Dealing with Regional Patronage

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I sometimes classify cooperative financial decisions as "the good, the bad and the ugly". Some decisions are clearly in line with cooperative principles and the long-term interest of the membership. Some are contrary to those goals. Some are "ugly" or maybe "clunky" is a better term. They may be creating some outcomes but those outcomes are not necessarily tailored for the cooperative. "Ugly" practices can also be artificially linked decisions that could be better determined independently.

Regional patronage has always created issues for local cooperatives. Regional patronage is an aspect of member-based profits. When the local cooperative receives regional patronage, they must pass it on to their members to avoid having it included in their taxable income. When a local cooperative passes on regional patronage, they include it in their patronage calculations as they distribute cash and stock. That can create cash flow implications if the cash and stock ratio of the regional patronage does not match that of the local cooperatives. Similarly, if the local cooperative is retiring equity more rapidly than the regional they face cash flow implications.

Some cooperatives retain regional patronage as unallocated retained earnings. This has become much more prevalent since cooperative level tax deductions became available. Retaining regional patronage eliminates the concern of whether the regional's cash and equity patronage balance matches the local cooperative's along with concern over the revolving cycle.

I consider routinely retaining regional patronage to be an "ugly" financial management practice. Regional patronage is a part of member-based profits. Retaining regional patronage results in retaining member profits as unallocated equity. Cooperatives need an adequate amount of unallocated equity but excessive amounts decrease the member's sense of ownership and create an incentive to liquidate the cooperative. If your board has a goal to increase unallocated equity you should manage equity retention towards that goal. There is no need to link that goal to the amount of regional patronage. Similarly, your board should establish the cash patronage percentage based on balance sheet goals and cash flow considerations. The effects of the regional patronage cash percentage can be factored in when determining the local cooperative's cash portion. The "good practice" of setting cash patronage based on your balance sheet and cash flow needs is superior to the "ugly practice" of automatically retaining regional patronage so that its effect on the cash patronage rate can be ignored.

The most compelling rationale for not allocating regional patronage is the fear that the regional patronage revolve at a slower rate relative to the local cooperative. That creates a cash drain as the local cooperative is in essence paying out cash for regional equity still on the balance sheet. That is however, somewhat an artificial argument. In some cases regional cooperatives more rapidly that the local cooperatives. I do not see local cooperatives accelerating their equity revolving cycle when that occurs. Future boards of directors, just like your board, should manage equity redemption based on a rationally developed equity redemption budget. That may involve accelerating or slowing the revolving period as appropriate. The timing of regional equity redemption is really just one of many factors that should be affecting equity management.

In short, your cooperative may or may not need to increase unallocated equity. You may or may not need to change your cash patronage rate. Future boards of directors may decide to increase or decrease the revolving cycle. Retaining regional patronage as unallocated equity links all of those decisions. That is why I consider it an “ugly practice” as opposed to the “good practice” of managing those decisions independently.