
Cooperative Finance, Equity and Capitalization: *Key Ingredients of Success*

Margaret Lund

Cooperation Works! Training

April 12, 2017

Do you have this book?

- *Cooperative Equity and Ownership: An Introduction* by Margaret Lund— University of Wisconsin Center for Cooperatives: www.uwcc.wisc.edu

Cooperative Equity
and Ownership:
An Introduction

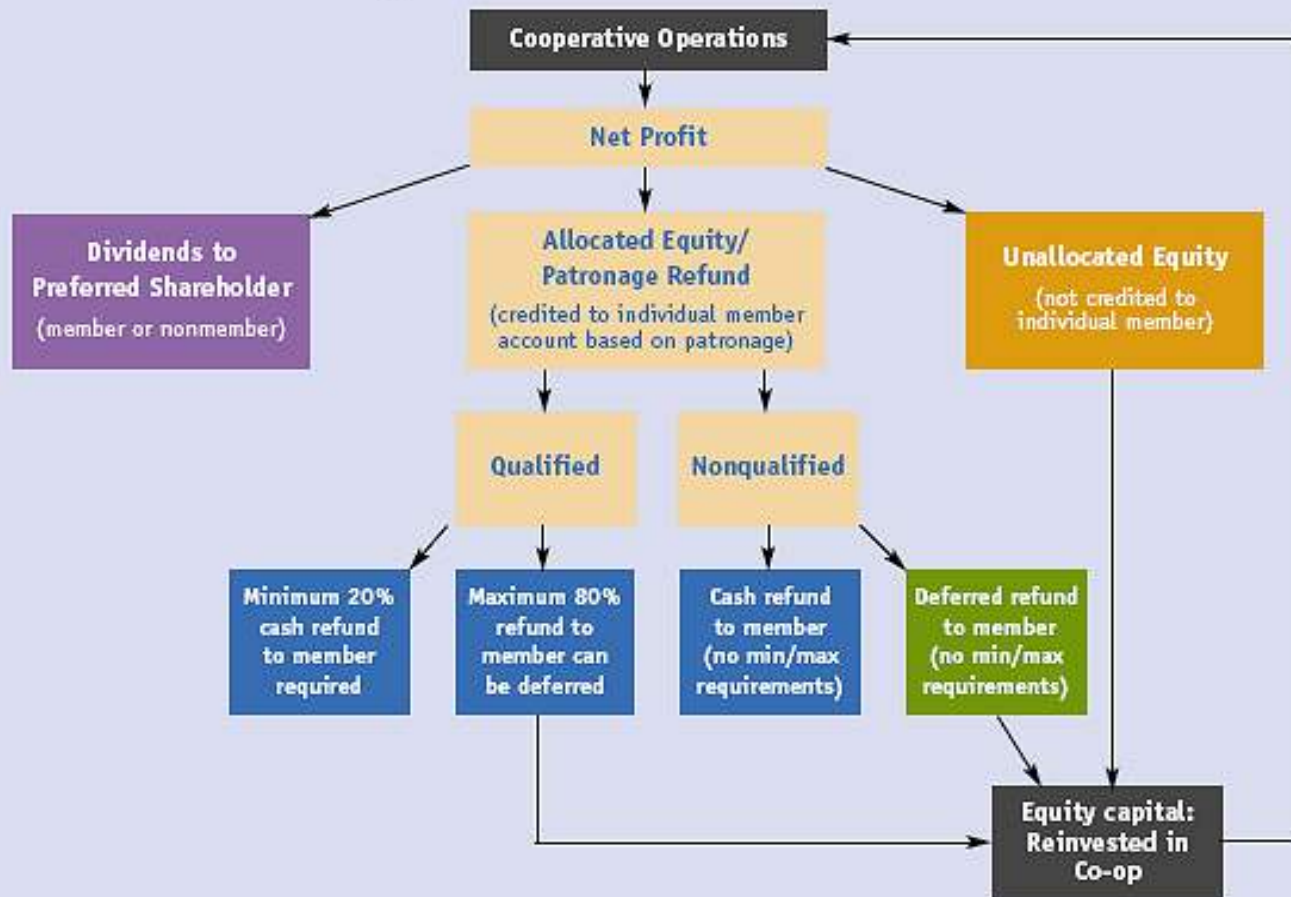
Common business ownership structures

	Cooperative Corporation	Corporation (C or S)	Sole Proprietorship	Nonprofit organization
Who are the owners?	Members	One or more shareholders. S Corp limited to 100 shareholders	Individual	No ownership
What is the business purpose?	To meet member needs for goods or services	To earn a return on owner investment	To provide employment for owner and a return on owner's investment	To provide services or information
How is the business financed?	stock/shares to members, and sometimes outside investors; retained profits	Sale of stock; retained profits	Proprietor's investment; retained profits	Grants, individual contributions, fees for services
Who receives profits?	Members in proportion to use; preferred stockholders in proportion to investment, up to 8%	Stockholders in proportion to investment	Proprietor	Retained within the organization
What is owner legal liability?	Limited to members' investment	Limited to stockholders' investment	Unlimited for proprietor	Limited to assets of the organization

Distinguishing Features of Co-ops

- Ownership
 - Governance
 - Flexibility
 - More complex set of values, obligations, expectations
 - Not distinguished by industry, sector, management style, demographics, or location
-

