Financial Education for Worker Cooperative Members

Topic 4: Creating a Profitable Business
Introduction

This curriculum was created as part of a project between the New York City Department of Consumer Affairs Office of Financial Empowerment and Make the Road New York, with the support of Citi Community Development to integrate financial empowerment tools and training into the cooperative development process.

It consists of 5 two-hour-long workshops:

- Topic 1: Basic Money Management & Budgeting
- Topic 2: Banking & Basic Financial Transactions
- Topic 3: Credit
- **Topic 4: Creating a Profitable Business**
- Topic 5: Basic Financial Statements
# Sample Start-up Budget

## Company name

### Startup Budget

**Start Up Costs**

- Purchase of Inventory
- Renovation
- Rent Deposits
- Marketing
- Office Equipment
- Furniture & Fixtures
- Working Capital
- Auto Equipment
- Other Equipment
- Start-up Insurance
- Fixed Monthly Expenses x (3-6) months (recommended)
- Start-up Legal & Accounting Fees
- Training & Education
- Sales-related Startup Expenses
- Franchising Fees
- Licenses & Permits
- Office Supplies

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase of Inventory</td>
<td></td>
</tr>
<tr>
<td>Renovation</td>
<td></td>
</tr>
<tr>
<td>Rent Deposits</td>
<td></td>
</tr>
<tr>
<td>Marketing</td>
<td></td>
</tr>
<tr>
<td>Office Equipment</td>
<td></td>
</tr>
<tr>
<td>Furniture &amp; Fixtures</td>
<td></td>
</tr>
<tr>
<td>Working Capital</td>
<td></td>
</tr>
<tr>
<td>Auto Equipment</td>
<td></td>
</tr>
<tr>
<td>Other Equipment</td>
<td></td>
</tr>
<tr>
<td>Start-up Insurance</td>
<td></td>
</tr>
<tr>
<td>Fixed Monthly Expenses</td>
<td></td>
</tr>
<tr>
<td>Start-up Legal &amp; Accounting Fees</td>
<td></td>
</tr>
<tr>
<td>Training &amp; Education</td>
<td></td>
</tr>
<tr>
<td>Sales-related Startup Expenses</td>
<td></td>
</tr>
<tr>
<td>Franchising Fees</td>
<td></td>
</tr>
<tr>
<td>Licenses &amp; Permits</td>
<td></td>
</tr>
<tr>
<td>Office Supplies</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$ -</td>
</tr>
</tbody>
</table>
Questions to Think About

How do we know if the business is profitable?

How do we calculate the profit?

What do we do with the profit?

How is a member’s share of the profit calculated?

What does a profit mean for the owners of the cooperative?
Creating a profitable business:

Two levels of profitability

Level 1: Does the product / service make a profit?

Level 2: Does the business make a profit?

Income Statement:

Revenues \( \text{(Total sales of goods and services = units} \times \text{price)} \)

- **Direct costs** \( \text{(Materials, packaging, labor, transportation, etc.)} \)

  = Gross Profit [LEVEL 1]

- **Indirect costs** \( \text{(Rent, utilities, administration, advertising, etc.)} \)

  = Net Profit or loss [LEVEL 2]
Creating a profitable business:

Level 1: Does the product / service make a profit?

Does the price of the product or service cover the direct costs and allow for a profit?

- Direct costs: (examples)
  - Materials
  - Packaging
  - Labor
  - Distribution/logistics
  - Rentals
Creating a profitable business:

Level 2: Does the business make a profit? If selling the product / service generates a profit, how many products / services will you need to sell to cover the business’s indirect expenses?

Step 1: First, figure out the total indirect expenses by month.

- Indirect expenses are expenses a business must meet on a regular basis, regardless of sales volume.

Examples:

Personnel
Administrative expenses
Accounting/bookkeeping
Insurance
Marketing
Webhosting
Subscriptions

Travel
Training/Certifications
Rent
Utilities
Maintenance
Storage
Trash disposal
# Example Indirect Expenses in the Income

<table>
<thead>
<tr>
<th>INCOME STATEMENT</th>
<th>Mo 1</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>TOTAL REVENUE</strong></td>
<td>$ -</td>
</tr>
<tr>
<td><strong>TOTAL DIRECT COSTS</strong></td>
<td>$ -</td>
</tr>
<tr>
<td><strong>GROSS PROFIT</strong></td>
<td>$ -</td>
</tr>
</tbody>
</table>

**INDIRECT COSTS**

- Officers' Salaries
- Staff Salaries
- Employee Withholdings
- Employee Benefits
- Liability Insurance
- Telephone
- Marketing / Advertising
- Travel
- Office Supplies
- Legal Fees
- Accounting Fees
- Rent
- Internet/Web Costs
- Utilities
- Amortization
- Other Expenses

| TOTAL INDIRECT EXPENSES | $ -  |

| PROFIT / (LOSS) | $ -  |
Creating a profitable business:

Step 2: Next, divide the total indirect expenses per month by the profit per product / service.

\[
\text{Break-Even Analysis} \quad \frac{\text{Total Monthly Indirect Expenses}}{\text{Profit per product / service}} = \text{# of products / services the business must sell to cover Indirect Expenses per month}
\]

Remember! The business is only making a profit if it is selling more than its break-even # in units.
Tie-in to Personal Household Budget

A business can provide:

- Supplemental income

- Replacement income

**Client:** My business is profitable.

**Counselor:** Is the business able to cover all of its costs and pay you a salary that covers the value of the time that you give to it?

