaneous developments - particularly rapidly increasing petrol costs and mildly redistributive Government activity on earning power - should give Co-ops some competitive advantages in the, as yet, very uncertain future.

Societies and Inflation

Inflation Tolls the Knell

MR. JOHN GALLACHER

(Parliamentary Secretary, Co-operative Union)

The Counter Inflation (Price Code) Order 1974 came into operation on 20th December, 1974. This Order substitutes a new Price Code for the Code which has been in operation since 1st November, 1973 (as amended from time to time) and closes a period of intensive consultation which took place between trade associations and the Ministries of Agriculture and the Department of Prices and Consumer Protection.

The Counter Inflation Act 1973 was the starting point for the Price Code. The present Government has strengthened the Code and, under the Prices Act 1974, taken additional powers over prices generally as well as abolishing the Pay Code. Manufacturers and distributors are in the position of being subject to close price and profits control while pay negotiations are unrestricted except for the social contract which exists between Government and the Trades Union Congress. This contract is in no sense a legal matter.

Both Mr. Heath's administration and the present Government became involved in the economic life of the nation to an unprecedented extent. The immediate reason for this is inflation, which has both national and international origins, but more deeply it represents a continuance of a trend which began during the war of 1939-45.

The maintenance of full employment (or over-full, depending on one's school of economic thought) has been a first priority for government since 1945. Whether inflation is a by-product or concomitant of full employment is for the economist to decide. We may yet see inflation co-exist with large scale unemployment, but in that event government policy will have been defeated by stronger economic forces.

The implications of price and profit control in a period of unprecedented inflation have scarcely been thought through. They carry threats for all private sector organisations and if they receive set-backs, either for reasons of liquidity or low returns on capital, or both, so that large scale State intervention is widespread, then effectively the mixed economy system will be at end. Britain will then have lived through a peaceful economic revolution and the only surviving examples of unadulterated capitalism will be those enterprises which contrive to enjoy the confidence of the trustees of the pension funds of the nationalised industries!

Role of the Movement

The Co-operative Movement, as always, has a foot in both camps. As a non-profit, non-capital gains creating institution it is already socialised, though, at the time of writing, independent of Government. Co-operatives have low profit requirements requiring only enough to sustain share interest at nominal rates, depreciation at original values, a return to customers of around 1% on turnover, and a residual for ploughing back either as reserves or for future development. The rate of development can be varied in accordance with the size of the residual, so Co-operatives are in a unique position under price/profit control.

The present Government has been slow to recognise the potential of consumer Co-operation in the fight against inflation. Possibly fragmentation and a century of emphasis on voluntaryism have spared it direct control from Whitehall. The British Labour Party is also uniquely state-board minded and in this they are well buttressed by trades union policy.

As part of the general distributive sector, Co-operatives have been involved in Price Code discussions both in their own right, via the Co-operative Union, and as part of the Retail Consortium. Although evidence from both sources originated separately, there was no serious division in either analyses or proposals made to Government. Both organisations were highly critical of the 10 per cent cut in permissible gross percentage margins enforced by the Price Commission in 1974. The so-called safety-net of 75 per cent of net profit reference levels introduced at the time of the 10 per cent cut in gross margin was of limited value because it could only be used if it did not result in distributors exceeding 100 per cent of gross margin.

The Revised Code

The revised Code improves upon the concession in the consultative document in that the safeguard for net profit margin is set at 80 per cent of the reference level instead of 75 per cent. This is still associated with a "licence" to go to 105 per cent of the gross margin reference level if that is necessary to achieve it. This will help the generality of retail societies although some would have liked the related lower gross/higher net basis which the Retail Consortium tabled during consideration of the consultative document. Inflation accounting awaits the report of the Sandilands Committee.

The Code allows a low profit safeguard as a percentage of turnover at 2 per cent (it was 1½ per cent) and extends investment relief at 17½ per cent of firmly budgeted capital expenditure on investment for the home market for plant, machinery and industrial buildings in the form of an addition to gross and net profit margins. Trade pressure on the Ministries involved resulted in the extension of this capital relief to expenditure on the construction of warehouses and to payments under hire purchase, credit sale and conditional sale agreements and under leasing agreements where the lease is for more than two years, provided the payments relate to plant and machinery.

A side aspect of the Price Code is the extent to which it has become a subject for bargaining between Whitehall and those who speak for interested parties. Unlike free collective bargaining over wages, however, there is no ultimate sanction, equivalent to the withdrawal of labour, open to trade associations. Ministers and their civil servants listen, comment politely, but make no offers. In the final analysis traders must like it or lump it. Organised labour would never stand for it.

The private sector has not been faring well under the dual effects of profit control and inflation. Joint stock companies have substantial profit needs in order to satisfy investors and sustain cash flow. Those responsible for producing results have the added fear that, even when circumstances affecting results are outwith their control, there may be a disposition to try new faces in an attempt to improve returns. In this context, we must all envy the captains of nationalised industries who have the twin havens of statutory monopoly and a blameworthy department in Whitehall. No wonder the queue grows daily at the Department of Industry!

Can a Market Economy Survive?

It is fundamentally unreal to control prices and profits in a sector of economic life where competition is supposed to work for the benefit of consumers. The market economy, in which price maintenance is virtually illegal, should by its nature operate to general advantage. If it fails to do this, or is prevented from doing so by reason of stringent controls on a continuing basis, then it would be better to accept the fact that the nation cannot afford a market economy.

The longer price/profit control remains the more unfair it becomes. The datum (any two of the previous five years) may seem realistic, but it assumes a static enterprise which distribution under modern conditions is not. This point was strongly made by the Co-operative Union in its submission as part of the review of the Code. Whitehall found it "interesting", but administrative pressures there are excessive and nothing tangible resulted. In any event are civil servants, however eminent, really practical experts when it comes to regulating the distributive trades? Are practising retailers gainfully employed when they must spend so much time in Ministerial offices debating a control mechanism which ought to be superfluous anyway in a competitive economy?

It may be that the creation of so large a public sector from 1945 onwards had already sealed the fate of joint stock capitalism. Certainly there are many natural monopolies, still mainly in private hands, where the benefit of market forces is outweighed by the high cost of achieving them - bread, milk and petroleum processing and distribution, for example. Already the Secretary of State for Prices, in defence of bread subsidy arrangements, has intervened in the matter of discounts allowed by bakers to retailers. If this kind of Ministerial regulation of buying prices increases, then taken in conjunction with profits control at the gross and net reference levels, plus taxation of profits and proposals for taxing personal wealth, it requires no crystal ball to predict the demise of even so resilient a system as capitalism.

A minor consolation in all this is that planned economies need not necessarily result in lower general living standards. If managerial skills are allowed to flourish and labour indiscipline loses its present status of a first principle, we may yet achieve a society whose standards will satisfy reasonable expectations. Even if it does not, there will be little that can be done about it in any case. If the evidence of other countries is anything to go by, then planned economies are not susceptible to change by conventional democratic processes.

Societies and Inflation

With Particular Relation to Profits

MR. R. A. LEE
(Chief Executive Officer,
Co-operative Retail Services)

In order to understand the impact of inflation on business operations one must initially be bold enough to attempt to define in simple language what the word "inflation" really means and how it occurs.

There are many people who will say that rising prices cause inflation. There are those who will diagnose the cause to be wage increases. Some will advance the argument that the real worth of wealth produced has been overstated by the measurement factor - money.

Meaning of Inflation

I would contend that rising prices and increasing wages are the results of inflation because the value of money in relation to other commodities has fallen. Unit costs of production have risen when measured by rate of output and are not therefore competitive; and for numerous reasons the money supply has been allowed to become excessive in relation to the value of those productions.

Thus we have an equation which is out of balance. Money, which is the manager's and the accountant's yardstick of measurement and also the means of recording business activities, has become unstable and unreliable. Unless corrective measures are taken, this out-of-balance situation accelerates, and the rapidly reducing value of money, when placed in the time-scale of production, wholesaling and retailing, aggravates the problem of asset replacement at higher costs which are not supported by real profitability. Hence we refer to paper profits, inadequate cash flow and illiquidity.

