Prepared for the Babson-Equal Exchange Cooperative Curriculum
By Margaret Lund, mlund95@gmail.com
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Financial Analysis of Cooperative Enterprises

Learning Objectives:

- To learn how cooperative enterprises are financially structured
- To know how cooperatives differ from other organizational forms
- To identify elements that make up a successful cooperative from a financial perspective
- To understand the various issues to be considered in underwriting or analyzing a cooperative enterprise

OVERVIEW:

What is the financial structure of a cooperative?

At their most basic, cooperatives are simply enterprises that are owned and controlled by their members for the benefit of these same members. **Joint ownership, democratic control and member benefit are the defining features that cooperatives the world over all share**. Co-ops operate in all industries, can be found in every country in the world, and vary in size from a handful of members to Fortune 500 companies. The flexibility of the cooperative model makes them a valuable tool for addressing any number of challenges or pursuing any number of opportunities. However the diversity of practice also presents a challenge for lenders and other analysts who don't often work directly with the sector. What "should" a co-op look like? How do you tell a good co-op from a mediocre one?

The capital structure of an enterprise refers to the way in which these assets of an organization are funded, that is, the way the balance sheet is "structured". Company assets are financed in one of two ways, either through equity (that is, ownership shares) or debt (funds borrowed from another, or liabilities). Like all businesses, the cooperative balance sheet is made up of a combination of assets, liabilities, and equity. The assets of a cooperative in terms of inventory, real property and equipment will usually look much the same as that of any other similar business. Many of a co-op's liabilities will be the same as other kinds of similar businesses as well, including short term debt to vendors and suppliers and perhaps longer term debt to a bank or other financial institution. Because cooperative are formed specifically to do businesses with their stated membership, in some kinds of cooperatives there may be special liabilities representing debts to members as well.

The greatest difference between cooperatives and other enterprises, however, is the way in which cooperatives structure the ownership or equity portion of their balance sheets. Ownership of an enterprise yields the right to a certain amount of control of the enterprise, control which is either

exercised directly, as in a sole proprietorship or partnership, or through a board of directors. Ownership is also linked to what in finance is called "residual claimant rights" which are rights to a particular share of company net income while operating, or a claim of divided assets if the company is dissolved. These two issues, **ownership** and **control**, and a third one**, benefit**, are what fundamentally differentiate one type of enterprise from another. To contrast:

Non-profit organizations are organizations that exist to pursue some stated purpose of common good. Their activities are generally limited to such activities, and any surpluses earned must be retained and reinvested in pursuit of the stated aim, or distributed to another non-profit organization. Non-profit organizations do not have individual owners. Control of the organization may be exercised by an elected board of "members" of the association as dictated in its organizing documents, but nonprofits are also frequently controlled by a self-perpetuating board which selects its own members. Nonprofits are bound by statute to pursue activities benefiting their stated membership if an association. If a charitable nonprofit, the benefit of activities must accrue to the common good as defined in IRS statute.

Investor-owned firms are businesses which are owned by individuals who expect an economic return on the capital they have invested in the business. Both control and benefit accrue based upon the number of shares owned. Generally those who own the most shares get the most votes for the board of directors as well as the highest percentage of net income, although the relative distribution of control and income can vary by mutual agreement. In some cases, as with most small businesses, majority owners are intimately involved in the operations of the business. In other cases, as with publicly traded companies, the majority of owners have no role whatsoever in the daily operations of the business and may never buy its products or use its services at all. These stockholders hold ownership with the single objective of making a profit from it. Investor-owned firms operate to benefit their investors through high net earnings, growth in company value, or both and are created to maximize return on capital invested.

