The Co-operative Economy - Co-operative Performance 2007/2008

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One of the key roles of Co-operatives^UK, formerly the Co-operative Union, is to monitor the performance of its member retail consumer societies. This key area of work has been greatly refined of late with the publication of the *Co-operative Review* which is now the most comprehensive report on the size and scope of co-operative enterprise in the UK. The UK Society for Co-operative Studies has had a long tradition of reviewing the movement's statistical performance with Professor Noel Branton, Ted Stephenson and James Wood coming to mind with their regular and excellent analysis of our movement's performance over 20 years ago. This task in 2008 has fallen on the broad shoulders of Alan Middleton. Alan knows a thing or two about society performance having 40 years experience on the Board of his local society - Lincolnshire Co-operative, one of the movement's outstanding success stories. Alan's analysis is frank, honest and some might say controversial in places but is essential reading for all directors. Hopefully, this article will spark others into joining this important debate.

Co-operative Review 2008 probably represents the most comprehensive report on the size and scope of co-operative enterprise in the United Kingdom published in recent times.

By publishing an annual review of the co-operative economy, Co-operatives^UK can help achieve a number of key objectives for the co-operative movement in the UK, its nations and regions and beyond.

Firstly, an annual review can increase the profile of co-operatives within the economy whilst, at the same time, demonstrating to government the importance of co-operatives to the achievement of their economic and social policy objectives. Secondly, an annual review can highlight successful co-operative enterprise and co-operative innovation.

An annual review can also establish an important and ongoing role for Co-operatives^UK working with a network of partners, to improve the collection of statistics and data on co-operatives and to establish methodologies for analysing co-operative performance.

For example, the listing of the UK's top 100 co-operative enterprises published in the Review is a provisional list and is ranked simply by turnover. The listing is therefore a 'starter for ten' – an invite to the co-operative enterprises in the list to work with co-operatives to produce, in future years, a ranking based upon other measures of performance. In order to achieve this we will need to build consensus around measures of performance that are appropriate to the co-operative economy, but at the same time measures that will allow us to benchmark performance against other sectors.

What makes a co-operative business successful can be measured in many different ways, from the distributions to its members, the services to its customers or even the ethical and environmental stance it takes. However, it remains that, in any business, in order to ensure sustainable growth it is necessary to generate profits.

Commercial Performance

A co-operative business must firstly be a successful business. Directors and senior executives have a responsibility to ensure that their co-operative is commercially succesful.

Co-operatives^UK has over the past ten years brokered an agreement amongst directors and senior executives on the indicators that co-operatives should use when measuring their commercial performance.

Whilst lay directors have a responsibility to understand the importance of commercial performance indicators and what each indicator tells us about business performance, they do not necessarily need a detailed understanding of the technical calculations underpinning them.

Of greater importance is an ability to recognise the drivers of commercial performance, and how these affect the indicators.

There are four measures of commercial performance that are appropriate to a co-operative:

- Profitability
- Financial stability
- Growth
- Co-operative Difference

Profitability

The key indicators of profitability are calculated as follows:

- Return on Capital Employed (ROCE) Pre Goodwill.
- Net Profit as a % of Sales.
- Return on Members Funds.
- Trading Profit after depreciation as a % of Sales.
- Trading Profit before depreciation as a % of Sales.

Return on Capital Employed (ROCE) Pre Goodwill

The assets of the society must be employed effectively and efficiently and must generate an adequate return.

Return on Capital Employed is recognised by industry and economic commentators as the most important measure of commercial performance. In terms of consumer co-operatives it overcomes differences of trade mix and therefore provides one of the most effective comparisons between societies and relevant competitors.

ROCE is calculated as:

Trading profit, after depreciation but before current amortisation of goodwill and excluding any exceptional costs or profits plus investment property valuations and profits from the sale of investment properties divided by average of start and year end capital employed plus goodwill amortised since 1999.

Where:

Capital employed is the sum of tangible and intangible assets, stock, debtors and prepayments, less creditors and provisions (but excluding deferred taxation).

Variation in societies' policies regarding property rental and valuations, goodwill and capital expenditure programme, must be taken into account when interpreting the ratio.

In order to ensure comparability current property valuations as declared in the annual accounts or provided by societies on the annual return to the Co-operatives[UK] have been used.

Where a society has no current valuation for all properties they have been excluded from the peer group and national rankings and shown as being not applicable.

ROCE is calculated using net book values for those societies not declaring a current valuation for property. The ROCE achieved is however likely to be over inflated and should therefore be treated with caution.

Co-operatives[UK] recommends that societies should aim to achieve a Return on Capital Employed of at least 10%.