If we attempt to reduce the situation to simple proportions so far as the retailer is concerned, it could be suggested that the essence of the problem lies in the relationship of prices and gross profits (sales), wages and other expenses (costs) and net earnings (cash).

Increased prices should increase sales if we only remain static in market penetration. Increased wages and other expenses may or may not increase the rate of cost dependent as these factors are on the level of sales achieved and the amount of wage increases and other expenses borne.

Importance of Rates

Net profit will, however, be real to the extent that its rate is not allowed to fall when expressed as a percentage of the sales achieved. It is assumed, of course, that gross profit rates do not vary materially in the short term. If they decline then obviously a greater volume of sales will be required to balance the equation.

The most important point to note is that we are dealing with rates, not amounts. The rate of net profit should become the insurance policy to cover the inflationary element included in sales.

Inflation in sales must be reflected in inflation in net profits if we maintain balance because the value of money has fallen in each part of the equation. In other words, the rate of net profit may be maintained but the amount of net profit must increase.

If we fail to achieve this position of "status quo" then we make less real money and we have less to spend. Real net profit and cash flow are obviously inseparable so far as management is concerned.

Under inflationary conditions, however, profits should be regarded as real only to the extent that they are net after depreciation at replacement cost of fixed assets and after allowing for appreciation in current assets - stocks, etc.

This does not mean that we need to change accountancy procedures fundamentally in order to record replacement values. We should provide at trading account level for outstanding costs as in the past at the level of prices and charges appertaining at the balance sheet date. We should, of course, anticipate all contingencies on a prudent basis as in previous years but there is no need to adjust asset values or amend depreciation rates at this juncture beyond those required to amortise the historical cost over the expected life of the asset concerned.

The purpose of the accounts at this stage is to record accurately what we have expended on current and fixed assets, what we have received from sales, what we have achieved at gross margin level, what we have spent on wages and other expenses, and what we have left as trading profit and assets, including cash, to start the next accounting period.

Replacing Stock and Assets

Inflation is, however, the danger signal which informs us that to replace our stock and to replace our fixed assets will require more money. We should, of course, already have an extra amount in cash or bank balances if our rate of net profit has been maintained and if we have not been obliged to suffer exceptionally heavy capital expenditure. We should, therefore, allocate from our net profit (cash resources) sufficient sums to build up replacement funds and if possible invest these sums outside the business in order to finance the increased costs of asset replacement - the sinking fund method of internal financing. These adjustments or allocations of surplus are best implemented after arriving at the trade account profit.

So far as taxation is concerned we must abide by the rules and regulations of the game. It has recently been stated that stock appreciations will be allowed for in computing taxable profit. This is not an absolute allowance because it only amounts to a deferred tax liability and upon withdrawal of the allowance a tax payment could occur. In other words, we should regard this concession only as a temporary aid to cash flow - we are allowed to defer payment of tax according to the formula employed.

The basic ingredient of the profit game which is causing the "paper profit" and cash flow problems is obviously money. Both as a measure of value and as a medium of exchange it has become a most unreliable commodity. At any one particular time it may adversely affect consumer spending because prices may rise faster than wages or it may generate spending because wages increase faster than prices. Whatever situation occurs a strain is placed upon the normal activities of retailers in their efforts to balance the equation to make real net profit supported by adequate cash flow.

It is beyond dispute, however, that the retailer who acquires adequate cash surplus from his operations, whatever the value of money, must provide himself with a power to spend and thus to develop his assets for future profit growth. The retailer who generates cash flow acknowledges the reducing value of money and at least maintains his <u>rate</u> of net trade earnings.

If we adopt this realistic attitude to a declining money value we obviously upgrade figures and downgrade money in our current operations and future development plans - we also control cash flow. The relationships (rate) should remain reasonably constant whilst all the figures will increase in amount - sales down to net.

Stock relationships, pension fund liabilities, members' capital balances, etc., all fall into the same category. All should rise as the value of money falls. To the extent that they do not, then we must retain from current earnings to maintain liquidity.

In the case of pension funds it must not be overlooked that here again there is a rate relationship. If wages increase then the contributions made by employees and employers will rise in amount because both are calculated on a rate basis.

If the general levels of interest rates increase then the interest to be charged to the Society and credited to the fund should also be increased.

Investment Outside the Society?

The investment of funds outside the Society raises quite a different problem. The falling values of equities and gilts pose serious problems. In the long term one would expect them to recover and capital losses should be recouped. On the other hand, the security of the fund could be threatened if inflation gets completely out of control. Caution should be exercised in the placing of funds outside the Society, especially in equities - there is an element of risk which appears to grow daily. Any deficiency arising from quinquennial valuations will normally require an addition to the annual special contribution. Here again, all things being equal, the original annual special contribution in amount has lost value. It will need to be increased at least to an extent to take care of inflation. The equation must balance because the base ingredient - money - has lost value. Obviously, these simple rules of procedure call for sophisticated analysis by actuaries because the wages upon which contributions are based will not be the wages upon which pensions will eventually be calculated. The principle, however, is not thereby invalidated which is to establish a rate of growth of the fund which will at least meet the deficiency arising from reduced money values.

What we must ensure is that we reflect the falling value of the pound sterling in the records we keep in order that we do not understate our liabilities and hence produce paper profits unsupported by adequate cash flow.

The adjustments and retentions we make are part of the re-alignments needed by allocation of earned surplus on current costs to meet the increased costs (money-wise) of the future. Most of these adjustments should be made after completing the trading account. They are allocations or provisions in a general sense caused by the reducing value of money.

The effects of inflation upon the nation's welfare and the adverse effects upon standards of living are, of course, quite different subjects. Indeed, the manner in which we allocate earnings, whatever their level, to the agents of production is significant, but does not affect the general case outlined so far as retailing and inflation are concerned. Even subsidies have to be paid for by somebody - they do not solve the overall problem of inflation - they merely alleviate burdens in selected areas and transfer the cost elsewhere. They may have social and moral justification but they cannot enhance wealth production upon which all economies must depend in the long term for standards of welfare.

The General Need

Until we produce wealth at a competitive cost and until we cease to print pound notes to balance our deficiencies, we must learn to live with inflation. If we accept that more money will buy less so long as inflation continues, then we must manage our affairs on a rate basis as opposed to an amount basis and thus generate more liquidity to meet the increasing costs of the future. In this way we will produce real profits, record our results correctly in our accounts, and generate sufficient cash flow to support the increasing costs of working capital and to finance future development plans.

Societies and Inflation

With Particular Relation to Taxation

MR. F. McMAHON

(Lecturer in Taxation, Department of Accountancy and Finance, Heriot-Watt University)

The effects of inflation on business taxation are very much in the news. In his latest Finance Bill the Chancellor of the Exchequer, Mr. Denis Healey, introduced a revolutionary tax relief for the inflation element in the value of stock in trade at the end of an accounting period. This proposal has been well received in business circles as a first step to easing company cash flow problems. How does inflation affect corporation tax?

Commonly the tax computation is based on the profit (with certain statutory adjustments) shown in accounts prepared on an actual cost basis. This taxable profit figure, therefore, is higher than if inflation accounting adjustment were made to the accounts.

Tax depreciation (capital allowances) on fixed assets like industrial buildings and plant/machinery is also calculated on the original historic actual cost. Arguably the tax system should recognise the different values in the cash of 1975 and that of three or five years ago. Where a machine cost £150 five years ago, its replacement now costs £450: and the business has no greater real value than before. Can the £300 be said to be taxable profit?

The result in both cases is taxing not real profits but paper profits, not trading surplus but the inflation element. Inflation itself causes liquidity problems but payment of tax on a profit that does not accrue in cash or receivables makes it more acute.