Cooperative Net Profit Distribution



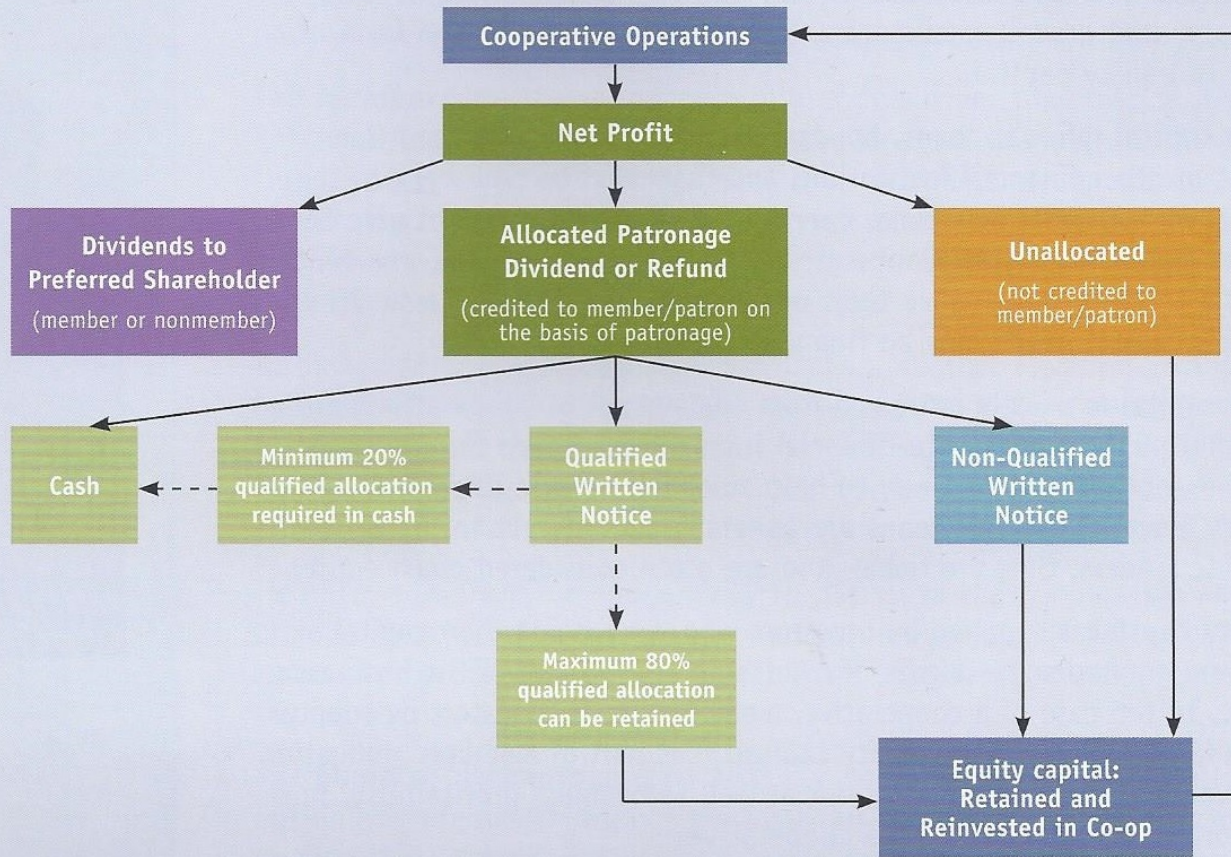
Both co-op and recipient pay tax

Member pays any required tax

Co-op pays tax. Upon future distribution to member, member pays any required tax, and co-op receives tax credit

Co-op pays tax

Cooperative Net Profit Distribution



Both co-op and recipient pay income tax

Member/patron pays any required income tax.

Co-op pays income tax. Upon future distribution to member, member/patron pays any required tax, and co-op receives tax credit.

Co-op pays income tax

Thinking about some examples . . .

- Renaissance Community Co-op
 - Cooperative Care home care co-op
 - Union Cab worker co-op
 - My Farmer marketing and ag supply co-op
 - My suburban consumer food co-op
 - My Own Home housing co-op
 - Island Employees Co-op with members of different income levels
 - Others . . .
-

Can you

- Explain the co-op difference -- Co-ops vs Conventional firms
 - Income statement
 - Balance sheet
 - Cash flow



Co-ops vs. Conventional Corporations

■ Income Statement:

- ❑ Similar market prospects, expenses (may make different decisions – OV)
- ❑ May enjoy more customer loyalty, inside market perspective from members
- ❑ May benefit from volunteer hours from members
- ❑ Do not have to generate market “profits”
- ❑ Can shift tax burden between member and cooperative
- ❑ Direct financial value to member/owners is more tied to profitability rather than growth in stock value

