How Does Money Flow through a Cooperative?

In a Cooperative, the workers own the business. That means the workers have a say in how the business is run, they vote for a board of directors to oversee and be accountable for the business, and they share in the potential profits – and losses – of the business. The details of how this all works in any specific cooperative are laid out in that cooperative's **Articles of Incorporation** and the **Bylaws**.

This document provides a simple example of one important element of worker-ownership:

- **How do profits generated in a cooperatively run business benefit the individual worker-owner of that business?**

The example below is adapted from the guide, **Think Outside the Boss: How to Create a Worker-Owned Business**, published by the Sustainable Economies Law Center.

Starting a Cooperative Business

Amy and John decide to go into business for themselves. They start Co-op Copy Center, a print shop that they incorporate as a cooperative. In the beginning, it has two members, Amy and John. Amy puts in $10,000 and John puts in $10,000. This is their initial capital contribution. They each have a Member Account, which now contains $10,000.

> *NOTE: while the initial capital contribution and any future share of the Cooperative's earnings (aka Patronage Dividends) are accounted for in a Member Account, the actual money sits in the Cooperative's bank account and is used as operating capital for the business.*

Here's what their accounts look like to start:

Worker-Owner	**Amy**	**John**
Initial Capital Contribution	$10,000	$10,000
Member Account Total	**$10,000**	**$10,000**

Amy and John then hire Bill as an employee. Bill is not a worker-owner in the Cooperative and, therefore, hasn't made an initial capital contribution and doesn't have a Member Account. But he does get paid regular wages, just like Amy and John.

The First Year of Business: A Healthy Profit!

Co-op Copy Center earns $150,000 from their printing and graphic design services. It spent $105,000 to buy materials, pay wages to Amy, John, and Bill, buy insurance, pay rent, etc. So Co-op Copy Center earned net revenue of $45,000 ($150,000 - $105,000 = $45,000). As members of Co-op Copy Center, Amy and John are entitled to a share of this net revenue. But how do we know how much they get?

First, we need to look at the bylaws. In some cooperatives, patronage is determined by how many hours you work as a percentage of the total hours worked by all worker-owners. In some co-ops it's based on wages, and in some it's a hybrid formula of hours and wages.

Co-op Copy Center bases their patronage just on hours. They look at how many hours everyone worked that year and figure out how much of that $45,000 was attributable to members' labor (work done by Amy and John) and how much was attributable to non-members' labor (work done by Bill).

	Member Hours Worked	**Non-Member Hours Worked**
	Amy: 1200 hours John: 1800 hours	Bill: 1500 hours
	3000 Total Member Hours	1500 Total Non-Member Hours
Total Member and Non-Member Hours Worked	**4500**	

Here's the math:

- 3000 Member Hours/4500 Total Hours = 2/3
- 1500 Non-Member Hours/4500 Total Hours = 1/3

So, 2/3 of the $45,000 was attributable to the hours of work done by Amy and John, the members (member labor). This is what their bylaws call a $30,000 Surplus.

1/3 of the $45,000 (or $15,000) was attributable to the hours of work done by Bill, the non-member (non-member labor). This is what their bylaws call a $15,000 Profit.

The Collective Account: The Business Needs Money to Make Money!

Like most businesses, Co-op Copy Center wants to build a financial reserve to help cover ongoing and future operating costs. When drafting their bylaws, they decided one way to build their financial reserve was by agreeing to put some of the net revenue (in this case, some of the $45,000) into their Collective Account before putting the rest into the individual Member Accounts. The Collective Account does not belong to any one individual Member, but to Co-op Copy Center itself.

In their bylaws, they agreed to allocate 100% of Profit (i.e., the net revenue that was attributable to non-member labor) to the Collective Account. So they put the $15,000 Profit into the Collective Account as retained earnings. Retained earnings are the earnings that Co-op Copy Center does not pay out.