Net Profit as a % of Sales

Net profit as a percentage of sales has a limited value as a comparative measure of profitability, as it does not reflect the returns that can be expected from different trading activities, and therefore trade mix. It nevertheless is an important indicator of the amount of profit being generated by the business and therefore available for distribution.

Net profit is trading profit excluding exceptional costs and profits, less net interest payable but not including interest payable on share capital and FRS 17 interest. Sales are VAT exclusive sales as shown in the Revenue Account.

Return on Members Funds

Defined as Profit excluding exceptional costs and profits and before tax and distributions plus investment property appreciation divided by the value of members funds.

Trading Profit after depreciation as a % of Sales

Trading profit also has limited value as a comparative indicator.

In order to enhance its value as a measure, a weighted benchmark of overall society trading profitability is calculated by applying relevant average profitability/sales ratios achieved by competitors onto the society trading mix. Societies can then be ranked on their actual performance versus the weighted benchmark.

Trading profit is as shown in the Revenue Account, but excluding any exceptional costs and profits and after the deduction of any benefits paid to members that cannot be classified as a true dividend.

Trading Profit before depreciation as a % of Sales

Trading profit, as defined above, but depreciation, as reported in the Notes to the Accounts, is added back to facilitate meaningful comparisons between societies, because some have significantly different depreciation policies. A weighted benchmark of overall society trading profitability before depreciation is calculated by applying the society's depreciation charge to the weighted benchmark as calculated above.

Financial Stability

Measures of financial stability are crucially important.

Historically, the main causes of the failure of societies have been when they have not been able to sustain their financial obligations. In particular, failure has occurred where trading profit could not cover the interest charges on borrowings and societies have been unable to reduce or repay borrowings when called upon to do so.

- Gearing
- Interest Cover

Gearing

Gearing measures the extent of societies' financial liabilities related to their accumulated reserves and share capital.

There will be a range of views as to what levels are appropriate for this indicator. At one end of the spectrum, a low value indicates that the society is financially sound and that liabilities are low in relation to Net Assets. However, one explanation may be that such a society lacks ambition and has been unwilling to incur debt to finance growth. Alternatively, it may have had no need to resort to borrowing.

Arguably, a high value could be classed as acceptable, providing that other indicators such as Profitability and Interest Cover are favourable. For those societies unable to provide a current property valuation no peer or national ranking is available.

Gearing is defined as Net Debt as a % of Net Assets (adjusted with reference to current property valuations).

Interest Cover

Interest Cover is defined as Trading Profit excluding exceptional items divided by net interest.

This indicator shows the value of profits in relation to interest liabilities.

The larger the number, the greater the degree of comfort that interest charges can be met. Where interest received is greater than the interest paid this indicator is not applicable.

Growth

Generally, successful organisations grow at the expense of the less successful. For trading organisations, this process implies a transfer of market share from the less successful to the successful. Growth indicators show advancement or decline relative to the market. It is important that co-operatives demonstrate their success by at least maintaining their position in the market. Growth is also important to mitigate the effects of increasing costs. Growth should contribute to improving the balance between direct operational costs and central overheads.

Growth is measured by:

- Like-for-like Value Turnover.
- Volume Turnover.
- Capital Expenditure as a % of Net Cashflow.

Like-for-like Value Turnover

Like-for-like value turnover is the value of trade adjusted for any store closures and openings. Where trade has been acquired through acquisition or new store opening, trade in the current year is excluded, as is trade in the previous year when a store is now closed.

Volume Turnover

Volume turnover is the value of trade adjusted for price changes.

The first indicator of growth charts changes in the volume of turnover (index 2002 = 100) for each group of societies, related to the performance of large retailers. It seems reasonable to show this benchmark, because large retailers are the main competitors to co-operatives and they set the standards for the industry.

Capital Expenditure as a % of Net Cashflow

Growth is not accidental. It depends very greatly on the capital expenditure that is invested in growth. This indicator relates capital expenditure of societies to their Sales.

Co-operatives^{UK} advice to societies for many years is that reasonable pace must be kept with the levels of investment in growth of our major competitors.

The ability to achieve this depends on profitability, which must be sufficient to sustain the investment. It can also be achieved by borrowing, but only if the returns outweigh the additional interest charges. The mix of trade may well be another factor that needs to taken into account.

Defined as being the sum of purchase of

tangible and intangible assets + new business acquisition divided by Net Cashflow from operating activities + proceeds from the disposal of tangible and intangible assets.