A ***cooperative***, by contrast, is an enterprise formed by a group of people to meet their own self-defined goals, which may be economic, social, cultural or some combination of these. In a cooperative, only members are allowed to be owners. Thus in a co-op, members cannot be passive investors but will always be active participants in the business in some way, whether as consumers, workers, producers or some other role. All cooperatives operate on the principle of "one member, one vote" so control is allocated evenly among members without regard to relative levels of economic investment. Co-op law and practice dictate that cooperatives must operate for the benefit of members, and that benefits must also be distributed "equitably" based upon patronage, or the amount of business that a member does with the cooperative, not upon the amount of capital invested. This may mean that benefits

are divided equally, or it may mean they are distributed in some other equitable manner such as the amount of business each member does with the co-op.

Thus in many ways, the balance sheet and financial structure of a cooperative will resemble that of other enterprises a great deal. Financial analysis of such a business would include similar level of review regarding the true market value of the assets of the business, for example, or the age or nature of the liabilities, as well as the key financial metric of Debt-to-Equity or the percentage of assets financed through investment by the owners of the business, whoever they may be. The difference with cooperatives, however, is that the way that the membership of the cooperative is structured – how the membership system works, the level of engagement of existing members, the percentage of members who chose to do business regularly with the cooperative etc. – will all provide an additional level of understanding of the true financial "strength" of the business. Developing a clear understanding of how a cooperative's member ownership structure works will give a better indication of the strength of the business as a cooperative enterprise.

Common stock, allocated and unallocated equity:

Co-op members provide the crucial flexible and patient equity capital needed to launch a new cooperative and help an existing one run smoothly. Equity shares represent ownership of an enterprise and ownership by an active and committed group of members strengthens a cooperative in many ways. But what happens when a member leaves a co-op? When they retire or leave their job at a worker co-op, move out of the area served by their consumer co-op, stop farming and marketing product through their producer co-op or otherwise cease to use the core functions of a co-op they have been an active member of? Should they still be owners of the business?

Most co-ops prefer that only active members are involved as owners and therefore decision-makers of the business and thus every cooperative must articulate a system not only for raising money from new members, but also for redeeming or returning equity to departing members. All decisions about capital redemption involve achieving an optimal balance between the solvency needs of the cooperative and the rights of members to expect some rational system for returning funds that were not intended to act as permanent capital.

Cooperative equity comes in three varieties and each may be treated differently when it comes to distribution to members. All co-ops require eligible members to purchase at least one share of voting stock or a similar membership certificate. This can cost as little as $10 in most credit unions to thousand dollars in some worker or producer cooperatives. Common stock gives its holder a single vote in all issues that come before the membership of the cooperatives. Most co-ops do not want to have inactive members exercising voting rights and will thus return the cost of a voting share to a departing co-op member immediately upon leaving the co-op. Common stock generally does not receive any interest or dividends.

In addition to “paid in” or contributed capital, the other major source of equity for any privately-held business is net profit or retained earnings. In cooperatives, all net profits are divided into one of two categories, allocated or unallocated equity. Allocated equity is that which is credited to individual member accounts based upon their patronage with the co-op. In addition to paid in voting shares, this is the major way that cooperative members hold and build equity in their businesses. Unallocated equity, on the other hand, is retained earnings that are not credited to the account of any individual member. These funds are kept by the co-op and reinvested in its operations in perpetuity. Such funds are owned by the co-op itself, and not by any individual member.

The decision regarding how a year’s profits will be divided between allocated and unallocated equity is made on an annual basis by the co-op’s board. Cooperatives operating in different industries may make very different decisions from each other, and even the same co-op may decide to allocate funds differently year to year. One major consideration is tax treatment – unallocated equity is taxed at the corporate level in the same way that retained earnings in a corporation are. In contrast, funds that are allocated to a specific member’s equity account are not taxed at the corporate level, only at the level of the individual member.

Another consideration is cash flow. Generally, a co-op will have a system for returning members’ equity funds to them over some period of time. Allocated equity therefore, while patient, is not permanent – it should eventually be returned to the member. Unallocated equity on the other hand may be kept and used by the co-op indefinitely. If a co-op is facing a large, long term capital expense such as buying a building, it may choose to allocate more profits to this “permanent” use of funds rather than allocating profit to shorter term individual accounts.

