
Governance and Finance:

How do they go together?

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Overview of session

- Role of the board of directors
 - What financial information should board members get?
 - When should they get it?
 - What should they be looking for?
 - Role of the board vs. role of manager
 - Understanding cooperative equity
 - Resources
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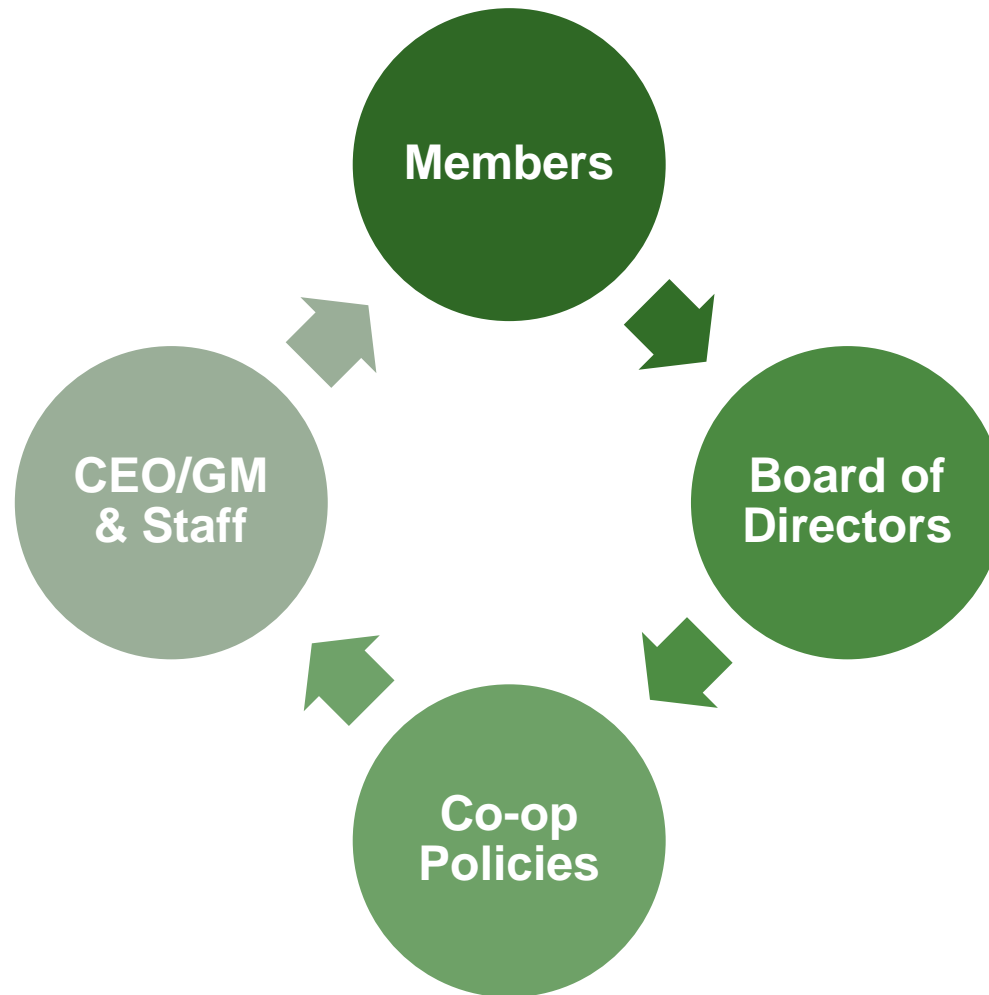
Cooperative Principles