Their bylaws also state the following:

> *"[a]ny Surplus shall be credited to the Collective Account as necessary to bring the year's contribution to the Collective Account up to 25% of the year's combined Profit/Surplus. All other Surplus shall be paid as Patronage Dividends in direct proportion to Patronage during the fiscal year."*

Fortunately, Co-op copy Center has already allocated 33% of the combined Profit/Surplus to the Collective Account, thanks to the large amount of earnings attributed to non-member labor. Thus, no additional funds are required to be put into the Collective Account to bring it up to 25%. Now that they've put enough retained earnings into the Collective Account, let's figure out how Amy and John will get their shares of the year's earnings (Patronage Dividends).

Patronage Dividends: Your Share of the Profits

Co-op Copy Center calculates its Patronage Dividends based on how many hours each Member worked relative to each other. Thus, Patronage Dividends are calculated by dividing up the Surplus at the end of the fiscal year.

We know from the previous table that Amy worked 1200 hours and John worked 1800 hours. Now, let's do the math:

- Amy's Hours/Total Member Hours = 1200/3000 = 2/5
- John's Hours/Total Members Hours = 1800/3000 =3/5

2/5 of the $30,000 Surplus = $12,000 in Patronage Dividends to Amy

3/5 of the $30,000 Surplus = $18,000 in Patronage Dividends to John

Patronage Allocation vs. Patronage Distribution

Amy gets $12,000 in Patronage Dividends. Does this mean she gets a $12,000 check to take home with her? Do they get it all back in cash?

Co-op Copy Center's bylaws say that Patronage Dividends get paid to the members "20% in cash and 80% as Written Notices of Allocation." When a Member receives a written notice of allocation for a specified amount, that amount goes into his/her Member Account as a credit which will be paid out in cash sometime in the future, according to what the bylaws provide for. The 20% paid out in cash is the Patronage Distribution and the 80% that goes into their Member Account is the Patronage Allocation.

Why don't Amy and John get it all back in cash? Co-op Copy Center needs a certain amount of cash on hand for operating expenses, and the funds that are in the Collective Account (retained earnings, etc.) may not be enough to run the business day to day. By paying part of the Patronage Dividends as Written Notices of Allocation, Co-op Copy Center will help ensure that it has enough cash on hand to pay for things like rent, salaries, landscaping supplies, debt service, etc.

So Amy and John get their Patronage Dividends as follows:

- $2,400 cash and $9,600 written notice of allocation for Amy
- $3,600 cash and $14,400 written notice of allocation for John

And here's how their Member Accounts look now:

Worker-Owner	Amy	John
Initial Capital Contribution	$10,000	$10,000
Written Notice of Allocation	$9,600	$14,400
Member Account Total	**$19,600**	**$24,400**

Bill does not get any Patronage Dividend (either allocation or distribution) because he is not a member. He only gets his regular salary.

The Taxman Cometh!

Each member must pay individual income tax on the *entire* patronage dividend (whether distributed or allocated) to him/her in the year in which it occurs. By law, a worker cooperative must distribute *at least* 20% of a member's annual patronage dividend so that the member has more than enough cash in hand to pay the additional income tax on the entire patronage dividend.

So, Amy must pay income tax on her $12,000 patronage dividend, even though she received $2,400 of it in cash and $9,600 of it as written notice of allocation. Since she is paying taxes on all of it now, when the additional $9,600 is paid to her in the future, she will not have to pay tax on it.

Many cooperatives, including Co-op Copy Center, distribute only this legal minimum of 20%, but some do more, and any cooperative can change their distribution/allocation ratio at different times to account for different factors.

