

Russian Roulette with Three Cylinders Loaded!

Phil Kenkel

Bill Fitzwater Cooperative Chair

In previous newsletters I discussed the results from a national survey on unallocated equity. The respondents indicated that members place a moderate to high value on their allocated equity and that it has a moderate impact on their involvement in the cooperative. A key question involving unallocated equity is whether cooperative members would liquidate the cooperative to obtain the value of the unallocated equity.

In the cooperative structure, a member has a defined property right to their allocated equity which is expected to be redeemed at face value at some future date. Collectively, the members have rights to the total equity of the cooperative. If the cooperative continues operation a member eventually has their equity redeemed and no longer has any ownership claim to the unallocated portion. That creates the situation where, if a cooperative were liquidated at book value, the members would receive more than the face value of their equity. The ratio of unallocated to total equity impacts the difference between the members' individual claim and their collective claim. Members liquidating a cooperative would lose the opportunity for all future patronage and the services of the cooperative. Those values obviously enter into the equation and we would hope that they would offset the incentive to capture the unallocated value.

The national survey included a hypothetical situation where cooperative members received an offer from an outside (non-cooperative) firm to purchase the cooperative at price where the members would receive double the face value of their allocated equity. Fifteen percent of the respondents indicated it was very unlikely that the members would sell the cooperative, 31% thought it was unlikely, 32% thought there was roughly a 50-50 chance while 15% thought it was likely that the members would sell and 7% thought it was very likely. Overall 54% of the respondents thought there was 50% or better chance of the members liquidating the cooperative for 200% of the allocated equity value. Among the subset of cooperatives that had over 50% unallocated, 48% of the respondents indicated a 50-50 or better chance. In that case, the hypothetical offer was equal to or less than the cooperative current net worth.

I always thought Russian roulette was a fool's sport since there is a one in six chance of disaster. Cooperative leaders appear to be comfortable playing with three cylinders loaded! In the next newsletter I discuss historical evidence on the link between unallocated equity and cooperative liquidation.

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