- Voluntary and open membership
 - **Democratic member control**
 - Member economic participation
 - Autonomy and independence
 - Education & training to members; information to public
 - Cooperation among cooperatives
 - Concern for community
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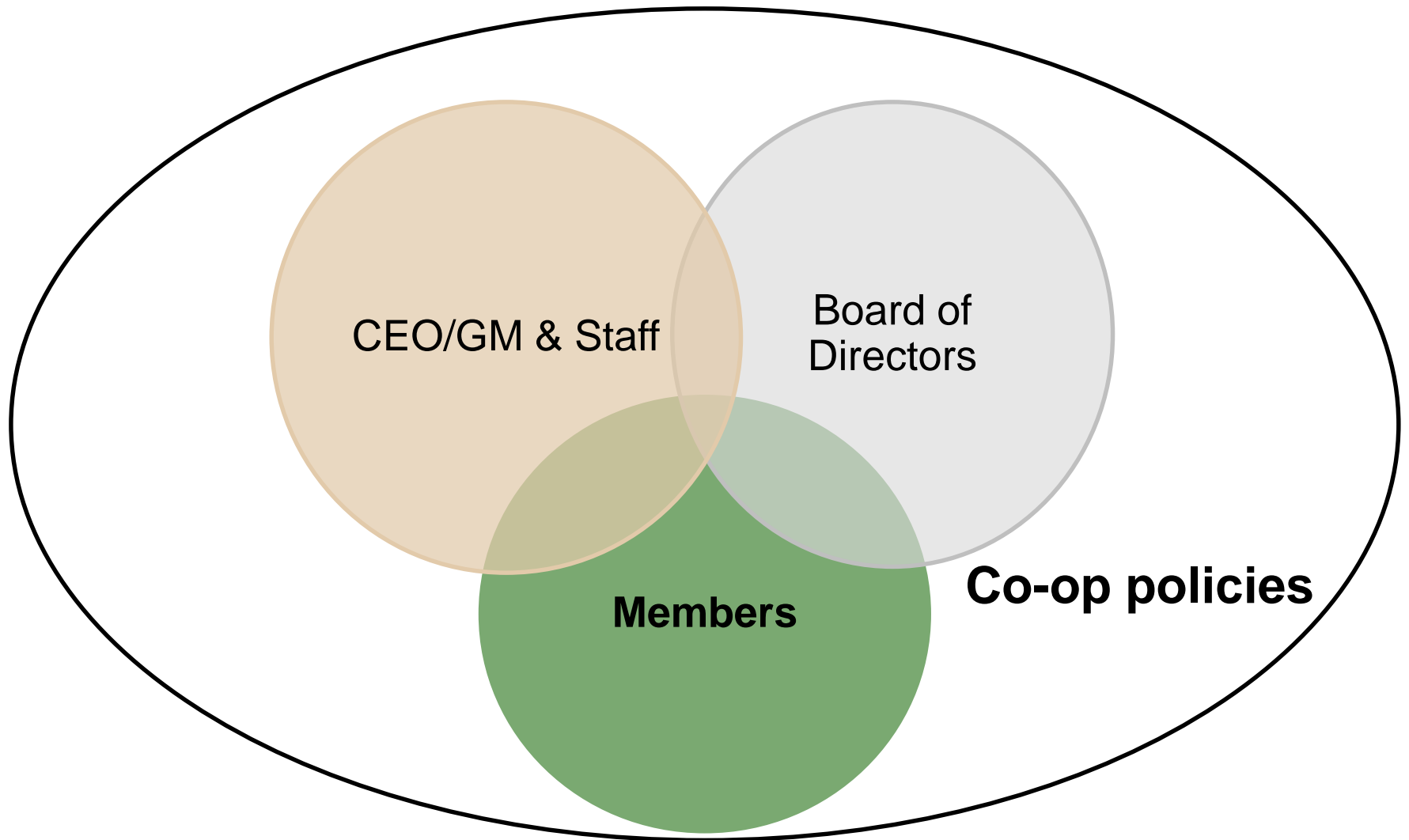
What do we mean by governance?

Governance is the way a company is controlled and how decisions are made.

Cooperative Governance



WORKER Cooperative Governance



Effective boards must:

- Protect the interests of both members and the cooperative corporation (*fiduciary duty*)
- Build an influential team, capable of opposing management when necessary
- Represent and communicate with members
- Preserve the co-op's character
- Monitor and oversee management

Duties of loyalty, care, and obedience



Duty of loyalty



- Don't represent special interests (that includes yourself!)
- Check your personal agenda at the door
- Disclose conflicts of interest
- Act in good faith

Duty of care



- Be competent
- Stay informed
- Expected to have the degree of skill, diligence, or reasonable care that an ordinarily prudent person would exercise in similar circumstances

Duty of obedience



Directors must comply with the following:

- ❑ Federal, state, and local laws
- ❑ Articles of incorporation
- ❑ Bylaws
- ❑ Policies

Fiduciary duty: Protect the interests of both the members and the co-op

- Build a culture of education and openness
 - Board members must understand and be able to oversee:
 - mission, vision, values of the cooperative
 - financial statements and the budget
 - the cooperative bylaws and policies
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Let's discuss:

What information do board members need in order to fulfill their fiduciary duty?

3 Basic Financial statements

- Income Statement – should receive monthly
 - Balance Sheet – should receive monthly
 - Cash flow Statement – prepared annually as part of an audit; should be produced more frequently when cash is tight
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What other financial information might a board want to receive?