Another consideration is the percentage of business that a co-op does with non-members. Allocated equity is the return of profits to a co-op member based upon their business done with the co-op. Profits from business done with non-members, as determined by co-op bylaws or the board, will often go into unallocated equity because it is owned by all of the members collectively, and is not attributable to the business of any one. Some co-ops do little or no business with non-members, so this is not a consideration. Other co-ops, however, such as consumer co-ops often do a large percentage of business with non-members.

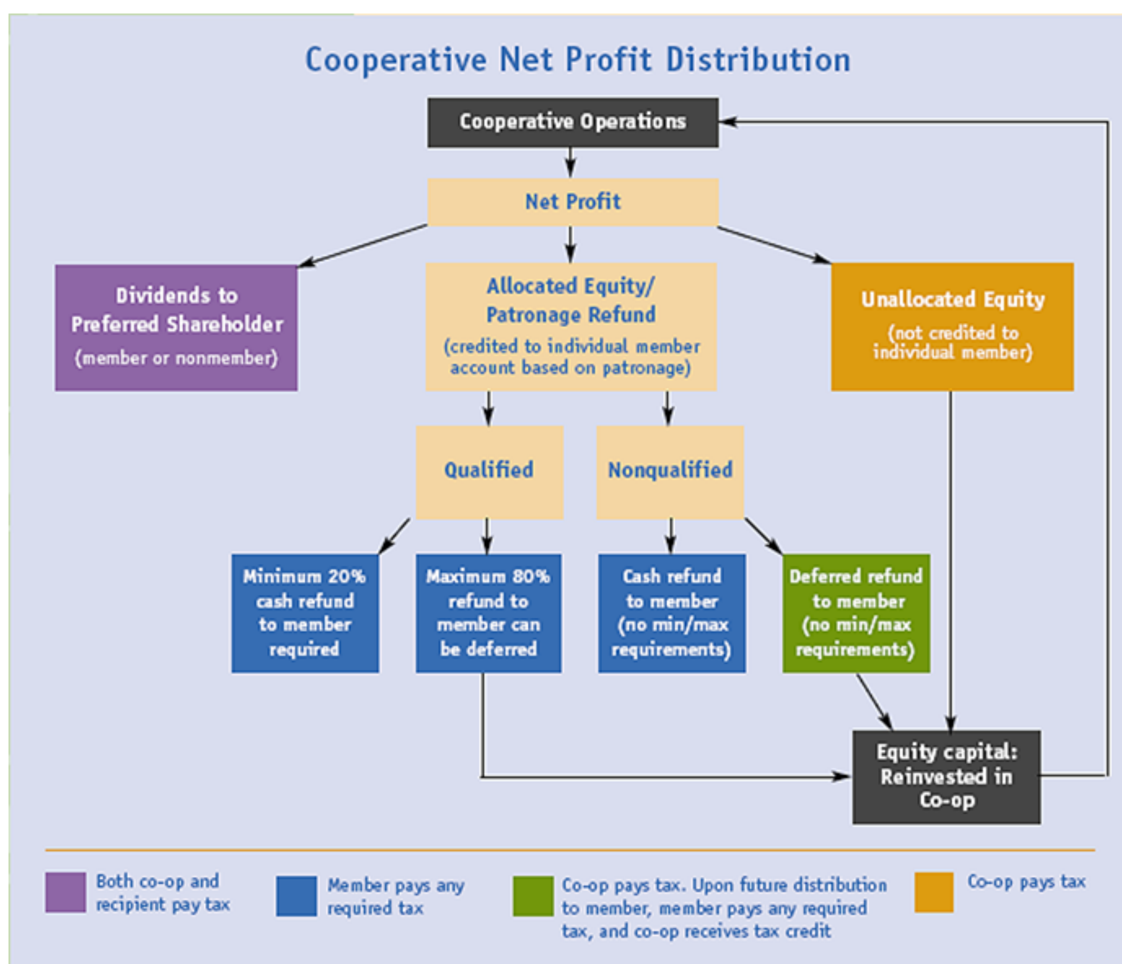
Co-op equity that is allocated to member accounts is then subject to a further designation between “qualified” and “nonqualified” equity. Qualified equity is attributable to particular members’ accounts and is taxable to that member (but not to the co-op) in the year the allocation is made. Federal tax law requires that at least 20% of qualified allocations be made in the form of cash distributions, primarily so that members have some funds available to pay their tax liability. A co-op can pay up to 100% in cash or some other combination. Qualified equity that is not paid in cash is kept within the co-op to meet ongoing capital needs of the business, eventually being returned to the member according to the equity redemption schedule set by the

