The Other 80-20 Rule

Phil Kenkel
Bill Fitzwater Cooperative Chair

My work on cooperative valuation has focused on determining the value of the cooperative firm. One measure was "member value" which is the present value of the cash patronage and equity retirement that a typical member will receive in the next ten years. On average, member value is two to three times the value of the allocated equity. You would have to give a member a member a pile of cash two to three times the size of their allocated equity to equal what they will receive from the cooperative in the foreseeable future. The second valuation measure I calculated is based on free cash flows to equity (FCFE). It is a commonly used valuation technique in privately held firms. The FCFE measure determines the fair value for an asset that is yielding the size of cash flows that the cooperative generates. On average the FCFE valuation is five to seven times the value of the allocated equity. Any member who was tempted to sell a cooperative should make sure the outside offer is at least that amount. Both of the valuation measures can be important communication tools in helping members understand the value of their cooperative. They can be calculated specifically for your cooperative.

The data from the valuation research on ten case study cooperatives has allowed me to ponder some additional points. We often talk about the balancing act between cash patronage and equity retirement. The ten case study cooperatives were quite diverse in size, business emphasis and profitability. Half were on an age of patron equity management system while the remainder was on age of stock. On average, the cooperative channeled about 80% of member cash flows as cash patronage and 20% as equity retirement. The equity redemption flow may be understated because I was unable to analyze estate settlements and other special situations. Most of the cooperatives were currently paying 50% cash patronage and 50% retained. The 80-20 breakdown came from the fact that cooperatives (and member business) tends to grow over the years. The equity being redeemed was the retained portion in past periods when business volume and profits were lower.

Is 80-20 the right mix? Each member would probably have a different perspective. Older, inactive members would likely prefer a higher redemption mix will younger active members would like to see a higher emphasis on cash patronage. It is interesting to see how cooperative boards are balancing the two channels of member benefits. The other balance act is the amount of funds reinvested in the cooperative. I'll report on that in my next newsletter.