**Client:** Not yet.

**Counselor:** Then your business is not yet profitable.
Internal Capital Accounts

A record called an internal capital account is created for each member to track:

• How much a member paid for a share in the cooperative

• How much of a profit was distributed to the member

• How much of the profit was reinvested in the business and reserved to pay taxes
What’s in an Individual Internal Capital Account?

2 PARTS

- Your membership share fee
- Some profits from co-op business

More on this in a minute.
When you join the co-op, you become a member by buying a membership share. When you leave, this amount is returned to you. It does **not** increase or decrease in value.

- Share could be $5 or $5,000 depending on the co-op

Each member is entitled to one vote in the co-op.
Membership Share is in Your Capital Account

Member share: All members own only 1 share
Excellent News: Your coop made a profit

Now what?

• Pay out cash to members?

• Keep (retain) some of the profits to reinvest in the co-op?
What is a Profit? In this Case, "Net Income"

Customers: $75,000

Rent: (1,000)

Wages: (20,000)

Supplies: (10,000)

Net Income: $43,800

Revenue earned from customers buying your goods or services

Expenses/Costs that went into providing services or goods to customers

Net Income = Revenue - Expenses
What Happens in a Traditional company when there is a profit?

**Profit=$300**

**APPLE CEO/Board**

**APPLE COMPANY**
Retain $200 in company (can be used for equipment, buildings, etc.)

**APPLE Shareholders**
(own APPLE stock)
Pay out $100 to shareholders in dividends
If 4 shareholders total, each owning 1 share, each receives $25

**APPLE Employees:**
Receive no shares of profits, only their wages
What Happens in a Co-op when there is a profit?

Profit = $300 → Co-op Board

Coop Business
Retain $200 in company (equipment, buildings, etc.)

Coop Members/Shareholders
Pay out $100 to Co-op members

Division of $100 is based on labor hours, not shares.

Employees who are not co-op members do not receive share of profits.
How does the co-op determine dividends?

Division of dividends: usually based on number of hours (labor hours) members worked in past year.

Total hours worked by all members at co-op last year = 50

Member share:
All members own only 1 share ($5/share)

Jane worked 4 hours, so Jane gets 4/50, or 8% of dividends.
How much to pay out to members, how much to keep in co-op?

Profit=$300 → Co-op Board

Coop Business
Retain $200 in company

Coop Members/Shareholders
Pay out $100 to co-op members.

This money is paid out in cash to co-op members. In our example, Jane gets $8, or 8% of the $100. Jane pays taxes on this $8.
How does money retained by co-op gets used?

INTERNAL CAPITAL ACCOUNT

Co-op Business
$200 retained

Collective Account
$150

Individual Accounts
$50

Corporate taxes (15%) = $22.50

Total in Collective Account = $127.50

Jane still gets 8% dividend, or $4 of the $50.
What does Jane actually receive?

First we determine patronage based on hours. Jane gets 8%.

In co-ops, this total amount ($150) is called a “patronage dividend.” Note: not all patronage dividends are paid out in cash to members.

Total Patronage paid out to members:
$100 in cash + $50 in internal accounts = $150 of profits to members
(started with $300 profit)

Jane gets 8% of total patronage dividend (12/150 = 8%)

$8 in cash + $4 in internal account = $12 Total

Jane will receive $8 in cash and a written allocation notice for the $4.
## Review of what co-op did with profits

How much to pay out to members, how much to keep in co-op?

<table>
<thead>
<tr>
<th>Co-op Board</th>
<th>Co-op Business</th>
<th>Co-op Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>$300 profit</td>
<td>$150</td>
<td>$50</td>
</tr>
<tr>
<td></td>
<td>$150 in internal collective account</td>
<td>Pay $50 into individual internal accounts</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Pay out $100 in cash to members</td>
</tr>
</tbody>
</table>

Patronage dividend
Members pay taxes on patronage dividend – both the cash and the written notices of allocation.

Jane pays taxes on $12, the $8 in cash she receives AND the $4 put in her internal capital account.
Why is this a good deal for the co-op and for Jane?

The co-op
The co-op benefits by paying less in taxes than a conventional firm would pay. This means that the extra money saved on taxes can be reinvested in the co-op, hopefully leading to more profits. The co-op can also use the funds in the internal accounts for investment, which is less expensive than if they needed to borrow it from an outside bank or investor.

Jane
If the co-op does better, Jane does better.
Investment in the firm is important.

Jane’s individual internal capital account acts like a savings or retirement account (for example, a Roth IRA). When she withdraws funds, she does not pay taxes on it. So instead of investing the stock market, Jane is investing in her own workplace.

When does Jane receive a payout? The co-op decides on payout schedules and balances the needs of the co-op with the needs of the members.
Internal Capital Account Balance

Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 | Year 11 | Year 12 | Year 13 | Year 14 | Year 15 | Year 16 | Year 17 | Year 18 | Year 19 | Year 20

-750 | 1,671 | 4,595,073 | 7,935 | 10,920 | 988 | 7,334 | 3,211 | (503) | (1,816) | 357 | 9,443 | 5,522 | 6,751 | 13,990 | 7,574 | 6,006

Contributions - Balance
Summary

- **Profitability** has two levels: *gross profit* and *net profit*
- Members of a cooperative pay for a membership share of the cooperative
- Profits of a cooperative can be distributed to the members and/or retained in the business
- Members’ shares, distributed profits and retained profits are tracked in an internal capital account