It is to improving company liquidity that the Chancellor's proposal about stock in trade is directed. Before he goes any further Mr. Healey awaits the report of the Sandilands Committee on Accounting for Inflation (expected in March 1975).

Awaiting Further Proposals

The extent of any proposed inflation adjustments is important for tax purposes. It is necessary to assume that any comparisons of the present historic cost system and any one of a number of reformed inflation accounting methods will rest on equal tax yields. Otherwise there will be dispute concerning the incidence of taxation between companies and, say, individual wage earners. Equity may have a place in economics: it has none in taxation.

It is likely that tax/accounting adjustments will be needed in other areas than profit-fixed assets, monetary transactions, stock in trade, losses, payment of taxes, capital gains.

At present accounting depreciation is disregarded for tax purposes and a set scale of capital allowances substituted. Inflation accounting would alter this. One method is to continue the present accelerated depreciation (first year allowances). Companies would be taxed on inflation adjusted profits and inflation adjusted depreciation would be disallowed: capital allowances (tax depreciation) would then be allowed, based on accelerated depreciation, inflation adjusted as necessary. Where depreciable assets (like plant and machinery) were allowed at 100% First Year Allowance, inflation adjustment would be unnecessary for tax purposes in this respect.

Alternatively tax might be charged on the inflation adjusted profit, thus allowing the inflation adjusted commercial charge for depreciation as a deduction. Rates of depreciation for specific types of plant would require to be laid down by the Revenue for accounting purposes. But this is no different in essence from the pre October 26th, 1970 system for capital allowances.

In both cases proceeds of sales and tax written down values would require inflation adjustment in any computation of balancing charges/allowances on disposal.

Profit and loss account items - sales, other income, expenses - have to be adjusted to balance date pounds. Conveniently an even flow of transactions may be assumed though this may prove unfair to the Revenue on the one hand and the seasonal business on the other. Some refinement may well be required.

Non-allowable expenses, e.g., entertaining, may be added back for tax purposes in the inflation adjusted amounts. Bad debts would be adjusted over their period outstanding.

Non-taxable income, especially franked investment income (dividends paid by one UK company to another) would be extracted in the inflation adjusted amount from the inflation adjusted profit.

Fluctuations in monetary items (e.g., debentures, bank deposit accounts) will give rise to gains and losses on adjustment. These may be fairly frequent and accordingly should be brought in as taxable and deductible items respectively.

Stock in trade is traditionally valued at the lower of historic cost or net realisable value. Inflation adjustment is needed for the period between acquisition and the year end accounting date. It may be difficult administratively to isolate each item and adjust it with complete accuracy. To begin with, it will be necessary to establish working rules which can be refined over the years for seasonal and other peculiarities.

Inflation adjustment for stock in trade is important to meet the taxation imbalance between companies with considerable stock holdings, like food and drink companies which are presently taxed on the inflationary uplift in those stocks and those companies with heavy investment in fixed assets, like heavy engineering, which benefit from accelerated depreciation.

In this area the proposed relief for increase in stock values in the financial year 1973 is a total change of attitude by the Revenue. By it companies holding stocks of £25,000 or more will be able to reduce the closing valuation of stocks by the amount by which the increase in book value exceeds 10% of the trading profit before capital allowances.

Essentially this is only a tax deferment because an undervaluation of closing stock is brought forward in the next year as opening stock. Further relief will depend first on the Sandilands Report.

Until the burst of inflation of the 1970s the main grievance about taxing paper gains was in capital gains tax. Because for businesses it was possible to defer payment of tax by replacing the asset, the inflation effect became even more pronounced. Therefore, to compute the real gain adjusted historical cost or adjusted 6th April, 1965 value will be deducted from sale proceeds.

The logic of inflation accounting projects that tax losses should be inflation adjusted. Assuming a continuing inflation, losses would be expanded where relief was given by carry forward and contracted as a carry back.

Inflation Accounting and Payment of Tax

Inflation based accounting may affect payment of tax. First, advanced corporation tax is deducted from dividends paid by a company and is remitted to the tax authorities. When mainstream corporation tax is computed at the end of the accounting year, the ACT is deducted to arrive at the further amount payable. Mainstream CT will be inflation expressed in year end pounds in the balance sheet. Advance CT which may have been due nine months before would be converted also to pounds at the balance sheet date when computing the MCT.

It is also arguable that to preserve real value to the Revenue final payments of corporation tax, which can be due as long as twenty months after the balance sheet date, should also be inflation adjusted. This is probably unlikely - although the Government also needs to make up its loss in revenue because the tax profits of an accounting period form only a measure of tax due. But certainly the trend is there for earlier payments to account and heavier interest charges for late payment.

Similarly tax deposit accounts for use in settlement of future corporation tax could also be kept in real terms so that deposits rose in value with inflation.

The final form of any change from present methods of computing taxable income on an historic cost basis will depend, firstly and fundamentally, on the Government's views of the Sandilands Report. The inflation accounting method adopted - whether CPP or Replacement Cost or one of the many variations thereof affects the tax system mightily.

Nor can political interpretations be left out. Some would oppose a tax system on an inflation adjusted accounting base, believing that grants, incentives and controls can be more equitable.

For sure, the future tax system will be no less complex.

Societies and Inflation

MR. DUNCAN McNAB

(Chief Executive Officer and Secretary,
London Society)

There is no doubt that throughout the country a serious position is developing as a result of inflation. Private industry and the Co-operative Movement are equally affected, and it is logical that the greater the inflation the more it affects the cash flow of every company throughout the land.

Inflation is continuing at an alarming rate and in its wake there is developing a rapid deterioration in liquidity throughout industry and commerce.

Distribution is caught in the jaws of a vice - on the one hand, gross margins are under attack, and on the other, expenses, personnel costs and development costs are escalating rapidly, and, what is more alarming, no one can do anything or see any improvement taking place in the foreseeable future.

In addition gross margins are controlled by the forces of competition and as we are only too well aware, this competition is becoming even more fierce, not just in the Metropolitan area but throughout the country. Selling prices are being squeezed by competitive pressures, and as a consequence trading margins are being reduced so we are facing a future of reduced margins and increased expenses. Fortunately most societies are in a trade boom showing large increased trade, almost across the board and this is counteracting to some extent increased costs, but it is quite apparent that increasing expenses in many societies are outweighing the extra profit on increased trade.

Prospect for Profits

Cash flow and liquidity can, in the main, only come from profits. The Movement must make profits if it is to progress, and if it is going to keep pace with our competitors. The fact that profits are subject to Corporation Tax must not act as a deterrent. It is better and much more healthy for a society to be successful and making profit and paying tax, than to be in the position of having no liability for tax.

There is no doubt that the squeeze on margins, taken in conjunction with the increase in expenses, will result in reduced profits for most societies. As a result of a reduced cash flow in many companies and societies no new development or re-development is taking place, but unless we develop and keep pace with the multiples we are likely to suffer a further decline in our fight for trade.

Under severe inflation, the difficulty we have to overcome is to strike the right balance between a continuing development and stagnation, It is therefore necessary to make certain that each new development can be a profitable asset to the society.

Inflation will continue to cause us severe trading worries, as no one can honestly say that inflation will soon be conquered. One has only to look at the financial papers and read published company accounts, (many from companies which were previously considered as blue chips), to see the serious position in which industry is finding itself.

The Question of New Developments

Many of our companies are slowing down their rate of development or cancelling projects altogether. A case in point is the John Lewis Partnership which has pulled out of the Wood Green Central Area Development because, as the Chairman stated, the Partnership felt unable to commit itself to the necessary building contracts or to the borrowing of the necessary funds. Other firms such as

Debenhams and Woolworths have publicly announced greatly reduced profits and also drastic cut-backs in development.

Societies in the main are in the exact same position as our competitors. Unfortunately many, including the London Society, are heavily committed to very costly but necessary development which with interest rates at their present high level and the escalation of building costs, makes profitability for the first five years of many developments very doubtful indeed.

