Some Reflections - and Projections: 1

Professor Noel Branton

The provisional figures for 1988 must be judged against the background of a surge in domestic demand of 7%, fuelled by tax cuts, abundant credit, and rising wages for the increasing number of those in employment. As against this, there were the efforts of the Chancellor to slow down the boom by the use of interest rate policy. This produced relatively little impact on consumer spending for the greater part of the year, though by December there were signs of slackening growth. For some businesses the Christmas trade produced new records though these were apparently less than anticipated.

Trading Results

The turnover of the retail Co-operative societies rose by 8% as compared with a 10% rise for retailing as a whole. The trading surplus after depreciation rose by 11.1% in amount showing a 0.1% improvement on sales as compared with 1987. Unfortunately, although Co-operative sales grew in volume and profitability, those of competitors grew even faster so that market share continued to decline albeit al a marginally slower rate. The number of societies continued Lo fall as also did the membership of the movement.

Professor Dawson last year in Journal 63 made the comment that the largest societies in terms of turnover do not always obtain the best results in their trading surplus on sales whilst those with the biggest increases in turnover often fail to show any comparable increase in profit. The latest figures confirm this point. A policy of boosting turnover, with a view to spreading fixed charges over a larger volume of business can produce satisfactory results only if the costs which must be incurred to secure the increase can be contained so that the additional revenue is greater than the additional costs.

One society, for example, showed a 17.5% increase in turnover but produced a 0.6% loss on sales. There may have been a special reason for part of this loss although in the previous year the profit was very small. Again, some of the medium-sized societies in Groups 4 and 5 produced a trading surplus as a percentage on sales comparable with that of the largest. The position of the smallest societies in Group 8, with a limited number of outstanding exceptions, can only be described as very depressing.

If we turn to the make-up of the retail sales of the societies, a chart shows the changes over a period of ten years between 1978 and 1988. Food sales, excluding dairy produce, remained a constant proportion of total turnover whilst sales of dairy produce declined. Non-food sales also constituted a smaller proportion of the total, but compensation was achieved by a growth in services. As compared with the retail trade as a whole, the Co-operatives achieved a smaller increase in turnover as between 1988 and 1987. The margin of difference, however, had narrowed, this being particularly marked in the Clothing and Footwear and the Household Goods sections. Since consumer spending in 1988 was focussed particularly on these sectors the movement enjoyed some share in the benefit though clearly not nearly so much as one would have wished.

Provision for Capital Investment

The trend of profitability of the societies as a whole continued to rise even though the increase was modest. It was 2.1% of sales, which is well short of the 5% on sales recommended by the Capital Structure Report or the more modest short-term target of 2.5%. After taking into account interest payments and appropriations the retained surplus amounted to £30m as compared with £19m in 1987. There were substantial increases in fixed assets though these were partly a consequence of property revaluation. There was, however, substantial new capital investment though this was well below the level indicated as desirable by the Capital Structure Report.

This under-investment in capital assets is all the more serious since retail business as a whole has been investing heavily during the 1990s. One estimate puts the total as high as £15bn between 1982 and 1988. Clearly such investment must confer competitive advantage on the private retail sector, a point made by Mr George McMillan in the January 1989 issue of the Journal. However, the figure almost certainly exaggerates whilst not disposing of the advantage. As much as one-third of the total may have gone into property since private retailers have expanded rapidly and, it would appear, rashly. Mr Michael Julien, the group chief executive of Storehouse, opened a BHS/ Mothercare store in the new St Enoch Centre in Glasgow at the end of May. He pointed out that there is now some 24m sq. ft of retailing space under construction in the UK and expressed serious misgivings if it should all become available. To give point to his doubts, many of the store units at the Centre still remain unoccupied.

Private retailers have nonetheless been spending heavily on the design and layout of their shops. Design consultants have been employed for this purpose. Even Marks & Spencer, faced with sales stagnation, has modernised its stores. In the retail trade as a whole the installation of electronic technology is rapidly increasing, involving considerable capital expenditure. Electronic point of sale equipment at check-outs is being widely adopted whilst Electronic Funds Transfer at Point of Sale (Eft-Pos), after a slow start, is quickly gaining ground. Indeed, one estimate claims that last year the number of Eft-Pos terminals jumped from 8.000 to 30,000.

Some Thoughts on Strategy

Over the years there has been a lively discussion within the movement of the appropriate competitive strategy to revive its fortunes. Perhaps it is appropriate to consider the approach adopted by leading and much publicised management guru, Professor Michael Porter of the Harvard Business School. He argues that competitive advantage may be secured by the adoption of one of three types of strategy which he describes as *cost leadership, differentiation* and *focus.* It is essential that management adopting a given strategy should be confident that it is sustainable.

Cost Leadership?

What are the possibilities of *cost leadership?* As the result of ongoing mergers and acquisitions the big groups are now to an increasing extent competing with one another. They have developed integrated supply organisations designed to reduce the costs of serving their stores. They are making increasing use of information technology to determine stocking policy. Competition between the organisations already in the field is likely to be fierce. The idea for a unified national Co-operative society which is advocated from time to time would have to compete in this battleground. In the present circumstances *cost leadership* as a strategy for the Co-operatives is a non- starter.

Differentiation

The proposal to slim down to 25 regional societies has far greater potential provided that Porter's strategy of *differentiation* can be developed. A business achieves competitive advantage through *differentiation* if it provides something unique which is valued by customers and for which they are prepared to pay a higher price sufficient to meet the cost of the *differentiation.* Self service was pioneered in the UK by the Co-operative movement as a means of cutting costs and enabling the customer to get quicker service. It was not a sustainable *differentiation,* however, since it was quickly copied by competing organisations.

The movement has, of course, one traditional source of *differentiation* in the payment of dividends on purchases. For a time, a few years ago, competing organisations tried to match this by the use of trading stamps to secure loyalty. These became discredited and dropped out of use though there are now signs of an attempted revival. The dividend was reinforced in the past by the sense of loyalty of members to their society and to the Co-operative principle. Whether this situation could now be revived in a sufficient number of customers is, in my view, highly questionable. The majority of customers nowadays show little loyalty to any retailing organisation, private or Co- operative.

A common criticism brought against retailing in general is the poor standard of service in retail shops. This, of course, is virtually non-existent in supermarkets. But not all customers appreciate self-service, particularly the elderly, whilst most people want information at some time. In many cases they look for this in vain. Improvement can only be secured through systematic staff training to which the movement has always paid particular attention.

Focus?

Finally, the focus strategy is perhaps better described as a niche strategy. It depends on segmentation which in Porter's analysis is something wider than market segmentation whilst including it. It covers the product and any services which are provided with it and is targeted at a group of customers who are either neglected or are inadequately served by the larger operators. There is no reason why a society which perceives an opening should not use this strategy as well as that of differentiation.

Further Outlook

The prospects for 1989 cannot be described as very reassuring. The high level of interest rates has begun to produce an effect and retail sales figures for April showed an unexpectedly large fall. The impact has so far been greatest in the south and discretionary spending in the north had been little affected by the end of May. Indeed, the North Eastern Co-operative Society was reported to have turnover up 11% on 1988. The likelihood of a "soft landing" for the economy seems highly improbable at the time of writing and few trading records appear likely to be broken in 1989.

The Author

EMERITUS PROFESSOR BRANTON is a former Dean of the School of Business and Administration at the University of Strathclyde where he was for many years Professor of Commerce. He has written extensively on Commerce and Business Management and his books have been translated into many languages. He is a former Deputy Chairman of the Scottish Business Education Council.