Co-ops vs. Conventional Corporations

■ Balance Sheets

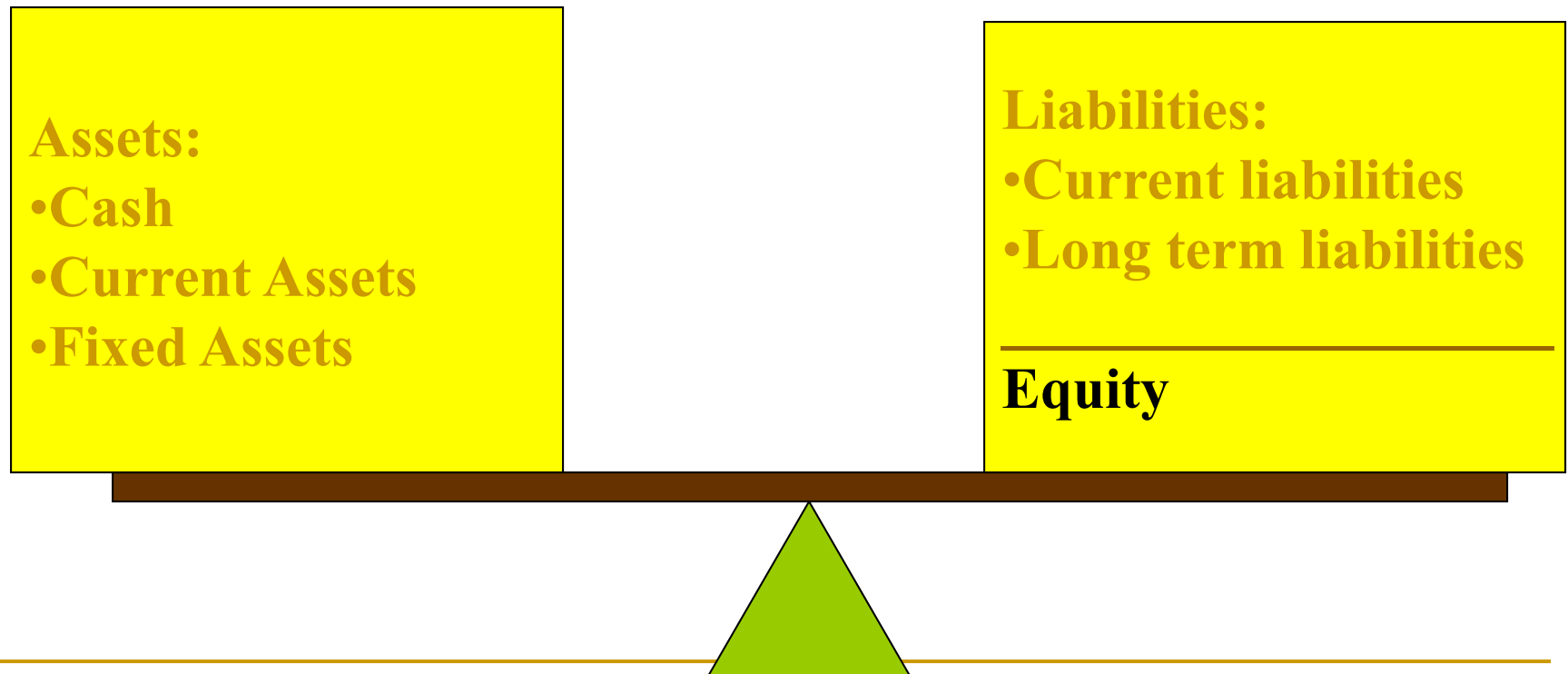
- ❑ Need same prudent proportion of equity as other businesses in the industry
- ❑ Generally must raise equity from many small amounts – more costly, time-consuming
- ❑ Member equity might be more “patient” (or not)
- ❑ Can choose between unallocated, qualified and nonqualified – more flexibility
- ❑ Difficult to “unlock” ongoing value of company without destroying co-op structure
 - Co-ops face many of the same liquidity issues as other privately-held companies

Co-ops vs. Conventional Corporations

■ Cash Flow

- Equity redemption schedule sometimes more rigid
 - Can have advantage of regular, predictable inflow of member equity
 - *but this can mask operational issues . . .*
 - Co-ops have flexibility to allocate patronage in cash or stock
 - Many parties involved in decision-making -- transparency, education and ***managing expectations become key***
-

The Cooperative Difference



What's the difference between \$1 from equity and \$1 from debt?

- Technical considerations
 - Financing considerations
 - Tax considerations
 - Legal considerations
 - Timing considerations
 - Control considerations
 - “Moral” considerations
-

How Much Equity Do You Need? (and where should it come from?)

Depends on:

- Nature of the business, assets needed
 - Industry practices, cycles
 - Lender/partner tolerance for risk
 - Purpose of co-op, preferences of members
 - Lifecycle of business (start-up, expansion etc.)
-

Member money in and money out

Generally a good idea to try and match co-op investment to co-op use

IN

- Direct investment
- Portion of profit
- Per unit retains
- Base capital plan

OUT

- Redemption schedule
 - Event triggers
 - Base capital plan
 - Passive “planning based on cash flow
-

Advantages and disadvantages of each . . .

Different Member Equity Strategies . .

- - One time, one amount, membership “fee”
 - Annual patronage distribution (driven by profitability)
 - Per-unit retains (based upon “use”)
 - Base capital plan
-

Different Member Redemption Strategies . . .

