Survey Results: Profits and Distributions

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Last week I discussed the equity management systems reported in the 2014 Annual Cooperative Business Survey conducted by the University of Wisconsin Center for Cooperatives. The survey also elicited information on sales, profits and profit distribution and retention. I'll discuss the results for the smaller size category (under $200M of sales) of agricultural cooperatives.

On average, the net income to sales ratio was 5.1%. Fifty nine percent of earnings came from member business, 31% from regional patronage refunds, 7% from non-member business and 3% from subsidiary businesses and investments. Fifty three percent of net earnings was allocated to members in both cash and equity, while 38% was retained as unallocated reserves. Equity redemptions represented only 5% of net earnings.

The allocated profit was distributed 50% cash, 48% qualified retained equity and 2% nonqualified retained equity. In terms of the equity being redeemed, 76% of the redemptions was for qualified equity and 24% was for nonqualified.

Several important trends can be gleamed from this data. Since the unallocated reserve retention is significantly larger than the nonmember business fraction, agricultural cooperatives are, on average, clearly retaining member-based profits as unallocated reserves. My research indicates that practice is the worst choice if the objective is to maximize the members' return from the cooperative. The ratio of unallocated to allocated equity can also create the threat of demutualization (liquidation).

The results also reflect a slow shift toward nonqualified distributions (more evident in the larger size category which I did not discuss). Survey respondent comments on the reasons for nonqualified distributions included the desire to control the growth of unallocated equity, and to avoid tax liability for the member. Some survey respondents also reported rationales for nonqualified which were unique to their cooperative. On average, cooperatives that issue nonqualified must also be aggressively managing equity retirement since 24% of the equity redeemed by smaller agricultural cooperatives was nonqualified while only 2% of the allocation was in that form.

Next week I'll take a look at the balance sheets and financial ratios.