Cut Costs or Distribute Profit More Efficiently?

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In last week's newsletter I discussed my recent research involving ten case study grain and farm supply cooperatives. The research examined profit distribution alternatives under low and high tax rates, with and without the DPAD. The cash patronage rates were adjusted such that each strategy maintained the same cash flow for the cooperative. The results indicated that distributing profits in a combination of cash and nonqualified stock resulted in a higher member return relative to retaining funds as either qualified stock or unallocated equity. That result held at both low and high tax rates, with and without the DPAD. The largest advantage to nonqualified occurred when the members had high tax rates and the cooperative used the DPAD.

The differences in the members' rate of return varied across cooperatives and depended on the tax rate and DPAD assumption. At low tax rates, without the DPAD the average difference in the rate of return was 0.6%. At high tax rates with the DPAD the average was 6.4%. One way to put those numbers in perspective is to consider what else a cooperative manager and board could do to yield a similar improvement in member benefit. Reducing costs is one alternative. At the low tax rates, with the DPAD the case study cooperatives would have had to reduce personnel costs by 10-20% (without reducing service) to obtain the same improvement in member return as could be achieved by transitioning to nonqualified retained patronage. At the high tax rates, with the DPAD the cooperatives could not obtain an equivalent improvement in member return even if they somehow eliminated all personnel costs.

Cooperative managers and boards of directors work diligently to protect the financial stability of the cooperative. They also strive to control costs and maximize efficiency. Ultimately, they are agents of the member owners who benefit through use, patronage and equity redemption. My case study/simulation research suggests that member benefit could be improved by changing profit distribution. A cooperative transitioning to nonqualified would likely need to do some analysis and communicate the change to members. Still, it might be more practical than operating the cooperative with no personnel!

If you would like a copy of the research paper, drop me an email at phil.kenkel@okstate.edu.

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