- Set schedule
- Triggered by certain events
- Base capital plan
- Passive “planning” based on cash flow availability

Generally a good idea to try and match co-op investment to co-op use

Variations on a theme . . .

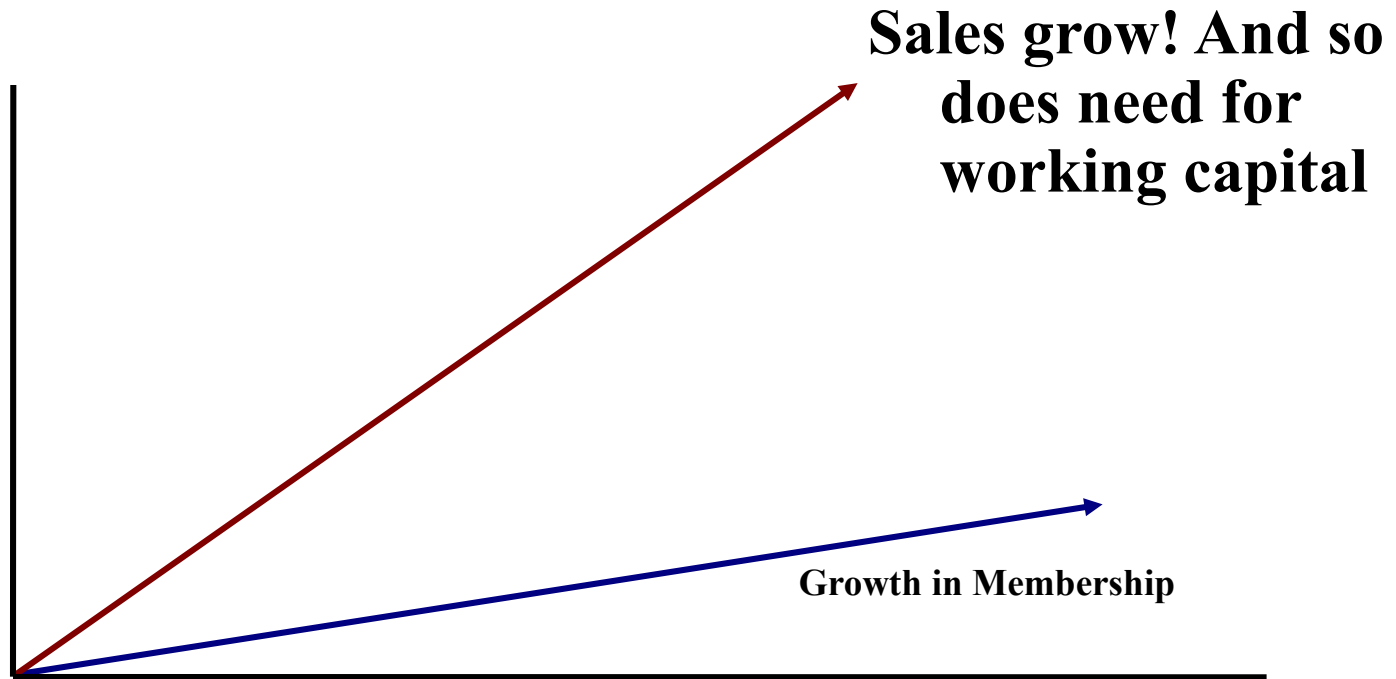
	Mondragon Valley	Equal Exchange	CHCA	Worker-owned Bakery	Old Farm Co-op
Community	10%	**	20%*	0%	0%
Co-op	45%	60%	50%	0%	0%
Members later	36%	20%	0%	80%	80%
Members Now	9%	20%	30%	20%	20%
When?	Base capital plan/retirement	On leaving the co-op	N/A	3 years revolving cycle	Paid to estate