co-op. Co-ops will sometimes pay dividends equal to a nominal interest rate on retained qualified equity but they are not required to do so.

Nonqualified equity, on the other hand, is designated as member funds, but is not attributed to specific member accounts. A portion of these funds can be paid out to members in cash if desired, or kept internally. In this case, the co-op pays taxes at the corporate rate on the deferred member distributions, just as it would with unallocated equity. The difference is that, unlike unallocated equity, nonqualified equity funds are designated as member equity; it is just that their future distribution to members is deferred indefinitely. At some future date when these funds are distributed to members in cash, the members will pay tax on the distribution and the co-op will receive a tax credit for the corporate tax it paid earlier.

The division between allocated and unallocated profits, between qualified and nonqualified equity, and between cash and non-cash distributions can be made in a variety of ways depending upon the co-op's capital needs, its tax position and the type of business it is in.

The following useful chart is from the University of Wisconsin publication "Cooperatives in Wisconsin" which provides a fuller discussion of this issue.



What are some common indicators of a financially healthy cooperative?

Cooperatives differ from traditional investor-owned firms in that they do not promise unlimited -- or even particularly high -- rates of return in exchange for the risk of ownership. Instead, cooperatives offer their members the advantages of an enterprise controlled by a group of like-minded individuals for the specific purpose of providing a specific set of benefits to those members.

In addition to a possible modest return on equity shares, cooperatives also typically provide financial and economic benefits to their members in a variety of other ways. These may include:

- Group purchasing discounts
- Shared risk
- Market presence
- Better information, technology

- Enhanced access to unique products
- Joint services
- Shared facilities

Some of these benefits are easy to identify and enumerate like discounts on group purchasing. Others, such as shared risk or access to markets, are more subtle and only become clear in the long-term, or in markets where the absence of a cooperative option makes the benefit of having one more apparent. Thus while a relatively simple return-on-equity formula may give an indication of success of an investor-owned firm, for a cooperative firm the formula is necessarily more complex. However, the degree to which members benefit from a cooperative is a good indication of the degree to which those member-owners will likely be loyal, committed, and continue to invest in the business, ensuring its financial success.

Analyzing cooperatively-owned enterprises therefore involves the same steps as underwriting a similar business with a conventional ownership structure with the addition of several more questions designed to uncover the strengths or weaknesses of the cooperative structure itself. These considerations will differ depending upon whether the business is structured as a producer-owned cooperative, a worker-owned cooperative, a consumer co-op or a service cooperative of like-minded small business owners. Understanding the structure of the cooperative – who are its members, what are the obligations of membership, how is profit or other benefits allocated, how is leadership selected and transferred etc. are all important indications of the strength of the operation, and how likely it is to be successful and stay successful in the future.