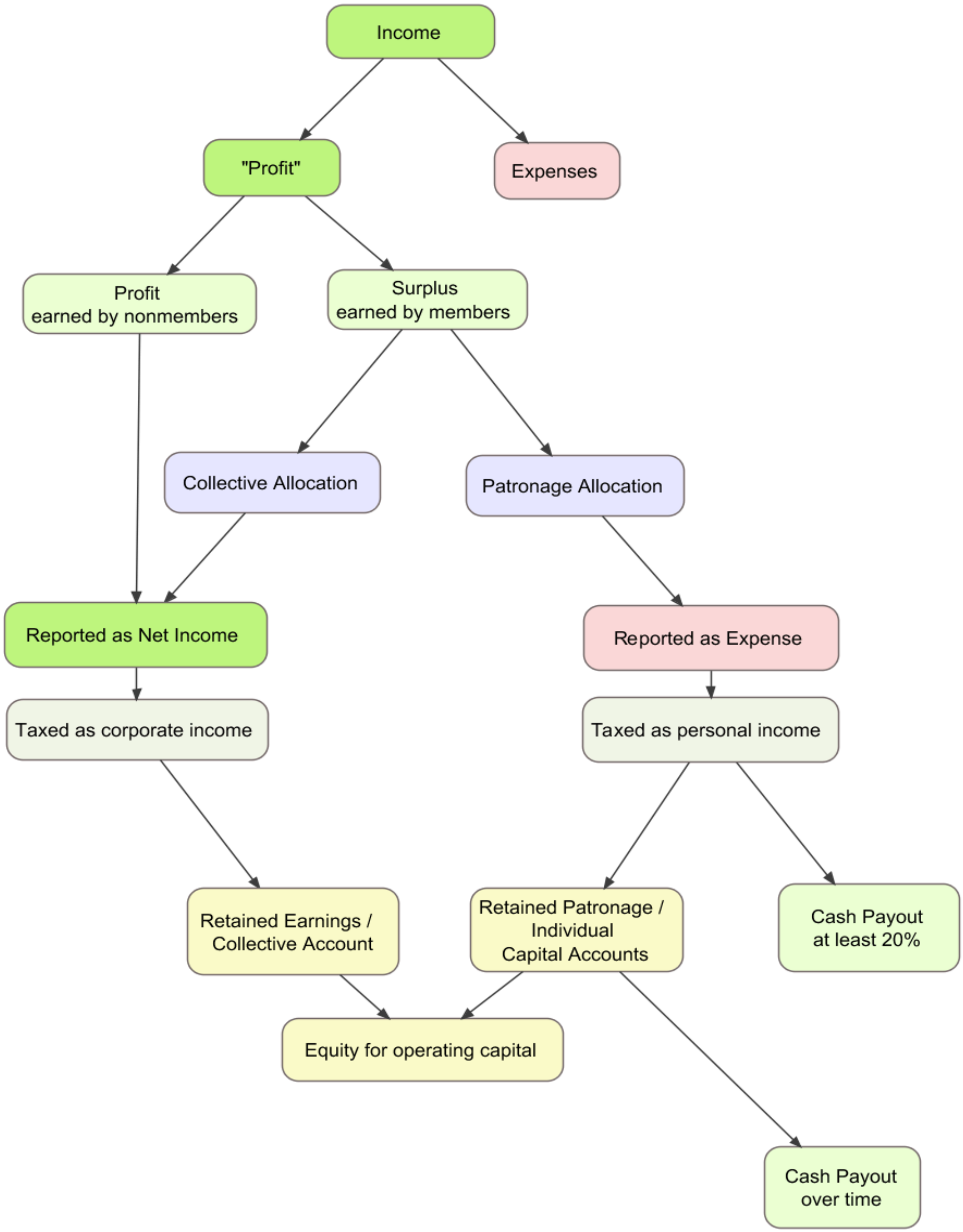
Redeeming the Member Account

In some Cooperatives, the redemption of member accounts happens automatically, say, within 3 or 5 years. This would mean that after 3 years of Co-op Copy Center's operation, Amy and John would receive the balance of their patronage from the first year, and would continue to receive annual distributions after that based on their patronage from 3 years prior.

Very few, if any, cooperatives distribute 100% of a members patronage dividend in the year in which it was earned. And some Cooperatives only distribute more than the legal minimum of 20% on a case-by-case, member-request basis, and/or at the point of voluntary or involuntary termination of employment.

Keep in mind, if there were losses in a given year, that would result in no distribution and, in fact, their account would have been debited their share of the loss.

If a member leaves the co-op, the amount in his/her Member Account becomes a debt that the Co-op then pays back to the member over an amount of time specified in the bylaws.


Income
"Profit"
Expenses
Profit
earned by nonmembers
Surplus
earned by members
Collective Allocation
Patronage Allocation
Reported as Net Income
Reported as Expense
Taxed as corporate income
Taxed as personal income
Retained Earnings /
Collective Account
Retained Patronage /
Individual
Capital Accounts
Cash Payout
at least 20%
Equity for operating capital
Cash Payout
over time