Other sources of equity or quasi-equity

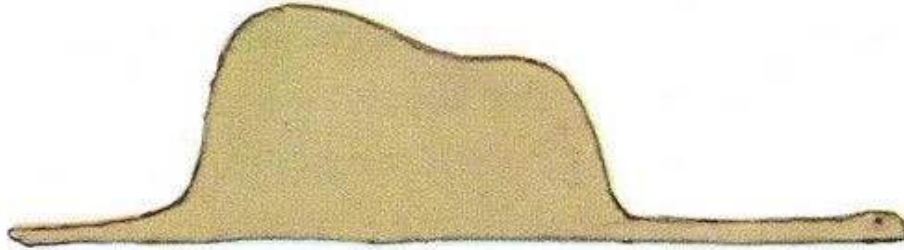
- Member loans
- Preferred shares (member or non-member – must be allowed by articles)
- Unallocated equity (member or non-member activity)
- Non-qualified distributions
- Loan guarantees
- Investor members (if allowed by state statute)
- Grants, other fundraising

Both success and struggle can lead to unique challenges for cooperatives . .

One unstable co-op equity situation



Another unstable situation . . .



- Declining growth/profitability can create a member equity redemption obligation that cannot be met without sacrificing:
 - *future growth/profitability*
 - *patronage for existing members*
 - *equipment/facilities*
 - *jobs*

Both Situations . . .

- Can lead to conflict between needs/desires of different generations or classes of members



Premier Cooperative

- Started in 1893 in Black Earth, WI
- Began as a farmer supply cooperative



Premier Cooperative



- Today Premier has facilities in 14 communities
- Services include:
 - Agronomy
 - Supply
 - Grain marketing
 - Convenience stores
 - Propane/petroleum
 - Hardware
 - Lumber
 - Auto/truck repair

Premier Cooperative

- In 1992, average age of stock redemption was 78
- Timeline kept growing . .
- Not feasible to “grow their way out”

What to do?

Premier Cooperative

- Limited rebates to those with over \$1,500 in purchases
 - Changed most patronage to “nonqualified”
 - Clearly tracked and divided out sales attributable to “consumers”
-

Results . .

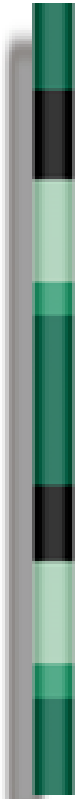
- Cash portion increased from 20% to a range of 30% - 57% cash
 - Age of redemption moved from 78 to 65 and getting younger
 - “a lot of hard work” but “forced us to operate in a more businesslike manner”
 - **Co-op has an equity strategy that matches its current members and their needs**
-

Good Capital Planning = Good Strategic Planning

Consider all areas of capital need not
just equity redemption

Co-op Value Proposition

Full Co-op Value Proposition


$$\begin{aligned} \text{Member's} \\ \text{Return} \\ \text{on Equity} \end{aligned} = \begin{aligned} &\text{Dividends} \\ &+\text{Cash Patronage Refund} \\ &+\text{PV of Retained Patronage} \\ &+\text{Opportunity Differences} \\ &+\text{Price Differences} \\ &+\text{Service Differences} \\ &+\text{Value of "Existence"} \\ &+\underline{\text{Value of Risk Reduction}} \\ &\text{Member's Equity} \end{aligned}$$



Key Ingredients of Success . . .

- Equity/Capitalization strategy should serve current members and their needs
 - *If it doesn't, be willing to change . .*
 - At the same time, be cognizant of needs of different “generations” of members
-

Key Ingredients of Success . . . cont

- Make the cooperative difference advantageous
 - Consider full spectrum of benefits, time horizon
 - Make sure members understand and appreciate this
 - Make sure the social benefits at the center of the business model do not become cost centers, but rather mechanisms that drive the economic mission of the business
-

A co-op should be more than icing on the cake



Key Ingredients of Success . . . cont

- Transparency is a key ingredient of successful democratic institutions
 - Invest in board and member financial training on all three aspects of financial statements
 - Apply complexity sparingly – *if they don't understand it, they are unlikely to trust it*
-