

# 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	
<b>Total</b>	<b>\$ -</b>

# 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** (*Total sales of goods and services = units x price*)

- **Direct costs** (*Materials, packaging, labor, transportation, etc.*)

---

= **Gross Profit [LEVEL 1]**

- **Indirect costs** (*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

<b>INCOME STATEMENT</b>	<b>Mo 1</b>
<b>TOTAL REVENUE</b>	<b>\$ -</b>

<b>TOTAL DIRECT COSTS</b>	<b>\$ -</b>
---------------------------	-------------

<b>GROSS PROFIT</b>	<b>\$ -</b>
---------------------	-------------

**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	
<b>TOTAL INDIRECT EXPENSES</b>	<b>\$ -</b>

<b>PROFIT / (LOSS)</b>	<b>\$ -</b>
------------------------	-------------

# Creating a profitable business:

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

<b>Break-Even Analysis</b>	Total Monthly Indirect Expenses	=	# of products / services the business must sell to cover Indirect Expenses per month
	<hr style="width: 100%;"/> Profit per product / service		

**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.

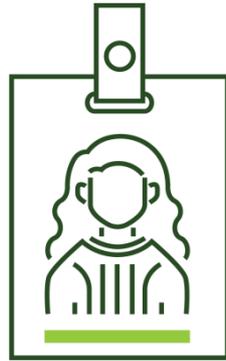
# Internal Capital Accounts

**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**



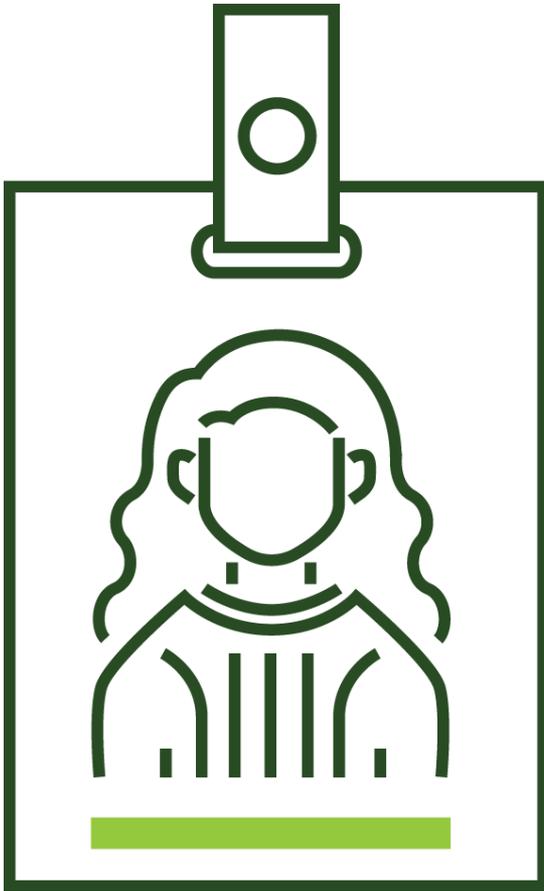
Your membership share fee



Some profits from co-op business



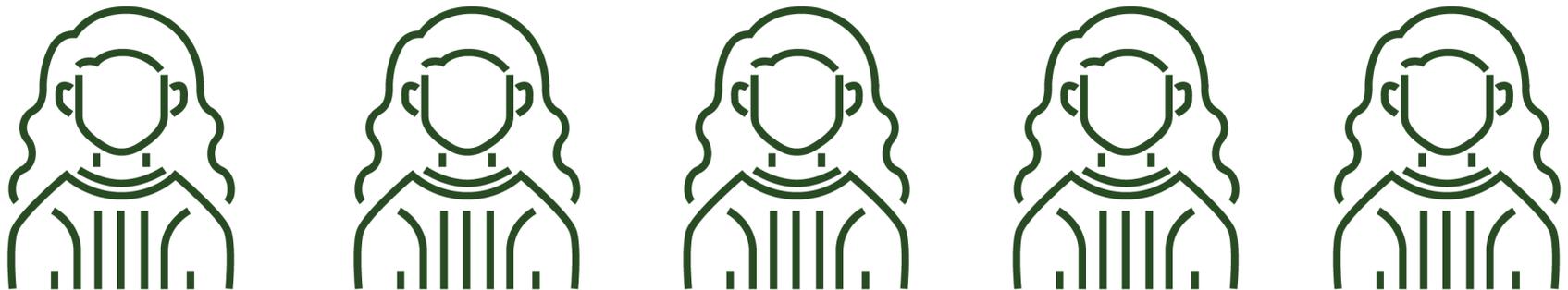
# Membership Share



- 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**

**Revenue** earned from customers buying your goods or services

**Rent:**  
**(1,000)**

**Wages:**  
**(20,000)**

**Supplies:**  
**(10,000)**



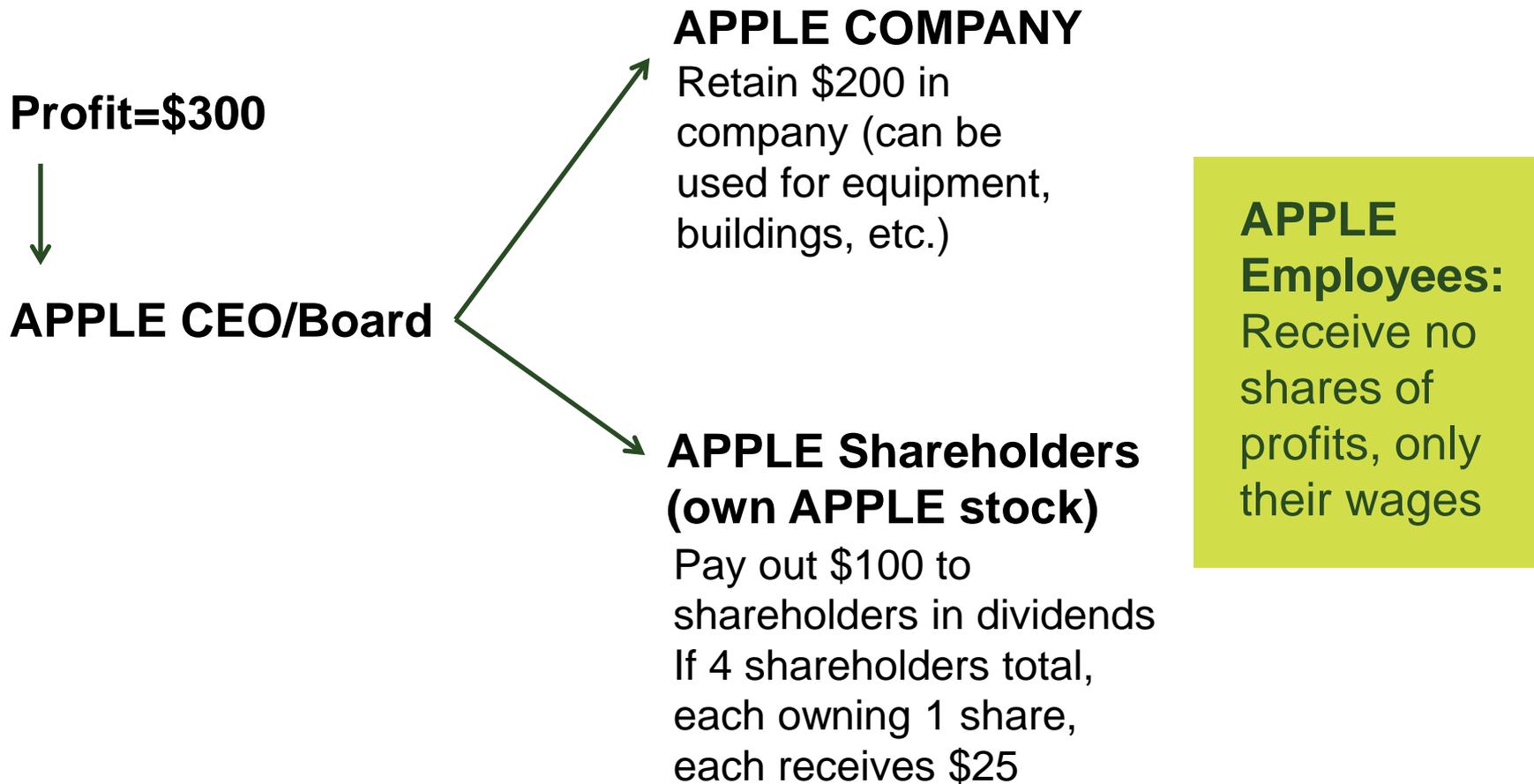
**Expenses/Costs** that went into providing services or goods to customers

