Cooperative Finance Fallacies

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I often hear statements about cooperative finance that might not hit the level of "fake news" but are highly questionable. The first "fallacy" is that retaining profits as revolving equity creates a future obligation that will be difficult to meet. When an investor owned firm reinvests in infrastructure they expect that future profits will provide a return on that investment. In a cooperative, we do not provide a return on equity and we expect that future profits will allow us to revolve that equity. Successful cooperative can effectively use the revolving equity system and the industry is rich with examples.

I hear many fallacies involving unallocated retained earnings. One statement is that because of the revolving period members don't mind the cooperative retaining funds as unallocated equity. At 5% interest a dollar received in 10 years has a present value of $.62 and even at 15 years it is worth $.48. Members never receive profits channeled to unallocated equity. I have yet to meet a producer who would prefer $0 to $62. A permutation on that fallacy is that retaining funds as unallocated retained earnings helps the member by shortening the revolving period. You can see from the previous math that if the cooperative changed half of your stock patronage to unallocated retained earnings they would have to speed up the revolving period by more than 10 years before you would be better off. I am not aware of any cooperative being able to do that.

Rounding out the unallocated retained earnings fallacies is the concept that high needs for infrastructure investment implies a need to retain funds as unallocated reserves. A high need for reinvestment does mean that the cooperative must retain profits. Those profits can be retained as either revolving equity or unallocated retained earnings. The equity redemption payments will not occur until the end of the revolving cycle. It is difficult to see how a current need for infrastructure investment changes the cooperative's ability to revolve equity in 15 years or justifies an unnecessary reduction in member return.

A final fallacy is that a transition to nonqualified stock creates a communication problem. Nonqualified stock reduces the member's immediate taxation associated with the cooperative. Last year's tax reform lowered many tax rates. I did not hear any argumenta that tax reform should not occur because it would be too difficult to explain to taxpayers that their taxes were going down. When grain prices increase or fertilizer prices decrease I don't see boards fretting over how they are going to break that information to the membership. Boards need to do the analysis but in most cases retaining profits as nonqualified stock can increase member return while maintaining the same cash flow for the cooperative. Good news is usually easy to communicate.

Maybe we need a "cooperative fact check.org" website to rate statements about cooperative finance!