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Agricultural Economics Department

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The Base Capital Plan for Managing Cooperative Equity

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Cornhusker Economics

Cooperative Extension

Institute of Agriculture & Natural Resources
Department of Agricultural Economics
University of Nebraska - Lincoln

The Base Capital Plan for Managing Cooperative Equity

Market Report	Yr Ago	4 Wks Ago	7/18/03
<u>Livestock and Products,</u>			
<u>Average Prices for Week Ending</u>			
Slaughter Steers, Ch. 204, 1100-1300 lb Omaha, cwt	\$62.57	\$73.03	\$74.18
Feeder Steers, Med. Frame, 600-650 lb Dodge City, KS, cwt	87.00	*	*
Feeder Steers, Med. Frame 600-650 lb, Nebraska Auction Wght. Avg	87.74	*	*
Carcass Price, Ch. 1-3, 550-700 lb Cent. US, Equiv. Index Value, cwt	97.91	119.69	116.16
Hogs, US 1-2, 220-230 lb Sioux Falls, SD, cwt	41.75	45.00	42.00
Feeder Pigs, US 1-2, 40-45 lb Sioux Falls, SD, hd	19.00	*	32.25
Vacuum Packed Pork Loins, Wholesale, 13-19 lb, 1/4" Trim, Cent. US, cwt	*	126.16	105.34
Slaughter Lambs, Ch. & Pr., 115-125 lb Sioux Falls, SD, cwt	83.87	*	86.50
Carcass Lambs, Ch. & Pr., 1-4, 55-65 lb FOB Midwest, cwt	*	203.85	186.60
<u>Crops,</u>			
<u>Cash Truck Prices for Date Shown</u>			
Wheat, No. 1, H.W. Omaha, bu	3.71	3.06	3.31
Corn, No. 2, Yellow Omaha, bu	2.15	2.29	1.98
Soybeans, No. 1, Yellow Omaha, bu	5.68	6.34	5.62
Grain Sorghum, No. 2, Yellow Kansas City, cwt	3.93	4.00	3.68
Oats, No. 2, Heavy Minneapolis, MN, bu	1.95	1.63	1.47
<u>Hay,</u>			
<u>First Day of Week Pile Prices</u>			
Alfalfa, Sm. Square, RFV 150 or better Platte Valley, ton	105.00	115.00	112.50
Alfalfa, Lg. Round, Good Northeast Nebraska, ton	75.00	60.00	65.00
Prairie, Sm. Square, Good Northeast Nebraska, ton	97.50	*	*
* No market.			

Equity management is always challenging for agricultural cooperatives, which generally rely on patronage-based methods for accumulating equity and are frequently subject to competing pressures from current and former patrons. Current patrons, who must pay income tax on patronage refunds, may seek to have a greater proportion of refunds paid in cash. Meanwhile, former patrons may press to have retained patronage refund allocations redeemed in a more timely manner. Faced with these demands, many cooperatives have experienced considerable difficulty in maintaining adequate levels of equity capital.

Most cooperatives that plan for the systematic accumulation and retirement of member equity use the first-in/first-out revolving fund plan. Under the revolving fund plan, a cooperative retains a share of the patronage refunds it issues each year. These retained patronage refunds are added to the revolving fund to provide equity capital and to be eventually redeemed in turn. The oldest equities are redeemed first, usually at the discretion of the board of directors and according to the financial needs of the cooperative.

The revolving fund plan is a popular method for managing member equity because it is easy to understand and to administer, and it provides new members an easy means for accumulating equity. In addition, equity will be held more or less in proportion to patronage as long as the revolving period is relatively short. However, low earnings or increased capital needs can extend the revolving period so that former patrons and the estates of deceased patrons may have their investments tied up in the cooperative for many years.

To ensure that financing is provided in proportion to use and to create a more stable stock of equity capital, some cooperatives have adopted the base capital plan for accumulating and retiring member equity. With this plan, each patron's required equity contribution is readjusted annually according to the cooperative's capital needs and the share



of the cooperative's total patronage attributable to the patron during a moving base period, usually the last three to ten years. Under-invested patrons, or patrons whose capital investments are less than their equity requirements, continue to contribute retained patronage refunds or direct investments to the cooperative. Over-invested patrons generally are not required to continue contributing equity and may begin to receive at least partial redemption of excess investments.

The operation of a base capital plan is illustrated in Table 1. The cooperative in this example consists of six members, one of whom is no longer active. The cooperative operates its plan according to a five-year base period and has \$18,250 of member equity. Suppose the board of directors has determined that the cooperative must have an additional \$250 of equity capital to meet its financial requirements during the next year.

The balance of each member's equity account is shown in column 1 of the table. Patronage attributable to each member during the five-year base period is shown in column 2. By dividing the figures in column 2 by the total patronage of the cooperative during the base period (\$1,092,796), the share attributable to each member (column 3) can be calculated. The adjusted equity requirements of the members (column 4) are computed by multiplying the shares in column 3 by the total equity requirement set by the board of directors (\$18,500). The adjustment to be made in each member's equity account (column 5) is determined by subtracting the balance of the member's

equity account from the member's adjusted equity requirement. A positive amount indicates a transfer of funds from the member to the cooperative; a negative amount indicates a transfer from the cooperative to the member. In this example, members A, B, D and E must contribute additional equity to the cooperative, whereas members C and F stand to have equity redeemed. Member F has not conducted business with the cooperative during the base period. Consequently, all of that member's equity is eligible for redemption.

Use of a base capital plan allows a cooperative to alter its equity requirements to meet changing conditions and capital needs, and financial planning is easier because equity sources are more predictable. Because the equity of inactive patrons is usually redeemed within a relatively short period, a base capital plan also reduces the need for special programs to handle retired patrons and estates. However, because of the plan's complexity, it may be hard for some members to understand. In addition, new members may find it difficult to meet their equity requirements. Consequently, the plan may not operate smoothly when there are frequent turnovers in membership or changes in patronage that require large equity adjustments.

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Table 1. Operation of a Base Capital Plan

Member	Beginning Equity	Patronage During Last Five Years	Share of Total Cooperative Patronage	Adjusted Equity Requirement	Equity Adjustment
	(1)	(2)	(3)	(4)	(5)
	----- Dollars -----		Percent	----- Dollars -----	
A	1,685	120,208	11	2,035	+350
B	3,345	207,631	19	3,515	+170
C	2,805	152,991	14	2,590	-215
D	5,515	327,839	30	5,550	+35
E	4,550	284,127	26	4,810	+260
F*	350	0	0	0	-350
Total	18,250	1,092,796	100	18,500	+250

* Inactive member.