**Net Income:**  
**\$43,800**

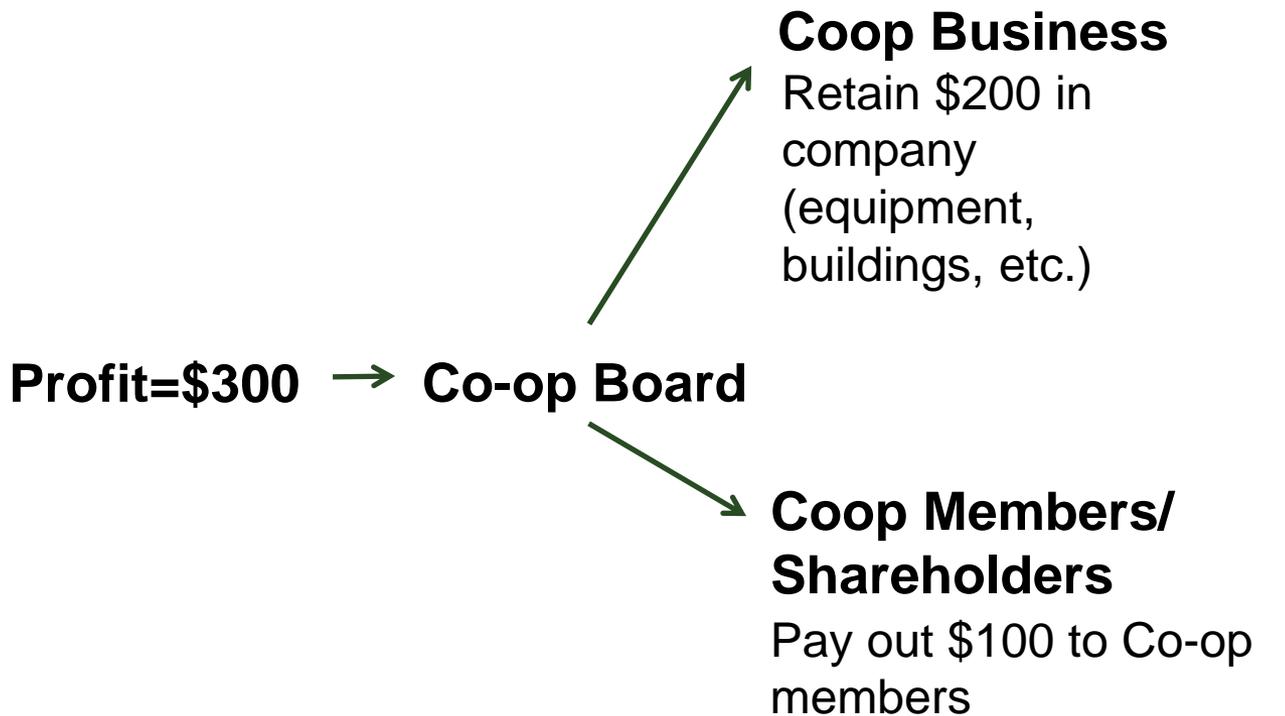
**Net Income =**  
Revenue - Expenses



# What Happens in a Traditional company when there is a profit?



# What Happens in a Co-op when there is a profit?



**Employees** who are not co-op members do **not** receive share of profits

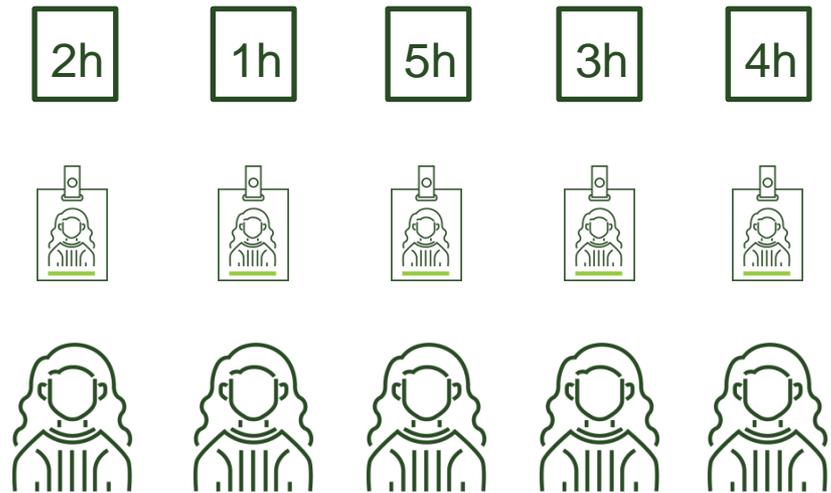
**Division of \$100 is based on labor hours, not shares.**

