Capital and Control
by David Hutton

This article was the basis of a paper given to a conference organised by the National Federation of Progressive Co-operatives in January 1988.

In my opinion neither increasing members' share capital nor even members' loan capital can provide sufficient funds for Co-operative development.

History

The latest figure of share capital in independent societies, £94 million, is a little more than a quarter of their borrowings. In real terms, share capital has fallen to some 8 per cent of the level reached in 1961. It is surprising that as much as this £94 million has been retained, bearing in mind that the average rate of interest paid - barely 4% before tax last year - is half the rate paid after tax by building societies where withdrawals (and deposits) are so much easier. There are 7,000 building societies doing this business, double the number of Co-operative investment centres. A member holding £100 in share capital in 1961 would have seen the purchasing power of that holding reduced to less than £8 today, in addition to any loss of interest.

The Future

Contributing substantial amounts of share capital is not a form of member participation comparable with purchasing loyalty or helping to make directors accountable to their members - although some management establishment figures would seek to persuade us otherwise. We could even ask ourselves whether large shareholdings are not becoming an anachronism - like the Guild stock checkers of yesteryear. The existing shareholdings are a tribute to the elderly members too loyal or too lethargic to withdraw their capital. Much of it arose from accumulated dividend, so commercial considerations won't apply. So long as these holders remain faithful - and share capital is significant in many societies - they help to keep interest rates down. But in the absence of dividend to replenish them the holdings are likely to be eroded. There is no future in counting on this source of cheap capital to finance major property development.

To tinker with the problem by making marginal increases in the interest rates may be counter-productive by drawing attention to the inadequate returns currently paid. Requiring meeting attenders or office seekers to commit themselves to higher share purchasing - £10 to attend meetings, £200 to stand for office has been mooted - cannot make a significant impact. Of course the idea of profit sharing or risk sharing for active Co-operators has its appeal but is difficult to implement in a meaningful way. In these circumstances I think we shall have to be satisfied with token shareholdings - it is *time* which the activists invest in their societies.

Mortgages and Money Market Borrowings

The capital market has become professionalised. Although a society would be unwise to put all its eggs in one basket, and borrow from only one source, larger societies are in a position to borrow medium term money from the market at competitive rates of interest, using their heavy investment in property as security. These three year evergreen acceptance credits, for instance, were first used by Frank Doherty for Nottingham Society, and subsequently even for London Society, at a time when these societies were being hard pressed by the Co-operative Bank. Such funds can be as cheap as borrowing from the members with unit loans and development bonds, particularly when the administrative costs are brought into account. There is nothing immoral in mortgaging property if the money is used wisely: it is normal in the Swiss Co-operatives, for instance, and of course for most private house owners in this country.

For whose benefit? Is it a Co-operative benefit for members that the society should sacrifice the society's interest by borrowing from them? Or is it wise to depend on borrowing from members at an interest cost significantly below the market rate? It is hard to steer a middle course.

Equity Shares?

It is one thing to propose that members' share capital should be made inflation-proofed, it is something quite different to propose that members should participate in the profits via a share issue. It is very worrying that someone so honoured by the Co-operative movement as Jim Mason should make a report on this subject which has to be corrected. He has suggested that our successful rivals get their capital much cheaper than do Co-operative societies. As I showed in an article in the September 8th issue of "Co-operative News" ("Why we should not ride the stockmarket roller-coaster") the stockmarket is, on the contrary, an expensive source of capital. Let me explain!

The principal motive for share investors is the expectation of capital gain and eventual dividend growth. It is the prospect of being paid, say, £1200 at a future date for the £100 invested today which makes the system work. The stock exchange gambles on the future value of the shares and success of the undertaking. Past and current profits are insufficient as an indicator of a good gamble. It would be a brave investor who would back a hunch on the accelerated growth of Co-operative profits!

The Example of Sainsbury

Sainsbury has been successful issuing shares in 1973 at £1.45 each which have been converted by 1:1 scrip issues on four occasions to be converted to 16 shares, last week valued at £2.30 each. This is equivalent to capital growth to 25 times the original level, and converts a dividend yield of 2.2% p.a. to 56% p.a. on the original capital. If Sainsbury were to seek more share capital, punters would expect a comparable growth rate.

Sainsbury financed its development from its own resources until recently, but it is significant that when it did need short term capital last year it did not offer a rights issue on its ordinary shares but instead borrowed £100 million in loans at a cost of 11% p.a.!

So Co-operators do not have to choose between principle and opportunism: at both levels the equity market would be a bad thing for them.

Finance of Stocks

Fixed assets are not the only item which requires capital investment - so do stocks. Stocks are a little more than a third of other fixed assets on average - and are usually covered by trade credit. Sainsbury turn their stock over so quickly that trade credit helps them to finance other capital expenditure. The coverage of stocks by trade credit varies greatly between societies: one would expect small societies to be able to make less use of trade credit because of the C.W.S. practice of automatic debiting of purchases made through the Regional Distribution Centres. In practice amongst the larger societies there is not a close correlation between purchasing loyalty to the C.W.S. and use of trade credit. This may be explained by the trade mix of the Society's sales, information not readily available to the ordinary member, by the use of the Society's own warehouses, and by what might euphemistically be described as variations in accounting practice as regards stocks and accounts owing at year end.

The Key Issue

Although getting cheaper capital from lenders is important to Co-operative societies, its benefit is dwarfed by the endemic under-use of the capital assets already in their possession. Co-operative Societies tend to wallow in an excess of under-used property: new sites are sought in one area whilst in another old assets are sold to our rivals, often at too low a price.

Instead of using the proceeds for development, they can be frittered away in distributions or uneconomic trading. Even on new sites, which of our supermarkets approach the £15.4 sales per square foot which is the *average* which Sainsbury currently achieves? Or the £92,000 sales per employee? £92,000 compares with the average of £58,000 which we achieve in the bigger societies. This differential is narrowing marginally, but at much too slow a rate.

It is here that the Co-operative problem lies. The solution will provide the cheapest capital of all: the cash reflected in the revenue reserves built by efficient trading.

The Author

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