- Financial ratios and analysis – quarterly, or more often as needed
 - Explanation of significant budget variations
 - Annual budget
 - Projections, esp. cash flow if it is tight
 - Industry performance standards for comparison
 - Private meeting with their auditor, if applicable
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The Income Statement – *a view of activity over a period of time*

Revenues – Expenses = profit/loss

Also called Profit and Loss (P and L). . .

The Income Statement

- + Revenues (sales)
 - + Other income
 - Cost of Goods Sold (direct care hours)
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- = Gross profit
- Operating expenses (fixed and variable)
 - Other expenses
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- = Net profit/(loss)
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A word about expenses . . .

- Profit margin is X cents on a dollar of sales
 - At 5% profit, it is usually easier to save \$100 (\$1.92 per week) in expenses than to find \$2,000 in new revenues
 - Fixed expenses (like management, training coordinator) go down as a percentage of sales as a company grows
 - For us, gross margin might be different than industry average because we may choose to pay caregivers more
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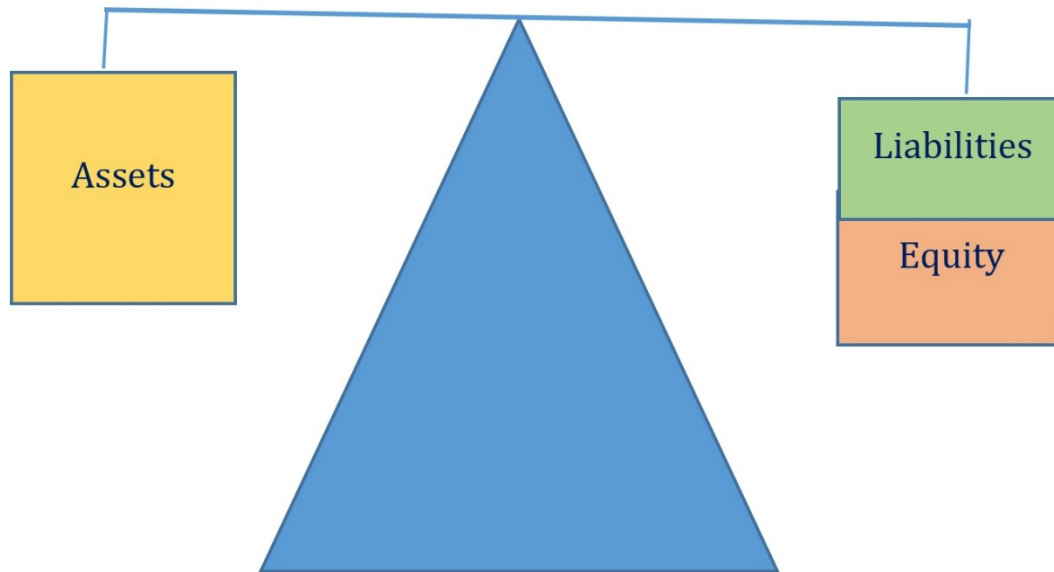
Note

- Revenue (or profit) does not equal cash . .
Why not?

Things to track . . .

- Look at period and year-to-date
 - Compare to this time last year
 - Compare to budget (with explanations of significant deviations)
 - Compare by customer or revenue source
 - Cash vs. accrual accounting (compare apples to apples)
 - **Are there any odd sources of revenue or expenses you don't understand?**
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The Balance Sheet – a “snapshot” in time



The Balance Sheet -- Assets

Cash

Other current assets (accounts receivable etc.)

= Total current assets+

Fixed assets (equipment, furniture etc.)+

Other assets

= Total Assets

The Balance Sheet – *what you owe and what you own*

Current liabilities (payroll, accounts payable etc.) +

Long term liabilities (bank loans, etc.)

= Total Liabilities

The Balance Sheet - *and what you own*

Paid in capital (from members)+

Member accounts (qualified and unqualified distributions of earnings to members) +

Retained earnings (earnings from previous years not allocated to members) +

Earnings YTD

= Total equity (net worth)

Things to track . . .

- Ask for the balance sheet! It is just as important as the income statement
- Are accounts receivable or accounts payable growing in unexplained way (*are you getting paid and paying your bills*)?
- Is there sufficient cash cushion?
- Is equity positive?
- Compare to previous year – any unexplained differences?
- **Are there assets or liabilities you don't understand?**

The Cash Flow Statement

- Cash from operating activities (earnings, non-cash items, purchase of inventory or other assets etc.)
 - Cash from investing activities (property, equipment, investments in other companies etc.)
 - Cash from financing activities (loan distributions, loan repayments, member shares sold)
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Things to track . . . “*Cash is what pays the bills*”

- Where is your cash actually coming from?
- Is it where you expect?