# 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

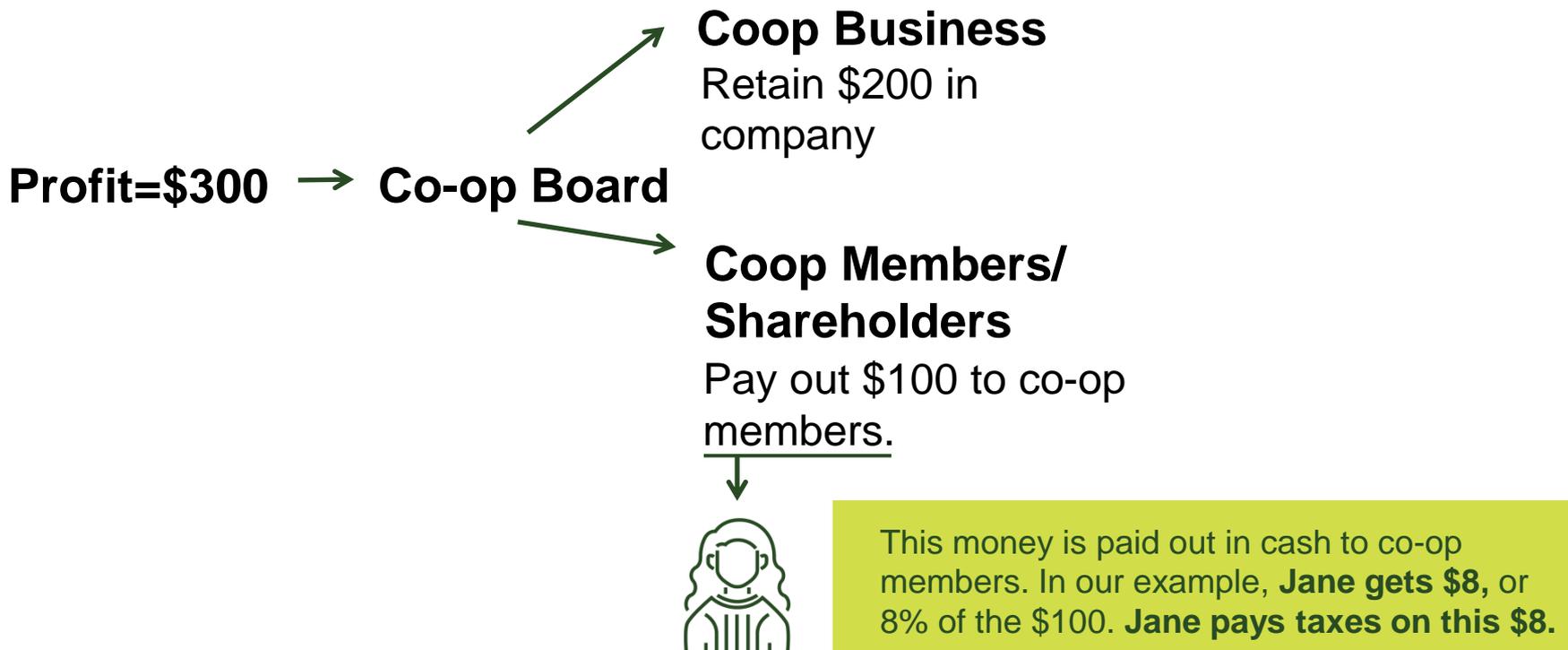
**Member share:**  
All members own only 1 share (\$5/share)



