

Myths in the BoardroomSOME CO-OPERATIVE SHIBBOLETHS EXPOSED

by

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The purpose of this article is not to provide the lay directors with the answers, but to provoke them to think for themselves. None of the old shibboleths should automatically be accepted at their face value. The old ideas may well have been valid in their time, but times change.

In theory, a Co-operative chief executive officer, backed by a hierarchy of officials, is responsible for the running of his Society, but this management is subject to the direction of a board of lay men and women who are periodically exposed to an electorate of such active Co-operators as can be persuaded to vote. What chance has an organisation based on this theory, of standing up to sophisticated competitors, its rivals in the High Street? In practice, of course, some chief officers manage their boards as effectively as they manage their staff - and this ability is indeed the extra ingredient X which they are required to have to be successful. (It might be added in

parenthesis that such an ingredient is probably no rarer than the ingredient Y required of business executives employed by some private enterprise retailers: the ability to get on with the "family" - or ingredient Z, the ability to get on with overseas partners, for those working in a multi-national conglomerate with a retail subsidiary. Each of these employers requires an extra dimension from their top functionaries.)

Nowhere is the difficulty of the chief officer/board relationship better portrayed than in dealing with figures (accounts or statistics). Figures are a form of shorthand communication with which many ordinary people feel ill at ease. Lay directors should not lack self-confidence in this area: they are often numerate, having an instinctive feel for the significance of figures, which sometimes escapes those with book-keeping or accounting expertise when they flounder in niggling detail.

Too Many Figures?

Even in a better Society, the lay director is faced by a proliferation of barely comprehensible figures, submitted with little time to study them before the decision for which they are supposed to be relevant, has to be taken. Facts must be relevant to action, not just information which it would be "nice to know". It is one of the favourite devices of chief officers who wish to keep the upper hand with their boards, to flood them

with statistics - just as it is a favourite device of boards wishing to delay a decision, to seek to postpone the need for action by asking for more and more information. If either of the two parties can be made to feel inadequate, the other has won the day; but the Society will have sunk in the sea of figures.

Turnover

The Co-operative society director's first interest must be in turnover, because no retailer can survive if it fails to keep pace with competitors. An assessment of the quantity of goods sold, calculated by dividing the value of sales by some statistical price index could be attempted, but any such precision is a will-o-the-wisp, not worth the bother. No price index can be accurate, because to be precise it would have to take account of the particular basket or mix of goods sold, which differs from Society to Society. The prices of particular commodities vary considerably from time to time. It is much better to stick to what is known: the value of sales at current prices. Even if one had a reliable price index, one would get bogged down in variations in consumers' expenditure - in some years governments clamp down on our standard of living, and we can buy less, whilst in others the standard has been allowed to rise.

Market Share

How can a Co-operative Society compare its sales with its competitors, to measure changes in its share of the market? Each month, the Department of Trade publishes statistics of retail turnover for a month (the weekly average of 4 or 5 weeks) ending some 6 weeks earlier. These statistics are summarised in the "Co-operative News". But care must be taken to use the value figures at current prices. The headlines often describe the changes in the seasonally adjusted volume index at constant prices. For example, the banner headline "10% DROP IN JULY DoT FIGURES" is a straight lift from a press release designed for economists. How misleading it could be to retailers can readily be appreciated when it is known that what was being described was a drop of 10% in the volume of trade at constant prices, equivalent to a mere 2% drop in the value of sales between June and July. Of course most Societies think in terms of a comparison with the corresponding figure a year earlier, and the value of sales in July were 11% higher than in the corresponding month of 1978. To lull Society boards into complacency by headlining figures which are correct, but likely to be misunderstood, is to do a great disservice to the Movement.

The Department of Trade does provide the detail which Boards need, the percentage change on a year earlier separately for the multiples, independent retailers

and Co-operative Societies for such kinds of business as grocery shops, clothing and footwear shops, durable goods shops, department stores and mail order businesses. The figures are based on relatively large samples, all appropriately weighted, and their reliability cannot be matched by any of the private market research organisations (which do, however, provide more specialist services on a narrower front). The Co-operative Union provides fairly comprehensive regional figures which are incorporated in the Department of Trade's figures, but other market research figures are likely to be too volatile to be helpful, when they purport to cover small areas.

R.P.I. Inappropriate

A Society would be wise to make some allowance for known population trends (e.g., the movement from Central London to the Outer Metropolitan Ring) but this is a relatively minor adjustment to the Department of Trade figures. Incidentally, the implied price index (obtained by dividing the index of the value of retail sales by the index of the volume of retail sales, available for food shops and some non-food shop groups separately) provides a much better index of the prices of goods sold in food shops, for instance, than does the total Department of Employment Retail Price Index. This is not so much because of the limitations of coverage of the R.P.I. - for instance the exclusion of an allowance for the expenditure of pensioners, a particularly important

group for the typical Co-operative society - as that the R.P.I. total figure gives considerable weight to motoring costs, mortgages, and other housing costs not usually included in the Co-operative shopping basket.