The specific answers to these questions may vary from co-op to co-op, but a common element of most successful cooperatives is that these important structural elements are **well-thought out, clearly articulated and logically consistent.**

The unique elements of a co-op are to be found in its broad ownership base, democratic governance structure, and its organizing principle to benefit members rather than necessarily pursuing the highest profit margin. Understanding how each of these elements work for the cooperative is the first step in assessing the strength of the enterprise:

Purpose: A co-op should have a clear purpose of who it is serving and why. While cooperatives are business enterprises, they are businesses in which profit is generally viewed as a means to an end rather than an end in itself. In today's market, people have more information than ever, and many more choices. In order to attract members and be successful, a co-op needs to be clear and compelling about what they are doing, for whom and why. Since co-op members are by definition not seeking ownership in the cooperative for maximum investment return, the co-op needs to provide some other compelling reason for member-owners to stick around.

Membership: Amongst the first decisions a new co-op will make is deciding who its membership will be. Co-ops can be owned by common buyers of a good or service (consumer co-ops, housing co-ops or shared services co-ops), by sellers (producer co-ops, artisan co-ops), by employees (worker-owned co-ops) by community supporters or even by some combination of these groups[1]. Defining a membership base, reaching out to these potential members and delivering a benefit to them that is timely and meaningful are really the essential jobs of a co-op. Membership policies will vary greatly depending upon the type of cooperative. For a consumer co-op with lots of members who may use the co-op once a week or once a month, an open, welcoming, and easily accessible membership program is usually the most successful. For a worker-owned cooperative, however, where the base of members is likely to be much smaller and where every member has a significant impact on operations. In these cases, it may well be prudent to have a more circumspect membership admission process, one that may require serving a probationary period and securing the affirmative vote of a high majority of peers. For a producer-owned cooperative marketing a specialty product, quality control is of the highest important and thus a co-op membership process would be remiss if it did not address this factor directly.

Another critical element of co-op membership is member buy-in – how much does it cost to become a member? The answer to this question will vary quite a bit sector to sector, and there is still debate within the cooperative community regarding what the cost of a co-op membership should be (high enough to be meaningful, low enough to be accessible). If member investment is *not* enough to provide sufficient equity capital for the business to operate smoothly, then the co-op leadership team will need to think about where, in addition to debt, their financing will come from. There is no substitute for having a buffer of patient capital to support a new or expanding enterprise, and cooperatives are no exception.

Governance: All cooperatives are governed by a democratically-elected board of directors. This board functions as the ultimate voice of the cooperative. While a well-managed co-op can get along fine with a weak board in good times, in tough times it is often the strength and competence of the board of directors that make the difference between failure and survival. Some important clues as to the quality of cooperative governance include such things as: whether board elections are contested (indicating either a controversial issue or a generally engaged membership – find out which) or not, how frequently the board and officers turn over, what sort of board orientation is conducted, what board education is offered, whether the board members do a regular evaluation of themselves (they should), how the board conducts its personnel responsibilities regarding the CEO or general manager, and whether and how well the Board is attuned to member needs and sustaining member commitment to the cooperative, etc.

[1] See chapter on multi-stakeholder cooperatives for more information about co-ops with more than one membership class.

Benefit/Patronage: Co-ops are organized to provide a specific benefit to members, whether that be access to particular goods or services, the opportunity to pursue certain markets, or the ability to work in a particular work environment etc. In addition to these benefits, co-op members are also guaranteed an equitable distribution of any profit that is derived from their business or "patronage" of the co-op. How the cooperative structures allocation of profits – both the decision of what portion of annual surplus is retained for use by the business vs. distributed to members as well as the decision of how any distribution to members will be made (in cash or a combination of cash and stock) – have significant implications for the financial health of the business[2].

How much equity is enough in a cooperative?

One of the most important decisions a new cooperative board will make is what equity investment will be required of each new co-op member. Member equity financing is a core cooperative principle. Co-ops are self-help organizations, and part of self-help is that every member contributes financially in some way to the well-being of the co-op, just as the co-op will later distribute surplus in an equitable fashion back to the members. Many founding boards start with a figure of how much money they think they *can* raise to get their new co-op started and work from there. It is far better to start with an estimate of how much money will *need* to be raised, and then think about the equity structure and membership composition that must be in place to raise the appropriate amount.

