The Experience of Leicestershire Society
by G.L. Fyfe

There have been vast changes in both the competitive challenges to the Society's trade and the standards now expected by the public. In order to retain a share of the market and develop new areas of business opportunity the Society has had to make significant capital expenditure. These levels of expenditure have been completely beyond the scope of the traditional funding structure based on share capital and retained profits.

Inadequacy of Retained Profits

The following figures show the degree of imbalance between capital expenditure and retained profits (plus depreciation):

	CAPITAL EXPENDITURE	RETAINED PROFITS		
		Reserves	Depreciation	Total
	£'000	£'000	£'000	£'000
Year to January 1970	276	160	281	441
" " " 1971	468	130	272	402
" " " 1972	631	126	296	422
" " " 1973	691	243	415	658
" " " 1974	534	219	333	552
" " " 1975	702	111	317	428
" " " 1976	632	273	302	575
" " " 1977	509	248	398	646
" " " 1978	1,151	869	511	1,380
" " " 1979	1,862	2,732	802	3,534
" " " 1980	2,447	1,306	948	2,254
" " " 1981	2,558	939	1,192	2,131
" " " 1982	2,840	892	1,018	1,910
" " " 1983	3,625	1,217	1,283	2,500
" " " 1984	8,533	61	1,538	1,599
" " " 1985	2,710	3,478*	1,823	5,301
" " " 1986	7,905	956	1,984	2,940
" " " 1987	7,790	634	2,370	3,004
	45,864	14,594	16,083	30,677

* includes Revaluation £1,405.

Some £45.9 millions has been invested in assets by the Society, but only around £31 millions of this has been supported by retained profits plus depreciation, in what has consistently been considered a healthy, profitable Society.

Scale of Investment in Trade

In the last 5 years alone, £30.5 millions has been invested right across the trading profile, both to replace existing assets and to develop new business:

	£'000
Grocery Retail Shops	2,117
Superstores	11,789
Food Distribution and Warehousing	1,042
Non Food Store and TV Rental	2,180
Chemists	223
Travel Bureaux	249
Funeral	1,070
Dairy	2,400
Transport and Garage	3,100
Other Property and Development Sites	6,393
	30,563

Clearly the Society has not stood still! However, could it be accused of living beyond its means and pursuing development policies beyond its profit generation and traditional funding resources? The answer to this charge is that without re-investment in modern premises and equipment, in the right trading locations, the Society's market share and consequent profit levels would rapidly dwindle in the face of the aggressive, professional competition.

Seizing the Chances: Assessing the Risks

Unfortunately the emergence of viable development opportunities, with which to fight the competition, does not occur on a neat timetable enabling funding to come from growing profits. In a limited geographical area the opportunities have to be taken when they prevail, as they may not exist a few years hence. The Society has taken a number of significant initiatives, after careful assessment of the risks, in a relatively short space of time. The fundamental problem that this has produced, illustrated by the figures above is that: *the society must have the confidence in the long term viability of the development projects to justify taking funds from outside the traditional sources, at a higher cost, until the profits generated by the projects and the disposals of older trading properties enable those funds to be repaid.*

While it is possible to see encouraging trends in the Society's traditional funding sources, such as Share Capital (through Membership schemes like

"Passport to Value") and Development Bonds, these cannot be realistically seen as answers to a problem of this magnitude.

There is probably more scope in the limitation of capital requirements by the tight control and review of "working capital" levels. The Society's stocks were some £11.7 millions in January 1987, which together with significant levels of trade debtors and creditors, provide constant potential for increasing funding requirements if not monitored.

Changes in the Sources of Finance

Leicestershire Society was formed in 1969. At that stage, the funds employed amounted to £4.2 millions. Now some eighteen years later, the funds employed are almost £37 millions. Let us compare the sources of these funds and how they have changed over the years.

	JAN 69		JAN 87		CHANGE	
	£000	%	£000	%	£000	%
Share capital	1958	46.4	3888	10.6	1930	(35.8)
Reserves	601	14.2	15195	41.3	14594	27.1
Revaluation	NIL		1405	3.8	1405	3.8
Revenue	601	14.2	13790	37.5	13189	23.3
Loans	1662	39.4	17687	48.1	16025	8.7
Super Fund	1503	35.6	1052	2.9	(451)	(32.7)
Development Bonds			1821	5.0	1821	5.0
Leasing Obligations			2613	7.1	2613	7.1
Secured Loans			12000	32.6	12000	32.6
Other Loans & small savings	159	3.8	201	0.5	42	(3.3)
	4221	100.0%	36770	100.0	32549	N.A.