Co-operative Difference

The final indicator is vitally important to the future of our co-operative enterprise. It is concerned with the measure of our co-operative difference, ie those aspects of a successful co-operative business that differentiate co-operatives from other businesses, particularly their investor-owned competitors. The Co-operative, Envirionmental & Social Performance Working Group have developed indicators of co-operative difference, which may better inform our judgement on this measure.

Co-operative Distributions as a % of Net Profit

The indicator of co-operative difference that will continue to be used, and a factor in the recruitment of members, is the availability and the value of exclusive economic benefits returned to members. In order to facilitate meaningful comparisons between societies, this indicator shows the value related to the net profit of the society.

The 2008 Results

Let us now see how the different types of co-operative activity performed.

Co-operative Review 2008 published at Co-operative Congress, at the end of June 2008 covers members' trading performance in the years ending either September 2007 or January 2008.

All Co-operatives

The UK co-operative economy has a total turnover of £27.4bn, pre-tax profits of £539m and it employs 237,000 people.

- Turnover £27.4bn
- Pre-tax profit £539m
- 237,000 employees

The UK co-operative top 100, which are listed in the review, account for 95% of total turnover.

Consumer Owned Co-operatives

Consumer owned co-operative businesses achieved a turnover of £12.7 bn, up 1.9% or 3.9% like for like, net profit of £471 m or 3.9% of sales, up from 2.9%, and a return on capital employed (ROCE) of 8%, down from 8.1%.

- Turnover £12.7bn up 1.9% or 3.9% like for like
- Net Profit £471m
- 3.9% of sales up from 2.9%

- ROCE 8% down from 8.1%

The turnover figure means that we have probably suffered a further marginal loss of market share, but the net profit shows a good move forward and represents a significant recovery, when one considers that ten years ago, it was hovering around 1% and we were not even measuring ROCE. I personally believe that a minimum of 5% or 6% net should be the short term target and that now looks reasonable, realistic and achievable. The Co-operative Commission of 2000/2001 declared that a ROCE of 10% should be the minimum short term objective. That now also looks attainable, but we still need to do better in the medium and longer term.

Individual Society Performance

Looking at the results on a society by society basis, it is clear that Lincolnshire and Channel Islands are the top performers, as can be seen from these 'at a glance' league tables.

Net Profit %

The Premier Division	
Lincolnshire	10.1
Channel Islands	6.7
Southern	5.3
The First Division	
The Co-operative Group	5.1
Lothian & Borders	4.6
Heart of England	4.6
The Second Division	
East of England	3.1
Plymouth	2.1
Midlands	1.9
The Third Division	
Midcounties	1.3
Scotmid	1.2
Anglia	0.2 LOSS

ROCE %

The Premier Division	
Channel Islands	12.8
Lincolnshire	10.9
Heart of England	9.3
The First Division	
The Co-operative Group	8.4
Midcounties	5.9
Plymouth	5.4
The Second Division	
Anglia	4.4
Chelmsford	4.2
East of England	4.0

Some societies have not made available to Co-operatives[UK] a statement of the current value of land and buildings, therefore, they are not included in this table as it is not possible to make an accurate calculation.

The biggest consumer owned society by far is of course the Co-operative Group with a turnover of £9bn, up 2.2% or 3.4% like for like. Net Profit is recorded at £345.2m or 5.1% of sales, up from 3.9% the previous year, and ROCE 8.4% against 7.3% last year. The Group must be pleased with this much improved result.

Midlands is the second biggest consumer owned co-operative with turnover of £854m, but net profit of only £15.2m means that they are anchored down at an unchanged 1.9%.

Third biggest is Midcounties, formed from Oxford, Swindon & Gloucester and West Midlands, whose turnover amounted to £712m. ROCE was 5.9%, down from 8.1%, but net profit of £8.6m converts to, what for them must be a desperately disappointing 1.3%, down even from the meagre 1.4% achieved last year.

East of England, the merged Colchester and Ipswich/Norwich operation reported a turnover of £441m, up 5.2% but only 0.9% like for like. Net profit was 3.1%, the same as last year and ROCE 4%, down from 5% last year. They will be looking to do better in the future.

Scottish Midland have been slowly dragging themselves back from some pretty poor results in recent years and turnover at £389m showed an increase of 1.8% or 2.3% like for like. Net profit at 1.2%, although far from satisfactory, is better than last years 0.1%.

Anglia have a new Chief Executive who was not responsible for these results, but who must be looking for substantial improvements before very long. Turnover at £350m was 3.4% ahead of last year but only 1% like for like. ROCE was 4.4% but a net loss of £636k is minus 0.2% of sales, but still only half of last year's loss.