And think about . . .

- How will new revenue sources (or other expected changes) impact your cash flow in the future . . . (*the time to get a line of credit is when you don't need it . . .*)
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Some ratio tools you can use

- Current ratio (current assets/current liabilities)
 - Debt:Equity ratio (what you owe vs what you own)
 - Days accounts payable
 - Days accounts receivable/ Aging of Rec.
 - Working capital (may need more with growth)
 - Revenue/client (over time and **by source**)
 - Client mix (and where you are making \$)
 - Hours/client (over time)
 - Mileage per client (over time)
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Take home idea . . .

- Make a dashboard of the 5-6 most important things for your co-op to make them easier to track . . .
 - Dashboard can include other financial-related goals like # of applicants per spend on certain recruiting initiatives
 - *But . . . A dashboard supplements but does not replace regular review of all financial elements . . .*
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Boards roles vs. Management roles

- You are on the same team
 - Management should support the board in making sound decisions
 - Management handles operations
 - Board makes policy decisions
 - Board hires, evaluates, and fires management
 - Board services as a trusted advisor to management
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The board must build its own team

- Represent members
 - Make sure that all voices on the board are heard
 - Orient new board members
 - Board development & evaluation
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Let's discuss:

What needs to happen in order for the board to serve its dual role of **supervisor** and **trusted advisor**?

Understanding Cooperative Equity

- Let's think about **what** equity is, and **why** it is, and **how** it works



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Let's Discuss . . .

- **What** is member equity?
 - How are we different from Sam's club? A nonprofit?
 - **Why** do we have Equity?
 - What is the difference between member equity and a rainy day fund?
 - If it belongs to members, why don't we just keep it in the bank?
 - **How** does it work?
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Why we have member equity

- To take care of the co-op in unexpected cash need
- To enable the co-op to respond to opportunities in the marketplace – *leverage loans for strategic growth*
- To provide everyday working capital needed by the business

Equity should be a benefit to the co-op not a liability

What is the Board's responsibility

- Enhance stability for the future (stewardship)
- Poise the co-op for strategic opportunities
- Manage expectations of members (communication)
- Balance current and future needs

Ask for help if you need it!

Let's Discuss . . .

- Why do we need a strong board?
 - Why do we need sound management?
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How can we be sure we are able to return equity to members?

- You return **value**.
 - What ensures the eventual return of equity capital to the members is the sound and profitable operation of the business and nothing more.
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Let's Discuss . . .

- What are some of the **value** that worker co-ops can return to home care workers?

What do you value about your co-op?

Communicating with members . .

- Talk about, take credit for, and quantify numerous ways of measuring value
 - Ask for ideas on new ways to deliver value
 - Consider ‘under-promise and over-deliver” on the financial return
 - Be transparent about your reasoning for annual allocations to members or co-op
 - Do some financial modeling about when you can redeem equity
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Communicating with Members cont.

- Are they better off with an investor-owned company? A nonprofit?
- Share your horizon . . . What you see for the future
- Build pride and understanding of being involved in building something awesome!

Every day you do this, you are an amazing success

How Much Equity Do You Need? (and where should it come from?)

Depends on:

- Nature of the business, assets needed
- Industry practices, cycles – HC is hard!
- Lender/partner tolerance for risk
- Purpose of co-op, preferences of members
- Lifecycle of business (start-up, expansion etc.)
- **What you want to do, what value you want to deliver to members**

You can consider some creative strategies . . .

- Offer preferred shares so outside supporters can invest in your work, particularly opportunities . .
 - Transfer member equity accounts to preferred shares, so they get some dividend
 - Consider a base capital plan, so once a certain amount of equity is built up, members does not need to add more (reward longevity)
 - Other
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What is the board's role?

- Decide what to do with annual profits (losses)
 - Allocation
 - Distribution
 - Set policy (ideally based on data)
 - Respond to requests for equity redemption
 - Communicate and educate
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Let's discuss:

What issues should a board consider when it is deciding what to do with profit at the end of the year?

Some Resources

- Networks
 - Other co-ops
 - Outside board member, finance committee member or advisor to the board
 - Consultants, specialists
 - Democracy At Work Institute website
 - University of Wisconsin Center for Cooperatives website
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