Return on Investment from Infrastructure Reinvestment?

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In this series of articles I have been addressing the simple question: "Are we reinvesting enough in our cooperative?" We have been working through the equation:

Growth rate = reinvestment rate x return on equity

A cooperative's reinvestment rate is the ratio of net capital reinvestment to net income. Net capital reinvestment is capital expenditures less economic (or book) depreciation. Last week we discussed why tax depreciation is a poor measure of actual or economic depreciation. Our formula would suggest that a cooperative that is reinvesting (net of depreciation) 50% of its net income and has an 8% ROE would grow at 4% per year. If the reinvestment rate falls to 25% of net income, growth falls to 2%.

Our growth rate formula also shows us that a cooperative's growth is a function of the return it generates on its net capital investment. Many boards don't consider the return on investment from an infrastructure replacement project. Their thought process is *"We have to replace the bin so the rate of return is illrelvant."* However, the return from that investment, along with those of existing assets, does ultimately drive the growth of the cooperative. Put another way, if our reinvestment in infrastructure is not generating an adequate return, in the long run we cannot deploy the capital to finance it. Inadequate returns can relate back to our imperfect measures of depreciation. If we are operating fully depreciated assets we may have a margin structure that is inadequate to support replacement assets. If our capital reinvestment doesn't generate additional efficiencies, it might have to be paired with some adjustments to margins.

Our growth rate formula also helps to emphasize the importance of feasibility analysis. That was the topic of our recent advanced director educational program. If we identify and reinvest in higher return projects we can grow our cooperative at a faster rate. *"Are you reinvesting enough?*" It depends on how fast you want your cooperative to grow and the returns from your potential investments. Next week, I discuss how debt financing enters into this equation!