A 2% monthly rise in building costs plays havoc with even the most ingenious form of costing, and it is little wonder that where there is no definite building commitment, industry in all its aspects is being extremely cautious over future building contracts, with the possible result of considerable unemployment in the building industry in about six months' time.

While it is possible to obtain loans provided adequate security is given (and this at times can be difficult) the rate of interest of anything between 14% and 17% takes the gilt off the gingerbread. While there are signs that such rentals may be reducing slightly, it would still appear that in many cases the only one who can possibly make a profit is the developer, and even they are under severe pressure with companies going bankrupt.

Previously we were the last to be offered new developments, but now we are even being offered second rate sites, at ludicrous rentals with further upward rent reviews every three years, which makes profitability almost impossible.

The Movement's Capital

The composition of the Movement's capital has rapidly altered during the past few years. No longer can we depend on members' Share Capital, which has declined quite rapidly and extensively.

Members' Loan Capital on the other hand has been increasing at a moderate pace, while we are all under pressure to invest superannuation funds outside our societies, or pay the market rate for the advantage of retaining such capital. It is perhaps galling that many superannuation funds which took expert advice and invested their funds in equities are now wondering what is going to happen if the share market remains at its present low level for any length of time. At the present time funds which are invested in societies are in a much superior position to those invested in equities or other forms of recommended market investments.

Food subsidies are affecting the cash flow of the Movement. In London Society alone the milk subsidy amounts to £100,000 per week, so we lose the use of ½ million pounds over the five weekly period, and in addition we have to add to this the loss in cash flow of the bread subsidy.

Stocks and Expenses

Replacing of stock at last year's level is costing some 30% to 35% more, and using London Society as an example, our cash flow is affected by some four million pounds in keeping to the last year's stock level.

With expenses increasing currently by 20% this is not only affecting profits but the additional cash required is a further problem which requires solving.

Stocks in distribution generally are too high and the rate of stock turnover requires to be increased to a much higher level.

While distribution has cut its expenses drastically over the past decade, starting with the introduction of self-service, followed by the advent of SET, the building of large supermarkets, and a much larger sales return per employee, further reductions in costs are immediately required.

Profits must be made and ploughed back, so that we can carry out future necessary development that can be run on profitable lines. Perhaps this is the time when the Movement should unite its ranks and adapt its policies to give maximum benefits to members and staff alike.

Societies and Inflation

With Particular Relation to the Society and the Member

MR. P. J. PAXTON

(Secretary and Chief Executive Officer, Cambridge and District Society)

Co-operative dividend is one area in which inflation has not adversely affected the member. Whether dividend is paid through dividend stamps or by traditional methods, the fact that the dividend return is based upon the inflating price levels of goods bought means that the level of dividend inflates pro rata, always assuming of course that other factors have not intervened to lead to a reduction in the rate of dividend.

Traditional Dividend and Stamps

Inflation does, however, raise an interesting further factor in the continuing arguments as to the relative merits of dividend stamps versus traditional dividend. This is particularly marked when inflation reaches the present levels of 20% per annum. Consider the two methods from the members' point of view. Dividend stamps give an immediate return; if spent on goods or desposited in a share account the only delay involved is that in filling a stamp book. The purchase can then be made or the share deposit will start to earn interest. Traditional dividend, however, is usually paid six monthly, approximately three months after the end of the trading period. The dividend earned therefore becomes available anywhere from three months to nine months after the purchase, an average time lag of six months. With the inflation running at 20% per annum dividend will have depreciated therefore by 10% from time of purchase to date of receipt. Thus a declared rate of 5% becomes an effective 4½%. The member loses in comparison with a dividend stamp operation but the society naturally gains, even without considering the effects of cash flow benefits.

Inflation has marked effect upon timing considerations and the argument advanced against traditional dividend applies equally to members' stamp bonus. The total involved is not so significant as that of dividend but it is clear that the usual bonus of 10p per book exchanged for goods or deposited to share is not an attraction and is largely discounted in the members' mind. Even doubling the amount of bonus is unlikely to lead to a rush of non-members wishing to take out membership. Timing again is the stumbling block for the possibility of receiving an additional 10p (or 20p) at some time in the future is not likely to weigh in people's minds when prices are escalating as now. The remedy is surely to consider giving the bonus to members immediately rather than by subsequent credit to a share account, which in any event in terms of clerical labour, whether the accounting is computerised or not, becomes an extremely expensive 10p deposit. If in addition it is not an attraction to the member then the practice should surely be re-examined. To discard the bonus altogether, however, would lead to a loss of a membership benefit, however small, and would add to the problems of falling membership; inflation, whatever its evils, cannot be blamed as the sole reason for this particular problem facing the Movement.

Spiralling prices and the dramatic fall in the purchasing power of money have a powerful effect upon the majority of people. The uncertainty of the future, enlarged upon daily by the media, leads everyone to live for today and is undoubtedly one of the reasons for the rapid changeover within societies from traditional dividend to stamps. In rapid inflation timing becomes paramount. But what of the side effects? It is no coincidence that the rise in the popularity of dividend stamps has seen a fall in total share capital available to retail societies. When translated into real terms the fall is, of course, even more dramatic over the last five years.

Share Capital

Co-operative share capital has been built up over the years mainly from undrawn traditional dividend and the switch over to dividend stamps now has stopped this source; hence the decline. Prior to this, however, the increasingly competitive interest rates over the last twenty years had diverted much of the small savers' money away that might otherwise have found its way into Co-operative share deposits. As inflation continues therefore it is likely that share capital will continue to decline in real terms as a source of funds to retail societies.

No amount of advertising or improvement of deposit and withdrawal facilities or similar activity, important as they are, will improve the inflow of new money to share capital whilst there is so much disparity with the interest rates being offered by the competitive investments. The attractions of Government sponsored savings often with tax concessions, building societies and the like are well known and the investor conscious of the return he is receiving has almost certainly already moved capital away from Co-operative societies and the capital which remains is there for convenience rather than to obtain a return. This factor, one feels, is the answer to those that seek a rise in share interest rates. In 1973 the average national share interest rate was 3.4% of share capital. At today's inflated interest rates it would be necessary to increase this rate four-fold to be competitive, at an additional cost in interest of more than £14 millions - over half the amount provided in dividend in 1973. At this level I would suggest Co-operative principles are called into question and the charge of remunerating capital, rather than rewarding member trading loyalty, would be hard to refute. In times of inflation, unless incomes rise faster than prices and consumer spending is held down, savings are unlikely to rise. The possibility of the introduction of index-linked loans to increase the attractiveness of saving to the investor cannot, of course, be ignored. Having regard to the economic climate therefore there is little optimism one can find in favour of share capital which is likely to continue to decline in real terms.

Before leaving the question of subscribed capital a word must be said about ordinary loan capital and small savings. The general economic factors affecting share capital apply equally in this sector also, though undrawn dividend has not provided a source for loan capital as it has for shares. In the national statistics the loan capital total is dominated by the employees' superannuation funds invested with the societies which amounted in 1973 to £86 million out of a total of £146. In the last five years, however, ordinary loans and small savings have been static at approximately £28 millions which means an actual decline in real terms.

Reserve Funds

If the introduction of dividend stamps has had a detrimental effect upon share capital accumulation then the real decline in that source of funds has galvanised societies into the realisation of the importance of building up reserve funds. The importance, in times of inflation, of collectively owned funds has been clearly seen by retail officials, and it must be said, the use of dividend stamps has given them room to manoeuvre in dramatically improving surplus retentions. Between 1964 and 1968 retail societies reserves improved by £4.2 millions to £49.0 millions; in the subsequent five years to 1973 there was an improvement of £67.3 to £116.3 millions. In considering these figures, however, it should be remembered that allocations to reserve in this period have included two main elements. First there has been the straightforward allocation from current surplus but, secondly, to this has to be added the capital surplus arising from the sale of assets. Particularly in the latter years of the past decade, societies have been active in closing smaller and loss making trading units and disposing of these and other surplus freeholds to take advantage of the inflated property values. The report of the Capital Resources study group quoted a figure of £7 millions surplus from property sales in 1971 but these are, of course, "once for all" gains, for the availability of surplus property is obviously limited and the fall in property values will in the short period at any rate, restrict the surplus to be made from property sales.