So how much is enough? That depends on a number of factors including the capital nature of the enterprise, typical business cycles or payment practices in the industry, lenders' or partners' tolerance for risk and therefore how much debt the project can leverage, the available pool of potential members and then finally the preferences of the founders. A twin question to how much member equity a co-op will take in is the question of how member equity will be rotated out and returned to members. The answer to both of these questions together will yield the equity structure of the co-op. ***A poorly designed or inflexible equity structure can lead to a financially unstable cooperative***.

The box below contains some questions for a new board to consider in setting up the equity structure of a co-op.

Some questions to ponder in setting up a cooperative equity structure...

[2] For a good explanation of how cooperative patronage works see "Cooperatives in Wisconsin" available from the University of Wisconsin Center for Cooperatives.

- Is business large or small? What are the desires/prospects for growth?
- Is the business labor or capital intensive?
- How much working capital is needed for inventory/seasonal needs?
- Is the membership base expected to grow or remain stable?
- How does expected member growth compare with expected business growth?
- Will the capital needs of the co-op grow or shrink as the business matures?
- What is an acceptable time horizon for patronage to be returned to your members? Do they need or expect it annually? Would they wait 5-7 years? Until retirement? Later?
- What would members expect to happen to cooperative assets upon dissolution?

Figure 1: Questions

Problems can develop when the capital needs of a business far outstrip the ability of new members to fund them. In such a case the co-op will need to be extremely profitable in order to make up the difference between equity supplied by new members and capital needed for business growth. Otherwise, the business will likely to be chronically under-capitalized or else will eventually dissolve in favor of an investor owner who can provide sufficient capital to finance the business's growth.

Another potentially unstable situation can develop when declining growth or profitability of a co-op creates an equity redemption obligation that cannot be met without sacrificing future growth and profitability, patronage payouts for existing members, equipment and facility upkeep, jobs and/or local ownership. In such cases the needs of past members to have their member equity redeemed is in opposition to the needs of current members to retain jobs, invest in facility improvements and retain cash portion payouts to active members. Such situations are not irresolvable, but it does take some careful planning on the part of the co-op as well as a clearly articulated common mission to maintain the financial flexibility to meet the needs of past, present and future members. For cooperatives, good capital planning is good strategic planning.

So how much equity do you need to start up a co-op? Many co-ops start with very little capital but a heroic effort by founding members who work tirelessly for little pay in pursuit of the co-ops objectives. Such efforts make good stories, but not necessarily good experiences nor stable cooperatives going forward. Rather than depending on Herculean efforts by founding members, a better method is to assume that the co-op will need sufficient cash to pay a competent and experienced manger to administer its day-to-day operations from the beginning.

The percentage of equity required to start a co-op varies a great deal from industry to industry and in different situations, but it is not unusual for 30% or even 40% or more of funds for start-up cooperative to come from members themselves. Once a member equity figure has been established, a new co-op must also decide how that member equity requirement is to be divided amongst potential members. Will everyone pay the same amount? If not, what is an acceptable level of difference? As with many things, there is really no single correct answer to this question

except ***that it is good cooperative practice for the member equity requirement to be proportional to the member benefit.***

In some co-ops, such as consumer co-ops, where all members are free to use the cooperative as much or as little as they please at a minimal additional marginal expense, it make sense for all members to pay a similar amount to finance the existence of the co-op store. An equal share system has the additional advantage of clarity and ease of understanding.

In other co-ops such as marketing co-ops or some purchasing co-ops where some members make significantly more use of the cooperatives services than others, it may make more sense to base equity requirements on a proportionate use basis. In these cases, a "per unit retains" method might be put in place, whereby a tiny fraction of every purchase or sale goes to the co-op in the form of member equity, forcing those who use the co-op most to also finance a larger share of its operations. Co-ops also sometimes require that members who do a certain percentage of business with the co-op to purchase additional equity so that their equity share is more proportional to use.