Profit of Paramount Importance

Because so much space has been given to turnover does not mean that profitability is not of paramount importance. At the end of the day, a Society has not made a profit until it has generated a sufficient flow of cash to be able to restore its capital to the equivalent of its original worth: as up-to-date in terms of current conditions as it was when the year started. This means producing a larger surplus to cover, for instance, the additional costs of replacing trading stocks (to the extent that these additional costs cannot be financed by trade credit) and to depreciate fittings and vehicles, for instance, so that when the time comes for their replacement, the money is there to pay the bill. But this is not the place to develop this argument.

Retentions - Wrong Denominator

The advice given in the Co-operative Union's bulletins is sometimes as myth-laden as that given by professionals closer at hand. In 1976 the Co-operative Union's Capital Advisory Committee recommended a 50% retention rate from earned surplus, to generate new capital. As Mr. Edmondson (not always on the side of

the angels) has pointed out, to express the need for retentions as a ratio to profits can be meaningless. Indeed, Mr. Pratt, in an August Review which leans heavily on Lady Longford, has promised to hedge his bets by expressing retentions as a percentage of sales as well. For Societies in difficulties, much more than this 50% is required. In a valiant effort to meet this situation the Union, with all the pomp of a voice from the oracle, has announced that retentions should, to allow for depreciation and corporation tax, be 65% in future - still ignoring the wrong basis.

Chief officers have their own reasons for building up reserves. (Some even hanker after secret reserves, which they can equally secretly tap in times of trouble; but that is another story.) Reserves are regarded as a source of non-withdrawable interest-free capital. But because the capital is interest free, it does not follow that it is free of cost. Retentions have, since 1933, been subject to income or corporation tax. The net effect in normal times (times are not normal and nowadays a Society can postpone paying corporation tax into the indefinite future provided it is expanding its business) is to suggest that it is better to pay a 60 to 70% tax to the government, than an annual charge of less than 10% p.a. to its lenders. It will be seen that such capital is quite costly to the borrower.

The Gearing Myth

The gearing ratio is defined as the ratio of published reserves to borrowed capital. Auditors, be they financial auditors or the new Co-operative Union trade auditors, use a gearing ratio to test a Society's state of health. Most Co-operative societies are more successful as property holding companies than they are as retailers. (There are conspicuous exceptions which it would be invidious to name.) Drawing this distinction between retailing and property owning has been described as political, but it is political only in the sense that it concerns important policies for the Board. Societies in difficulty do not generally require help with their capital, so much as with their ability to trade profitably.

But to return to gearing. Reserves depend on the value which is put on assets, and as some of the major assets are land and buildings which may be valued at their original cost, many years ago, the gearing ratio may depend on the age of the assets rather than the good husbandry of the Society. The ratio will have been rendered meaningless by the ravages of inflation.

Pensions - Is Self Investment Bad?

It is fashionable to frown on the use of employee superannuation funds as a source of Co-operative capital. Mr. Justice Brightman in his 1976 judgement on the case between Mr. Evans and the

London Co-operative Society's Pension Committee was at pains to say that Co-operative Societies, denied access to the stock market to borrow money, must be allowed to borrow from their employees' pension funds. There were two stipulations, the first that the rate of interest must be freely agreed, and the second was that the loans must be adequately backed by independently valued property, etc., with the safety margin stipulated in the Trustee Act. Those who are clever on the stock market can always think of securities in which one should have then invested - after the event. For the record it should be said that the "equity cult" notwithstanding, the return from shares in the long run is not significantly different from the yield on money invested in a Society loan. This has certainly been true of the Co-operative Pension Funds Unit Trust. Investing in such a trust has, of course, the added disadvantage that you are marginally helping your competitors, by giving them an additional source of capital. The Co-operative fund invests, surprisingly enough, in Cavenham, the John Lewis Partnership, TESCO, Boots, Debenhams, Marks and Spencer and U D S. Small amounts, of course, but none of these organisations are known to have pension funds lending money in the opposite direction.

The Millom Spectre

Of course, a Co-operative Society must take account of its liquidity - its ability to meet cash commitments. The

spectre of Millom is not easily laid. (And yet the myth that Millom, not a Society in membership of the Co-operative Union, distributed more than £1 to each shareholder holding £1 shares also dies hard. It is not usual for such liquidations to yield a profit to the shareholders!) But on the whole, retailing is a stable business. As the Financial Times (25 August 1979) has said:

"stores have considerable defensive qualities relative to manufacturing industry, not least the ability to pass on their costs more quickly. Working capital control can be more flexible - stocks are less likely to get out of hand and can often be financed by creditors. The successful stores tend to generate plenty of cash ... Finally the store groups tend to have valuable property assets against which they can easily raise money if necessary."

Wrong Fire Equipment

In recent years, the Co-operative Movement has been hard hit by our very large private competitors. In these circumstances, the CWS has been used as a possible fire brigade, offering more capital at competitive rates. As has been said before, it is usually the managerial problem of trading profitability which needs to be solved, not a capital shortage. It is the same with amalgamations. Joining two medium sized societies together to form one large one will only exacerbate

their problems, if there is a management vacuum at the top. These are two aspects of the same problem which has been discussed throughout this paper: ensuring that you are answering the right question.

It is hoped that as a result of reading this contribution, the lay director will be provoked into thinking for himself. By insisting on relevant information on which decisions can be reached, he will help management to pose the right questions. In this way management and Board together will provide the 1% inspiration to the 99% perspiration to which we have all become accustomed.