The General Prospect

Inflation, and the increasing rate of inflation, has resulted in a dramatic change of emphasis in the way retail societies are financed. The economic factors affecting the level of savings combined with the high level of interest rates prevailing, will mean that there will be no immediate future increase in share and ordinary loan capital available to retail societies. Emphasis on increasing retentions to build up reserves must continue to the point at which societies become independent of subscribed capital. The lesson of the last ten years, however, would seem to indicate that this alone will not be sufficient. The total funds available in 1973 of £402 millions compares with £434 in 1964. Even allowing for the healthy increase in reserves in the latter part of the decade there has been a marked real decline in funds available. The costs of new developments both in terms of fixed and working capital continue to inflate, however, to say nothing of the inflationary effect upon existing working capital. Once societies have run down their own investments further capital can only be obtained by going to the market for money either in the form of overdraft or on short term borrowing at the market rate. Such short term borrowing is likely to be most likely to succeed if directed to the institutional investor rather than the member however. What does emerge, very clearly indeed, is that if inflation continues at 1974 levels then further retail development is likely to be curtailed due to the high costs and limited supply of capital.

Societies and Inflation

Why Do Companies Have Liquidity Problems?

PROFESSOR JOHN SIZER

(Professor of Financial Management and
Head of Department of Management Studies,
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During the last twelve months some dynamic changes have taken place, and continue to take place, in the external environment in which companies operate. The energy policy of the Arab countries, the shift in the distribution of world income between the oil rich developing countries and the developed industrialised countries, a continuing escalation in world commodity prices, rampant domestic wage and price inflation, and the aftermath of the three-day working week in the United Kingdom, have caused companies to recognise that they are operating in an environment that requires faster and more sophisticated adjustments and reactions than in the past. In particular many accountants and managers are having to recognise for the first time that cash flow is in many ways more important than profit shown in the Profit and Loss Account. They must also recognise that the liquidity problems they face are also being faced by their customers and their suppliers.

On the day the Chancellor presented his Budget to the House of Commons, the Confederation of British Industry reported that its latest survey of industrial trends

> "provides strong evidence of the widespread nature of the deterioration in corporate liquidity that has taken place and that is expected to take place".

In his Budget speech the Chancellor said

> "There is however a more immediate and urgent threat to employment in Britain at the moment than inadequate demand.
>
> "The impact of inflation on the company sector risks forcing thousands of firms to restrict their output and lay off workers in the coming winter not through lack of demand, but simply through lack of working capital."

In this article the causes of the liquidity crisis referred to in the Chancellor's speech are identified.

Impact of Inflation on Working Capital Cycle

As the Chancellor indicated in his Budget speech the exceptionally high rate of inflation has had its major impact on the company sector's working capital requirements. In every business there is a circulating asset or working capital cycle of activity. The working capital cycle for a manufacturing company is illustrated in Figure I. It will be noted that profit is shown in the Profit and Loss Account when the customer is invoiced, not when the cash is received. The amount of circulating capital required by a company and its level at any particular time will be governed by the speed with which the cash cycle can be sustained. The faster the cycle the less the investment in working capital must be, and the faster the rate of turnover in the elements of working capital the less the total investment needs to be. The rate of inflation is also a major determinant of the rate of growth of investment at each stage of the working capital cycle. A company facing a high rate of inflation but nil growth in real terms, finds that the inflation increases the investment in the early stages of the working capital cycle before any additional cash was generated from higher selling prices. Many companies planned for growth in real terms in 1974 and this growth also led to a build up in the investment in the early stages of the working capital cycle before additional cash flow inflow was generated.

This situation was further seriously aggravated by the Price Commission criteria for allowing higher prices. The Chancellor admitted in his Budget speech that the high rate of inflation

> "has made the operation of the price controls far more severe than was originally intended".

It was not possible to increase prices sufficiently to cover the higher costs and leave sufficient cash flow to finance the higher investment in working capital. Nor were the prices allowed by the Price Commission generating adequate profits to allow external finance to be raised. Not only were the Price Commission criteria too hard, but also the need to seek Price Commission approval for higher prices delayed the period between higher costs and investment in working capital occurring and the subsequent increase in selling prices. Two other factors were also affecting the speed with which the cash cycle could be sustained. First, because companies' suppliers were facing similar liquidity problems their service to customers was affected. Raw materials and components were in short supply, which caused production interruptions and bottlenecks. This adversely affected stock control and production planning and, therefore, the level of stocks and work-in-progress. Similarly, companies' customers had liquidity problems and they extended the period of credit taken and also, in some instances, the level of bad debts increased.

The situation many companies faced was very similar to that of a company that is overtrading. Like a company that is overtrading, companies in 1974 have budgeted for and achieved higher profits, but have a deteriorating cash position because the profits generated have not been translated into net cash inflows. The company facing a liquidity crisis in November 1974, like the company overtrading, found that the rise in sales and profits was accompanied by a disproportionate increase in stocks, work-in-progress and debtors which more than absorbed the cash flow generated by the higher sales.

Other Factors Influencing Company Liquidity

If a company has no access to external funds not only must it finance additional investment in working capital from internally generated funds, but also pay dividends, interest payments, and corporation tax, and hopefully, undertake essential capital investment. These other factors have been added to Figure I to give the permanent and working capital cycle shown in Figure II.

In November 1974 many companies had limited, or nil, access to medium and long term external finance. The Stock Market was in a depressed state because investors had little confidence in the ability of the Government to solve the country's serious economic problems and at the same time in the ability of companies to achieve growth in earnings per share and dividends compatible with the current rate of inflation. Investors were pessimistic about the future profitability of the private sector with the result that price earnings ratios were at extremely low levels and dividend yields extremely high. Lack of shareholder confidence and the high cost of equity finance meant that virtually all companies had no access to this important source of company finance. Furthermore, the high rates of interest and/or the fact that many companies had reached their borrowing limits because of lack of interest cover or asset cover, resulted in companies being unwilling, or unable, to raise long and medium term loans. Industrial and commercial companies relied heavily on bank finance; some £2,300 million during the first half of 1974. By November the generation of internal cash was not sufficient in many companies to provide a satisfactory basis for seeking further funds from the banks. They were therefore concerned that they would be unable to meet their corporation tax payments when they became due in January 1975 - payments that would be substantially higher than in previous years for three principal reasons. First, the inflation had allowed many companies to generate higher, but nevertheless inadequate, taxable profits. Secondly, the taxable profits are calculated on the first-in first-out (FIFO) basis of stock valuation. This meant that a large portion of the taxable profit achieved was required "to maintain the working capital of the business intact", i.e: the cash flow generated was required to replace stock at higher prices, but was partially to be drawn out of the company in the form of tax payments. Thus, the Chancellor admitted in his Budget speech that inflation

> "has increased the cost of replacement stocks to a degree which under the present tax rules imposes burdens which industry was never meant to carry".

A third reason for the substantial increase in corporation tax was the tax changes introduced by the Chancellor in his April 1974 Budget.

In the aftermath of the three-day week, there were significant signs of the impending liquidity crisis in the corporate sector. In the first quarter of 1974 the financial deficit of industrial and commercial companies rose sharply to by far the highest quarterly figure recorded. Companies borrowed £1,300 million from banks. Despite these signs the Chancellor increased the rate of corporation tax from 50% to 52% and the advance corporation tax (ACT) on dividend payments. He also required additional payment to be made amounting to 50% of ACT due to be paid during the financial year 1974. These measures increased company taxes payable in 1974/75 by some £475 million.