Lincolnshire recorded a turnover approaching £217m, an increase of 6.1% or 5.5% like for like. Net profit was an amazing 10.1% at £20.2m, up marginally from 10% last year. ROCE was 10.9%, down from 21.2% in the previous period, a figure that was affected by a number of one-off items.

Southern Co-operatives, a successor to the famous Portsea Island Society, will, I am sure be pleased to have produced such a good result. Turnover at £198m was up 10.4% or 7.6% like for like and net profit was £9.7m or 5.3% against 4.7% last year.

Plymouth & South West are another society fighting back from difficult times and it is clear some tough decisions have had to be made. Turnover at £161m was down 1.4% but up 1.6% like for like. Net profit of £3.1m was 2.1% of sales, not very exciting but better than the 1% of the previous year. ROCE was 5.4% up from 4.8% last year.

Channel Islands, a consistently good performer, has once again turned in a top class result. Turnover was £137m an increase of 8.9%, ROCE 12.8%, up from 11.3% and net profit of £9.1m is 6.7% of sales, moving forward from 5.8% last year.

Lothian and Borders achieved a turnover of £123m, 8.2% ahead of last year but only 0.6% like for like. Net profit of £5.1m is 4.6% of sales, the same as last year.

Heart of England turnover at £78m was only 0.1% up from the previous year but 3.5% like for like. Net profit of £3.3m matched Lothian in percentage terms at 4.6%, up from 3.7% last year and ROCE was 9.3%, down from 28.4% in the previous period, which again included some one-off items.

Lessons to be Learned

So what message, if any, can we draw from these figures? The first and perhaps most obvious thing is that the top two performers are both relatively small, certainly not among the big players. In fairness I have to acknowledge that some of the very smallest societies are also some of the poorest performers. The second thing to strike me is that the top two performers in financial terms are also the two societies who are most heavily involved in their communities. Is that merely a co-incidence? I think not, I believe there is more to it than that. Does it tell us anything about the case for one UK wide consumer owned co-operative? I think it might.

I have never been convinced by the arguments for a single national society. Yes, a case can be mounted that one UK wide society would enjoy commercial success beyond that of the current national average. But success is not assured. One only has to look at the examples of Austria and Germany to understand that. National societies can fail and have failed. The problem for me with having just one society, is that it is but one small step from there, down to none.

In any event, such a society would, in my view, be unable to communicate effectively with its members or create in them any sense of identity or ownership. Successful consumer owned co-operatives were born out of the communities they served, not invented hundreds of miles away and dictated to from above or afar. A single national society would not look like a big version of Lincolnshire or Channel Islands. Because these societies are small, lines of communication are short. They can identify and exploit local opportunities in a way which would simply not be possible in a national society. Being completely integrated in the community and having high calibre people right there on the ground, means that development opportunities and acquisitions present themselves to local societies in a way which simply would not happen in a national society. That is the distinctive co-operative difference, meeting our co-operative and social objectives, generating commercial opportunities **and** serving our members.

So should Lincolnshire and Channel Islands sign up to a single national society? Given their current financial performance and what we know about the extent of their activities in the communities they serve, it is difficult to see how their members would be better off in such a society at the present time.

However, let me end this section of the review on a lighter note. I mentioned to the late John Tilley, former Parliamentary Secretary of the Co-operative Union once, that if there was a national society, I would not wish to be on the Lincolnshire regional committee. "I shouldn't worry Alan", said John, "they wouldn't want you".

Other Sectors of the Co-operative Movement

The size of the co-operative economy is further illustrated by the figures from the other important sectors of the movement.

Agricultural Co-operatives

The number of agricultural co-operatives has risen from 404 to 428 in the year. Turnover totalled £4.5bn, but profits of £30.5m, equates to only 0.7% of turnover.

Worker Co-operatives

The number of worker co-operatives analysed is up 21 to 394. Turnover of £138.7m has been achieved by 239 of these organisations. Profit amounted to 2.2% of turnover.

Housing Co-operatives

There are 13 more housing co-operatives included in the review this year, a total of 658. Turnover of £127.5m, produced a profit of £10.2m which is equal to 8% of turnover.

Fishing Co-operatives

Fishing co-operatives are included in the review this year for the first time and it is reported that there are 69 of them with a turnover of £29.5m. Profit of £1m is 3.3% of turnover.

Conclusion

It is clear to me that all co-operatives need to be competitive and innovative and in order to be successful they must match the growing expectations and aspirations of their members.

Alan Middleton is a Director of Lincolnshire Co-operative Limited writing this paper in a personal capacity