Valuing the Cooperative Firm

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In recent newsletters I discussed two important issues: the value that members place on allocated equity and whether excessive value of unallocated equity could entice members to sell the cooperative. That raises the question as to the value of the cooperative firm. All cooperatives need a cushion of unallocated equity so the value of allocated equity can never represent the total owners' value. The total equity value (allocated and unallocated) is the accounting measure of the ownership but it doesn't measure the potential value of the cooperative in generating cash flows or the value that the owners will receive as the profits are distributed.

There are commonly accepted accounting principles for valuing privately held firms. One technique is to value the firm based on present value of the projected future cash flow. We recently completed a research project applying the future cash flow evaluation method to 10 case study Oklahoma cooperatives. Six years of complete financial and volume data was used to project future financial statements. We developed two valuation estimates. The first was based on the total cash flows generated by the firm, less those required to service debt and maintain infrastructure. The second valuation represented the value of the future patronage and equity retirement payments that the members would receive.

On average, the value of the cooperatives, based on the present value of their future cash flows was over 7 times the value of their allocated equity. That value simply indicates what a firm like the cooperative would be worth on the open market. The second value was the present value of the member's payments. On average it was 2.1 times the value of the allocated equity. The difference is of course, that when the member leaves the cooperative and receives their final equity redemption they are leaving behind a thriving cooperative for the next generation. They did not receive, and hopefully did not want to receive the entire value of the cooperative.

The valuation results are impacted by how rapidly the cooperative is expected to grow (requiring more funds to be retained) and the interest rate used to discount future receipts. The member value is also impacted by a wide range of decisions such as profit distribution (cash, qualified and nonqualified stock) and by equity redemption management. The take home message is that the true value of the cooperative is in its ability to generate future profits and services. Research on quantifying that value can help us communicate our value package and it comparing cooperatives.

We will be presenting more on this research at our Advanced OCCD in January 2015.

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