Effect on Capital Expenditure

With lack of cash to finance additional working capital, to pay dividends, interest, and corporation tax, it is not surprising that many companies had to cut back and postpone planned capital expenditure programmes. Furthermore, lack of confidence in the Government's ability to solve the country's serious economic problems without a significant fall in the level of consumer demand and increase in unemployment made Boards of Directors extremely pessimistic about their future investment intentions. The CBI reported in its Survey of Industrial Trends that, while fifteen months earlier the number of companies expecting to lift capital expenditure reached record levels,

> "the collapse of investment intentions is widespread throughout manufacturing industry."

More seriously, not only was there a lack of finance to allow essential capital expenditure to take place, there were also indications that many companies were having to cut back the level of their output because they could not finance their increased investment in working capital. The number of bankruptcies and company liquidations was also increasing at an unhealthy rate. It was not surprising to read in the Chancellor's Budget speech

> "The same factor (lack of working capital) could force some firms into bankruptcy and it is already compelling many of them to cut back on plans for investment to which they were firmly committed only a few months ago."

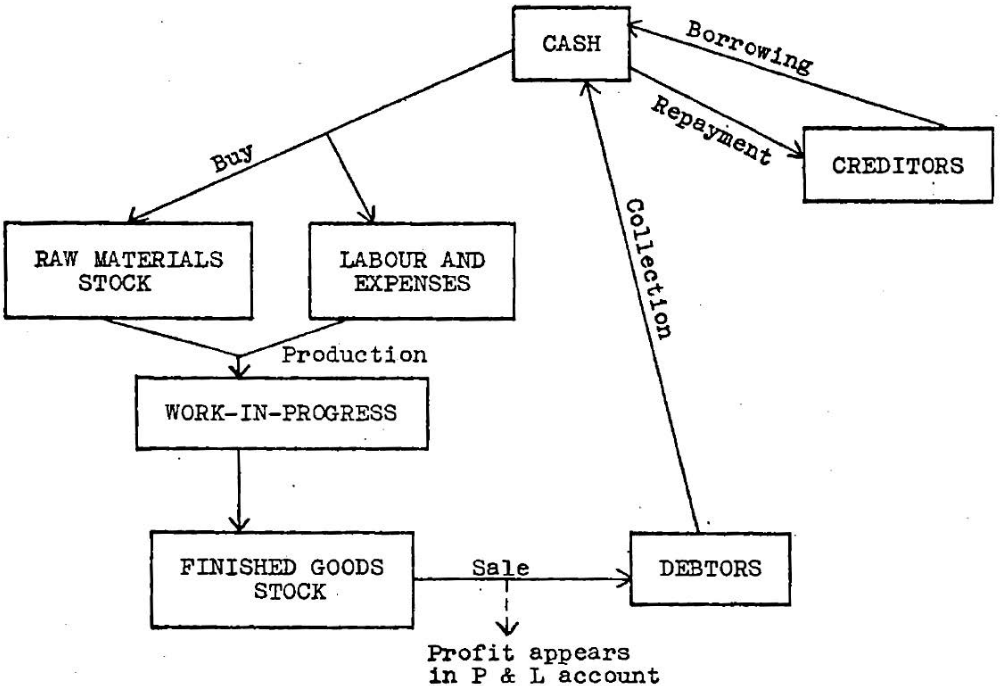

FIGURE I WORKING CAPITAL CYCLE OF MANUFACTURING FIRM

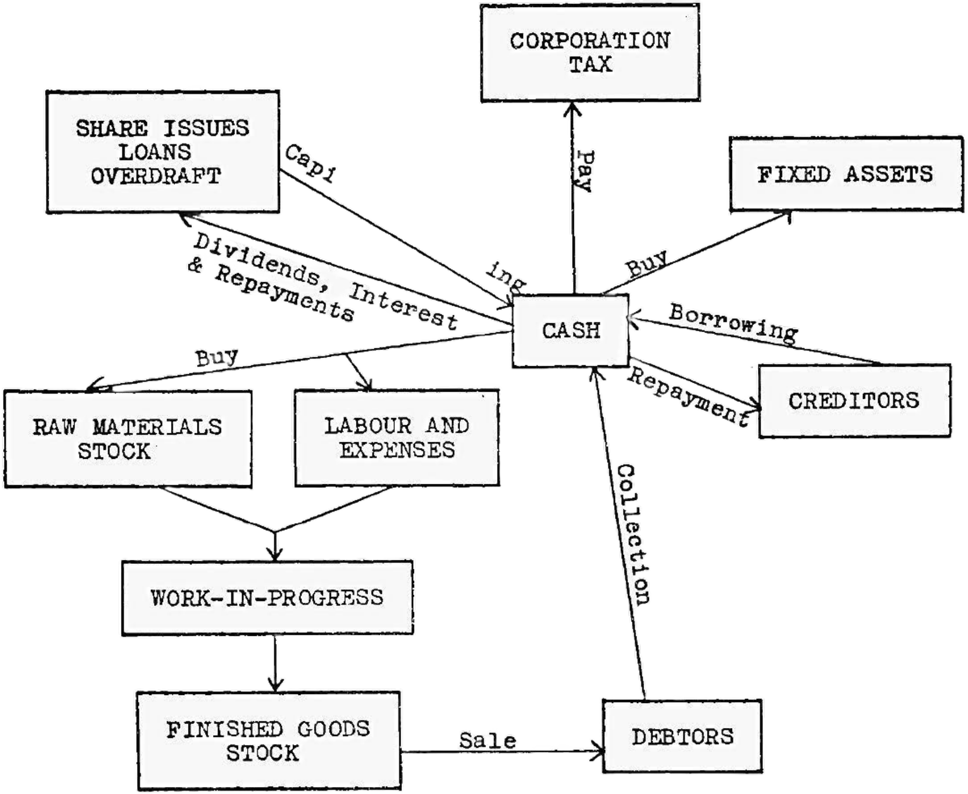

FIGURE II PERMANENT AND WORKING CAPITAL CYCLE OF MANUFACTURING FIRM

Societies and Inflation

With Particular Relation to the Management of Societies

MR. T. E. STEPHENSON

(Senior Lecturer, Department of Management Studies, University of Leeds)

Management has been accustomed to an economic situation where the rate of economic change was, in financial terms, relatively slow. With costs and prices rising steadily but not rapidly, management adapted through a process of piecemeal adjustment which took place without any great upset to the society or to the beliefs and operational methods of management. However, the present rate of inflation is such as to threaten this relatively stable state and the ways in which management thinks and behaves.

Need for: 1. New Procedures of Control

In the first place management finds that reliance on the historical view, on what has happened in the past, is no longer an effective guide to the present and the future. Experience loses some of its value. In practical terms this means, among other things, that control figures based on past performance lose some of their validity; for example, average personnel costs based on the last six or twelve months of a highly inflationary period give little or no guide when the important question is what has happened in the last month or so, for this may bear little relation to the longer term average.

This example emphasizes the dilemma of control and adaptation. In times of rapid change there is need for efficient control systems so that management quickly knows what is happening and can do something to control the situation. In a period of very rapid change, that is doubly difficult. First, control systems imply stable procedures and structures but these may create just those inflexibilities that are dangerous in a rapidly changing situation. Procedures devised for more leisurely times, when little or no harm was done if information was processed on the basis that it would still be relevant in three months' time, are not at all satisfactory when information is required almost on a day-to-day basis. Thus new procedures are required. Secondly, the control information that is eventually at the disposal of management is likely to be out of date. In a period of rapid change, no matter how speedy the transmission and processing of control information the situation to which it refers will have altered; decisions based upon that information will be out of date and to a great extent inappropriate. The actions resulting from these management decisions are likely to be mismatched with the situation in which they are applied. This does not mean that all is lost, but that management has to build into its decision-making a greater tolerance for uncertainty and error.