Analyzing a cooperative business:

Generations of lenders have relied on the "5 C's of credit" – Capacity, Capital, Collateral, Character and Conditions – to evaluate companies they lend to. It remains as useful an arrangement as any to methodically address the key risk factors that small businesses face and focus on the elements that differentiate successful ones from less successful ones.

Co-ops are businesses just like any other, so in many ways underwriting them is the same as underwriting a similar business formed under a partnership, LLC, or sole proprietor ownership status. The exceptions to this are that the cooperative will need to articulate some things that can be assumed in a conventional ownership structure. For example, a sole proprietor naturally owns all the net profits of their business; with a co-op, distribution of net profits amongst the co-op's membership is something that need to be decided. The other is that the cooperative should be able to provide some advantage over a conventional business structure – there should be some compelling reason that the business is structured as a co-op, and co-op leaders should be able to tell you what that is. The "five C's of Credit for Co-ops" include:

Capacity: Capacity, or cash flow, is basically the ability of a business to generate more cash on a regular basis than it needs to pay its debt obligations. Historical sales, market data, projected equipment needs as well as fixed and variable operating expenses will all go into this equation for a co-op in the same way they would for any other business. Key elements for a cooperative will also include the degree to which the co-op's membership impacts market and sales, the way that surplus or profit is returned to members, and how member's equity affects cash flow.

In a consumer-owned cooperative, members of the co-op are by definition customers of its products. Members, therefore, should be able to provide the co-op with reliable and perhaps unique market information, and they should also presumably be more loyal to the co-op than outside buyers. Other kinds of cooperatives such as those owned by workers or producers, might also have access to unique market information from their membership and similarly may be able to rely on their members for additional flexibility or resources in tough times

In a cooperative enterprise, cash flow is also affected by the way in which surpluses, or profits are passed through to members as well as how member equity is purchased and redeemed. Most co-ops distribute profits or "patronage" at the end of a fiscal year, after all other financial obligations have been taken care of. If this is the case, then the cooperative status has no more affect than other methods for "owner's draws" from other kinds of businesses. Some co-ops, however, offer members discounts or other monetary benefits over the course of the year rather than just one time at the end.

A final nuance of cooperative financial analysis is the need in some instances, to examine both the cooperative and the cooperative's members. In most business situations, historic market data is a fine basis for establishing projections about future revenues. For co-ops that have a relatively small number of members and/or co-ops who sell exclusively or primarily to their members, it may also be necessary to assess the cash flow ability of key member-customers to be able to accurately predict revenues for the co-op. A loyal base of member-customers can be a great strength to a cooperative enterprise, and one that can help it survive and prosper in times when other investor-owned companies suffer. However, a co-op with a less-than-reliable membership base faces potentially significant problems. Understanding the relationship between co-op members and co-op revenue is part of capacity assessment when underwriting co-ops.

Capital: Lenders and other analysts also look at a company's balance sheet for additional security that a loan can be paid and to make sure that the owner(s) are sufficiently invested in the project and not relying overmuch on debt to finance their business. For most small businesses, initial capital comes from the entrepreneur, family, and friends with an occasional private outside investor. For cooperatives, equity capital should come from the co-op members.

In addition to member capital, some cooperatives have in their organizing documents the ability to issue preferred shares to outside investors (these are generally non-voting shares that can pay a dividend up to about 8%). It is also common in some co-op sectors to raise additional "quasi-equity" through loans to the co-op from members. Such loans are debt, but should be willing to be made subordinate to outside lenders debt.

***Collateral*:** Collateral for most business loans consists of the assets of the business and for cooperatives; the assets are no different from the assets of any other similar business. Where co-ops do differ on the collateral question however is in the area of personal guarantees. Most lenders routinely require personal guarantees as part of the collateral for any loan to a sole proprietorship or partnership. For a cooperative with more than a handful of members, however, securing personal guarantees from every member will likely prove difficult. Not only would it be cumbersome to get signed guarantees from potentially dozens (or in the case of food co-ops, hundreds or thousands) of members, but members may understandably not want to guarantee 100% of a loan when they don't control 100% of the enterprise, and in fact get only a single vote for the board.

