Using Unallocated Retained Earnings to Finance Agricultural Cooperatives

Historically, U.S. agricultural cooperatives have relied primarily on retained patronage refunds for accumulating equity capital. Typically, a cooperative returns its net earnings to members as a combination of cash and non-cash patronage refund allocations. Members maintain ownership of the noncash allocations, which provide equity until the cooperative eventually redeems them in cash when they are replaced by future allocations.

Over time, however, retained earnings have become an increasingly important source of equity capital for cooperatives. Retained earnings consist of net income that a cooperative does not allocate or distribute to members. The equity obtained from retained earnings is not allocated to individual members, and generally there is no expectation that it will be distributed to members except upon dissolution of the cooperative.

In 2008, cooperatives kept 31.2 percent of their net income as retained earnings, more than eight times as much as in 1962. In fact, cooperatives retained a greater proportion of their net income as retained earnings than as noncash patronage refund allocations. That same year, 32.1 percent of cooperative equity was held as unallocated retained earnings, almost three times as much as in 1962. By 2015, both marketing and farm supply cooperatives held about 40 percent of their equity in unallocated form. Cooperatives marketing grains...
A recent University of Nebraska–Lincoln Department of Agricultural Economics study evaluated the advantages equity capitalization plans based on retained earnings may provide cooperatives by comparing the after-tax present value of the cash flows members receive under such a plan to that of a plan based on noncash patronage refunds.¹ The study found that the cooperatives that are most likely to benefit from obtaining equity from retained earnings are those characterized by low marginal tax and growth rates and whose members are characterized by high marginal tax and discount rates. The study also found that the plans that provide the greatest present values are based entirely on either retained earnings or noncash patronage refunds rather than a combination of the two. An analysis focused on the tax deductions created by the American Jobs Creation Act concluded that those deductions were more valuable when applied at the patron level than when used at the cooperative level to offset taxable income on retained earnings.


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