In management terms this means that greater emphasis has to be laid on the development of more flexible procedures and structures, discarding many long-accepted ideas about management authority and delegation. The need for greater speed points to greater decentralisation in the large retail society, with managers having greater discretion to make decisions in the face of rapid change in their own functional, geographic and commodity areas. At the same time these decisions will have to be taken within a policy framework that is well understood and is itself flexible. More frequent and regular meetings of top management will be essential so that a co-ordinated policy can be maintained within which management can operate and use their discretion. This pattern of management with its emphasis on much more frequent meetings coupled with added delegation needs to be developed throughout the retail society. It will have the benefits of providing frameworks within which management can operate at all levels and it will provide a mechanism for maintaining management co-operation in difficult times. In this way it will contribute to the maintenance of morale.

2. To Think in Systems Terms

A second significant way in which rapid inflation disturbs established management beliefs and behaviour is that uncertainty takes on a new and threatening meaning. In one sense there is a high degree of certainty; managers are certain that inflation will continue at a high rate for some time to come. What is uncertain is the effect of this on the business of the society, on the consumer, on the general level of economic activity, on employment levels and on the activities of Government. There is also the uncertainty as to when if ever the high rate of inflation will turn down. Management is faced with a level of uncertainty that calls for a radical relearning of much that is taken for granted. Learning new methods and new ideas was less urgent in the past, managers could take their time and indeed could cope with change through active and more or less systematic resistance. Managers could be inattentive to the information which threatened their current ways of looking at things, and still hope to survive. They were able to develop programmes to keep things as they were and, where change could not be wholly avoided, could strive actively to contain it if not suppress it so that it created the minimum of disturbance to the established ways of operating. Where change had to be accepted in any area of management the stability of the remainder would be stressed. All these tactics were aimed at keeping things as they were and so long as change was not too rapid they might well succeed without destroying the society. A society could survive without speedy adaptation while operating in a manner which did not take much account of many of the changes in the environment. This view of change can be seen as part of the general attempt of management to maintain a comfortable level of stability.

However in the present situation these traditional means of defence no longer work and this in itself is upsetting for managers. In a time of high inflation managers cannot disregard the never-ending signals which point in the same direction; they cannot undertake stabilising exercises when they have not adequately developed techniques for handling the situation; they cannot suppress the facts and effects of inflation because these infiltrate every part of the working of a retail society, so that managers cannot balance change in one part against stability in another part of the society.

Management is thus engaged in the task of learning a new way of handling a situation while at the same time keeping the society in business. The problem is not made easier by the fact that even the language of the past loses some of its meaning. Inflation no longer means price rises of three, four or even five per cent per year, it means rises of the order of twelve to twenty per cent per year. It calls for a new understanding. If managers are to cope with this new situation they will have to think more than ever in systems terms, that is, to think about the inter-relationships of the different parts of the society, of the different functions within it and of the flows of goods, people and money within and between it and the environment. The relationships between rapidly changing price levels of different commodity groups and lines, and between different rates of costs and revenue will all call for urgent attention. Established ideas on product mix will need to come under scrutiny as well as many other aspects of the total retail society.

3. For Flexible Attitudes

A third significant impact of high rates of inflation is that the overall attitudes of management come under pressure. In times of slow inflation, steadily rising prices allied to the reality of steady expansion creates an atmosphere of optimism and there is the feeling that the situation is under control. Very rapid inflation and uncertainty about the future, with the past providing little in the way of guidelines, provide a new type of situation and there is the tendency for a feeling of helplessness to appear, a feeling that the situation is out of control, a feeling that is strengthened by the uncertain political and social context which inflation generates. This situation can have the effect of making management less willing to look at long-term plans and more ready to take ad hoc decisions to gain some measure of protection. For example, there is the danger that managers over-insure by trying to procure immediate supplies for fear they will be caught short later. The result may well be the creation of shortages, increasing prices still faster and pushing up operating costs. More generally inflation can lead management into decisions which distort the distribution of resources.

The sense of loss of control mentioned earlier may be felt particularly by those managements which have in the past relied heavily on external sources for their continued survival. Relations with suppliers and markets can be upset as firms and societies become more vulnerable and as consumers' behaviour becomes more uncertain.

Inflation places management in a state of flux and moves it into unknown areas. Any reaction of panic or pessimism can only add to the difficulties of management. What is needed is that managers give systematic thought to the impact of inflation on the individual trading departments within the society, on the functional departments such as personnel, on the relationship of goods to cash and on the total operation of the society. A continuing appraisal on these lines coupled with greater flexibility of attitudes, structures and processes allied to a built-in, realistic appreciation of the nature of inflation could create an effective management for a Co-operative society.

Societies and Inflation

With Particular Relation to Government Anti-Inflation Control Methods

MR. J. M. WOOD

(Formerly Parliamentary Secretary, Co-operative Union)

When in the dark days of 1944 the major political parties represented in the Coalition Government pledged themselves to the maintenance of full employment after the War, there were two important consequences. First, inflation became endemic in this country as it could no longer be cured by the creation of massive unemployment. Secondly, the need for an element of central planning of the economy was firmly established.

Every businessman - whether Co-operator or capitalist - wants to be left alone to get on with his job, free from outside interference, but the freedom he craves is unattainable without an element of planning by public authorities. Freedom within a highly developed society cannot be absolute; the freedom of each individual ends where the freedom of others begins. The basis of freedom is communal discipline.

The British economy is a mixture of public spending and private enterprise. The Government element is important. Public expenditure is a large part of total expenditure, and involves the raising of huge sums in taxation. Public corporations are responsible for much of the basic industry, and the Government is able to exercise powerful authority in many other fields. All this gives them extensive economic power and influence. In post-war years the role of Government has changed from that of "policeman" to "Father Christmas" with valuable favours to bestow. Increasingly consumers, trade unionists and industrialists are looking to Government to rescue them from any economic calamity that happens to strike them.

The Aims of Government Planning

The major problem facing us is how to plan the economy to achieve a high and regular rate of economic growth, to secure a steady and progressive increase in the standard of living of the people, and to promote commercial prosperity. There is abundant evidence that the market economy does not possess the automatic regulators with which it has sometimes been credited, and that the normal pattern is a recurrence of booms and slumps at more or less regular intervals. Although planning for prosperity is not necessarily synonymous with State control, it certainly involves State interference.

The Budget has been converted gradually from a programme of taxation to an instrument of planning and control, in conjunction with general fiscal and credit policy. There are two principal elements of these policies: the more equitable distribution of income; and determination of the size and shape of the economy. The Government is increasingly taking upon itself the planning of the entire future - not only of the economy - but of society itself. Projections have been made of the basic elements of the economy, of the distribution of population, the shape and lay-out of cities, and the provision of services, education, cultural and other amenities.

Limitations and Changes

Planning is not a panacea; nor is it infallible, given the present techniques and state of knowledge. The failure of the National Plan of 1965 is sufficient evidence of this. Two of the major goals of national planning are, first, full employment, despite growth in the working population and structural changes brought about by technological change; and, secondly, control of inflation, which seriously distorts the growth of the economy and leads to inequalities in the distribution of the national income and so to unemployment. Underlying these and other objectives is the need to maintain our democratic institutions, which will be seriously threatened if we are incapable of solving the serious economic problems which have beset us since the end of the Second World War. One of the most intractable of our current problems was neatly summarised by the Rt. Hon. James Callaghan during a Parliamentary debate a few years ago:

> "The dilemma that I think this country is faced with is that people will punish their leaders and punish their governments, if they cannot have both a perpetually rising standard of living and full employment, and all the good things they need even though they are not earned."

In practice, economic planning in Britain is a mixture of exhortation, sticks and carrots, and outright compulsion. How many people remember the long and checkered history of the prices and incomes policy since the days of Sir Stafford Cripps? First, there were efforts to secure the voluntary co-operation of both sides of industry; then the establishment of a National Board for Prices and Incomes; then a compulsory "early warning" system; followed by a standstill on prices and incomes for a limited period. So the policy was progressively implemented and supported by statutory powers to impose restraints on both prices and incomes. The National Board for Prices and Incomes was disbanded by the Conservative Government in the spring of 1971 after it had produced its 169th report and cost the country £5 million. By the autumn of 1972 inflation had begun to assume alarming proportions, and so began a new round of Counter-Inflation Acts, with two new agencies - a Price Commission and a Pay Board - to monitor codes of practice approved by Parliament.