Share Capital
This has increased from £2.0 millions by £1.9 millions to £3.9 millions largely as a result of mergers with Kettering, Rothwell and South Leicester but whereas in 1969 share capital accounted for 46.4% of total funds, the percentage is now down to 10.6% a reduction of almost 36%.

Reserves
These have increased by almost £15 millions from £601,000 to £15.2 millions and now represent 41% of funds compared with just 14%, an increase of 27%. The Revenue Reserves of nearly £13.8 millions have been realised in cash but the Revaluation Reserve is confined to properties

inherited from Rothwell and South Leicester. The other Society properties are worth far more than the figures at which they are included in the Society's Accounts - as indicated below:-

In the books at	£23.1 millions (Trade & Non Trade)
Really worth	£43.7 millions
Hidden reserve	£20.6 millions

Loans

As a percentage of total funds, loans are up from 39.4% to 48.1% but at January 1987 some £17.7 millions compared with £1.7 millions in January 1969.

a) The internally invested *Superannuation monies* have been purposefully reduced from £1.5 millions to £1.0 million but now represent only 2.9% of total funds compared with 35.6% in 1969.

b) We have attracted more than £1.8 millions of investments in *Development Bonds* which offer attractive rates of interest to certain investors, particularly those persons who are not liable to pay income tax.

c) Instead of outright purchasing *many of our fixtures, fittings, plant equipment and commercial vehicles, we have chosen to lease* them in recent years in order to conserve our cash and to reap the benefit of lower effective rates of borrowing. As a Society in a non-tax paying situation we have reaped the benefit of a modest net cost of borrowing from the organisation providing our leasing facilities, as they are able to use our capital expenditure to reduce their tax liability and to pass on some of the savings to us.

d) The *Secured Loans* have been obtained from two well-known Banks at very fine rates of interest. We can only borrow at fine rates of interest if bankers believe that

i) our business is well managed;

ii) our financial controls are tight;

iii) our trading performance is likely, over time, to produce enough profits and cash flow to enable us to pay the finance costs and to repay the capital borrowed; and

iv) we are able to provide them with suitable security against the monies that they have lent to us.

These loans are the most significant change in the funding structure of the Society during the period reviewed. The *Other loans and small savings* represent savings by individuals. The sums involved are relatively small.

Conclusions

As indicated earlier, the Society must have confidence in the long term viability of the major projects that it is investing in. Post-event audits in respect of a number of the Society's recent capital developments are quite encouraging. As an example, the Society opened a new superstore in Kettering in November 1985 and added a Home extension in July 1986. The site was inherited from Kettering Society. The building and site preparation costs amounted to £3.4 millions, to which must be added a further £1.1 millions of fixtures, fittings and plant. The profit contribution of the store in the year to January 1988 is likely to exceed 11% and what is more, the store was professionally valued in January 1987 as being worth £6.5 millions.

Equally as another example, a new supermarket opened in Lutterworth in November 1986 at a cost of £695,000. It is likely to produce a profit contribution in the year to January 1988 which will exceed the cost of financing the capital on the store.

The most recent of the Society's new food developments is at Market Harborough, which opened in early October 1987. The first indications are very promising indeed, with sales exceeding the 'best' estimates. What is also pleasing about the Market Harborough development, is that the cost of this new development is likely to be funded entirely out of the proceeds of disposal of the previous food store which only took one third of the sales of the new store. This provides an example of how the Society's capital has been redeployed into developments that are more relevant to today's shopping needs.

Courage is necessary to embark on new capital - hungry developments, but without that courage and initiative, the Society's market share would be likely to be eroded by its increasingly powerful competitors.

Note of the Author

G.L. Fyfe has been Chief Executive Officer of the Leicestershire Society since 1975. He commenced his Co-operative service in 1956 in Scotland and studied at the Co-operative College in 1959-60. He is vice-chairman of the C.W.S. Board, a director of C.I.S. and of the Co-operative Bank and chairman of Shoefayre.