***Character*:** For a loan to an individual entrepreneur or partnership, the "character" assessment is meant to be an overall measure of trustworthiness and integrity. For some lenders, this just means looking at a credit score. Other times lenders will take into account other character factors such as reputation, relationships with customers or suppliers etc. So how do you assess the strength of character of a cooperative?

Part of the answer too will be a demonstrated history of paying vendors and other obligations on time. Part of the answer will be the reputation of the co-op – are customers happy? Is it known for quality? For a cooperative, however, part of the "character" question will also be an assessment of the strength of the common institution that all of the members have built. While management and leadership are as important in cooperatives as in any other organization, a strong cooperative also has an identity that is separate and distinct from the identity of its individual leaders. A cooperative's governance must be democratic, and it also must be perpetual by both design and practice. A cooperative with a strong "character" will be one that has clear and complete organizational documents, a well-ordered way for new members to join the co-op and departing members to leave, thoughtful and well- written statements of mission and purpose, and a history of consistently pursuing and advancing that mission and purpose under a regularly rotating slate of leadership.

Conditions: The conditions that affect a loan include both the conditions of the borrower, and the state of the overall industry, economy etc. that might affect the financial performance of the business. In this context you will consider the competitive landscape, nature of customer relations, supply risks, industry issues etc. Much of these considerations are the same for a cooperative and a non-cooperative business. One key factor that may positively affect co-ops is the strength of their membership base. U.S. food cooperatives, for example, took a much smaller hit to their sales growth overall during the recent recession than did investor-owned natural foods stores and many believe this was due to the loyalty of the co-op's members. Recent data from Canada indicates that cooperative enterprises overall survive longer than other businesses. Because of the intimate and connected nature of the co-

op's membership as buyers, sellers, workers or whatever, the co-op may be able to create for themselves a superior set of market "conditions" to the one experienced by their conventional competitors. It is certainly worth investigating and asking co-op leadership how the membership of the co-op affects the market conditions the co-op faces.

Conclusion:

Because of their joint social and economic objectives, egalitarian structure and rich ties to the community, cooperatives can be an excellent business structure in a wide variety of situations. Having a broad base of ownership, while it does involve some complexities, also ensures that a wide variety of people are knowledgeable about the co-op and vested in its success, a situation that can be particular useful in tough times. Cooperatives that build upon the ideas and commitment of their members and provide meaningful but prudent benefits commensurate with the level of member investment are the most likely to be financially strong and successful over the long term, as both businesses and as cooperatives.

Background reading:

Pitman, Lynn. "Cooperatives in Wisconsin: The Power of Cooperative Action". University of Wisconsin Center for Cooperatives.

Required reading:

Frederick, Donald A., 2005. "Cooperatives 101: An Introduction to Cooperatives". Cooperative Information Report 55, U.S. Department of Agriculture Rural Development.

Lund, Margaret and Lynn Pitman, 2012. "The Cooperative Equity Toolbox (working title)." Forthcoming Working Paper from the University of Wisconsin Center for Cooperatives.

Exercise:

Imagine three very different enterprises (a small homemade ice cream shop, a large fish hatchery and a home health care agency for example) and think about each structured as

- A nonprofit
- An investor-owned company
- A cooperative

How would the capital structure look different in each case? What affect might this have on market development? On operations? Other issues?

Now think of each business as a cooperative, but a different kind of cooperatives – as a worker-owned co-op for example, a consumer-owned co-op, or maybe a cooperative of small independent business operators. How would the fact of having a different membership base in each case affect the capital structure of the co-op? Would they make different decisions, for example, about allocated and non-allocated equity? Would they charge different amounts for membership? Would they likely adopt a different schedule for returning equity to members?