Another change of political thinking, which owed much to the power of organised labour, produced the Prices Act of 1974, which strengthened the controls over prices, introduced subsidies for important consumer goods, and abolished the statutory control of wages. The attitude of organised labour in Britain represents a formidable obstacle to economic planning. In the Labour Government of 1964-1970 Frank Cousins was Minister of Technology whilst still nominally General Secretary of the Transport and General Workers' Union. He had repeatedly expressed considerable scepticism about - indeed opposition to - what was still only a voluntary wages policy. His life's work had been based on the doctrine that a trade union leader's job was to get more wages for his men; even a voluntary incomes policy seemed incompatible with that life-long objective. Trade union policy has changed little since then, and now the only restraints on wages are the "social contract", backed up by Government with the threat of financial penalties upon employers, including Co-operative societies, which grant increases beyond the norm laid down.

Difficulties for Co-operative Planning

Co-operative societies, in common with other forms of large business enterprise, need to plan for the future. Budgetary control is a systematic study of accounting figures and the many factors influencing the future development of the business. It is a thermometer to measure at all times the health of the enterprise. It is necessary for the accountants or other responsible officers to interpret and report on the effect of external influences on the business. This function includes the continuous appraisal of economic, social and governmental influences. In the present political and economic environment the achievement of effective budgetary control presents formidable difficulties. The chairman of one of the country's largest food groups, in giving his company's half-yearly report, recently stated:

> "Given the present economic and political uncertainties, no attempt to estimate the results for the second half of the year is made."

This is a serious matter for any business, but its freedom of action is severely circumscribed by Government intervention in the economy, and by events on a world-wide scale which even the Government is powerless to influence. The extent to which Government had lost control of events is illustrated by its inability to plan the economy for even a year ahead, and the apparent need to introduce supplementary budgets to adjust revenue and expenditure at frequent intervals. In such circumstances what kind of meaningful budget is the businessman able to produce?

The two principal elements of budgetary control are sales and expenses. Sales are influenced by the general state of the economy, the level of employment, the impact of direct and indirect taxation, purchasing power in the hands of consumers, credit controls, and the measure of confidence in the future possessed by businessmen and consumers alike. The demand for consumer goods is likely to fluctuate with changes in price levels which are brought about by the supply situation and the introduction of such distorting factors as Government subsidies. Apart from restricted supplies of certain consumer goods arising from external causes, such as the shortage of sugar, one of the effects of stringent price and profit controls is empty shelves in the supermarkets, as manufacturers and distributors alike no longer find it worthwhile to sell certain goods at a loss. The Price Code is being revised for the next phase of the Counter-Inflation policy, and although powerful representations have been made to the Government by the Retail Consortium about the anomalies and inequities in Phase III, it is certain that gross and net percentage margin control will continue, based upon historical reference levels which have less and less relevance as time passes.

An outstanding example of stop-go Government intervention in retailing is to be found in the restrictions on certain types of consumer credit, despite the powerful arguments of the Crowther Committee that such restrictions should find no place in permanent Government policy. It is an indictment of so-called "planning" that the powers to control consumer credit are still based on the war-time emergency legislation. With the intensification of cash-flow problems brought about by price and margin controls, retailers' stocks may have to be reduced in both food and dry goods departments. The combination of restricted stocks and artificial deterrents on sales are likely to play havoc with any forecasts of turnover, and cost ratios.

In relation to expenses, the removal of statutory restraints upon wages are likely to involve Co-operative societies in difficult negotiations with the trade unions. Wage increases under threshold agreements are likely to add further pressure on costs. The implementation of the equal pay policy will be more severe upon businesses which employ a mixed labour force than upon (say) the variety chain stores which rely almost entirely upon female labour. Increases in indirect taxation are to be expected, with Value Added Tax as the most likely candidate. Customs and Excise have been preparing the procedures for multiple rates of VAT for some time, but it is impossible for retailers to make any useful forecasts about the effect of tax changes upon sales or cost ratios.

The history of proposals for a State superannuation scheme is one of considerable frustration for Co-operative societies. The Conservative Government's legislation on this subject has been abandoned by the Labour Government, and new proposals are awaited. There is no reason to suppose that Co-operative superannuation funds which are invested in the business will be at risk - provided they are adequately secured - but it may be taken for granted that superannuation schemes will be more costly as such refinements as inflation-proofing have to be introduced. The ever-increasing costs of local government continue to put pressure on commercial rates, but in the absence of a declaration of central Government policy, and particularly the possibility of an entirely new system of local government finance, forecasts of additional demands upon Co-operative societies from this source must be unreliable. Fuel costs, postal and telephone charges, and the cost of converting shop and office equipment to the metric system, must also be taken into account.

Co-operative Action for a Solution?

Co-operative societies make a continuous contribution to the control of inflation by the redistribution of trading surpluses among consumers, but unfortunately the Movement's share of the retail trade of the country is not large enough to have a substantial effect upon the economy. One of the greatest contributions that the Movement could make, however, would be to achieve the maximum efficiency in its commercial operations because the country cannot, in its present situation, afford to waste any of its resources whether material or human.

Since the days of Sir Stafford Cripps the Co-operative Movement has willingly collaborated with the Government in supporting sensible measures to combat inflation, but it is a matter of deep regret that such measures have not been applied consistently, have been bedevilled by the absence of political consensus, and have often been hindered by people and institutions pursuing selfish ends. Co-operators know from experience where the shoe pinches: they have seen their shareholdings eroded steadily by inflation, and prices in the shops rising rapidly from causes over which they have had little or no control. The dialogue between the Government and retailers in general and Co-operative societies in particular has been one-sided. The mystique of the Budget is an anachronism that we cannot now afford. Gimmicks like the Selective Employment Tax make no permanent contribution to solving the problems of inflation. Without a full appreciation of the issues at stake, and the wholehearted support of the mass of the people for sensible and equitable policies, the spectre of inflation will never be banished.

Societies and Inflation

Up the Creek - Without Liquid!

MR. R. WOODS

(Secretary and Chief Executive Officer,
West Yorkshire Society)

In the current period of rapid inflation, the Movement has to take a serious step towards implementing "inflation accounting", and cease to delude itself that it is making satisfactory "profits".

The fictitious element of "paper profit" caused by stock inflation has been acknowledged in the November Budget, but not in societies' accounts. The effect of under-depreciation of assets which falsely increases our so-called "profit" is not yet fully appreciated.

The following illustrates the need for depreciating at REPLACEMENT VALUE rather than the present practice of depreciating at historical cost:

		£
1969	Cost of vehicle	2,500
1974	Cost of replacing vehicle	4,900
	Cash retained in business (Depreciation 20%)	2,500
	NEW CAPITAL REQUIRED	2,400

Unless profit retention is equal to the depreciation charge new capital will have to be raised, and this will merely renew the asset and allows nothing for expansionary development.

The same principle applies in varying degrees to Buildings, Fixtures, Machinery and Plant.

The practice of some societies of not depreciating Buildings mystifies me, and two questions arise:

1. Where does the cash come from to re-build the premises when they are obsolete?

2. At some point in its life a building ceases to appreciate in value and decline takes place. Is "double depreciation" then charged?

The traditional Co-operative rates of depreciation must be discontinued and the following substituted:

Buildings	4%	per annum
Fixtures	16%	" "
Machinery	16%	" "
Vehicles	33%	" "

(Even after the asset is "written off" depreciation should continue and be credited to an Assets Replacement Reserve.)

This suggestion is only an acknowledgement and not a solution of the problem, but unless higher depreciation rates are used the Movement will find that DCF will mean DISCONTINUED CASH FLOW and we will truly be up the creek without liquid resources.