**Jane** worked 4 hours, so Jane gets 4/50, or 8% of dividends

# First Decision:

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



# Second Decision:

## How does money retained by co-op gets used?



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%.**

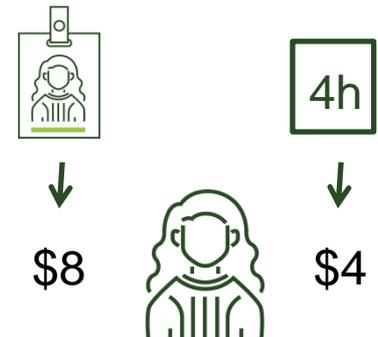
In co-ops, this total amount (\$150) is called a “patronage dividend.” Note: not all patronage dividends are paid out in cash to members.

**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.

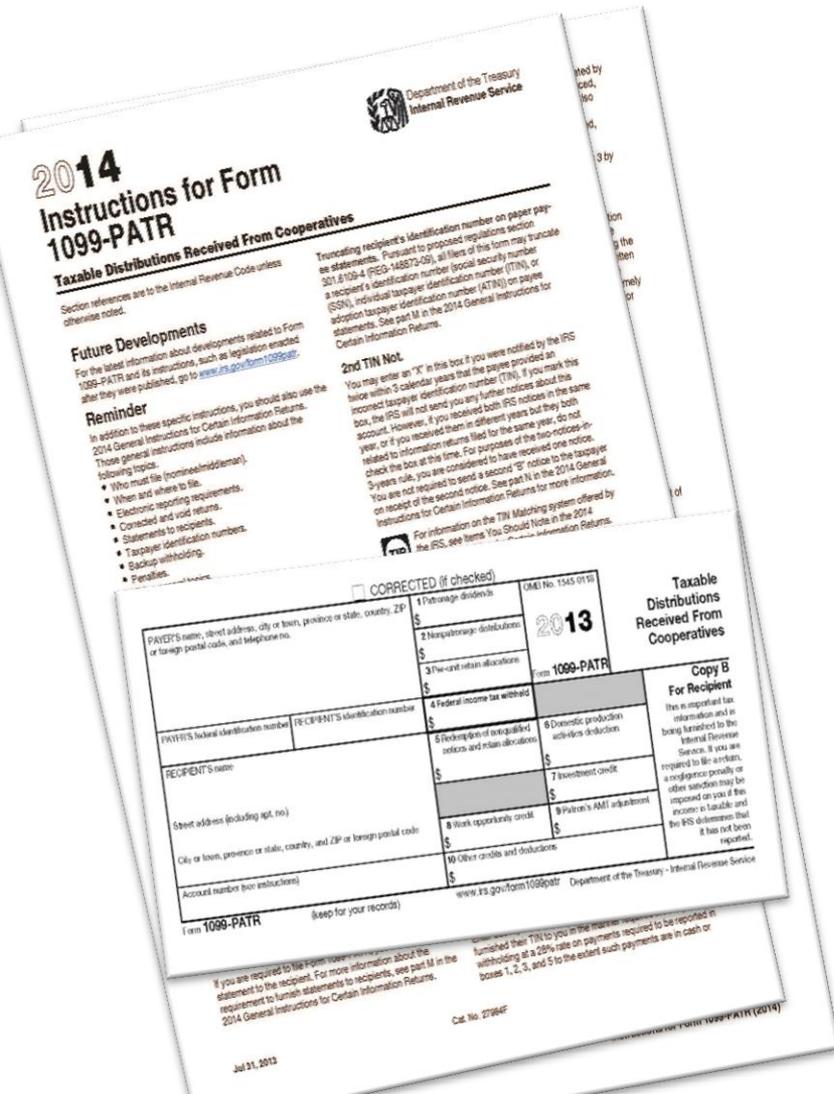


# Review of what co-op did with profits

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



# What does Jane pay in taxes?



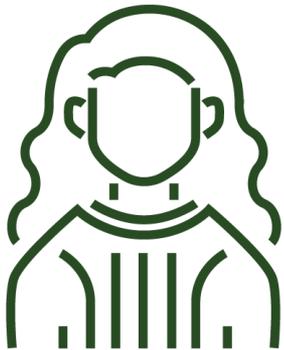
**Members pay taxes on patronage dividend – both the cash and the written notices of allocation.**

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

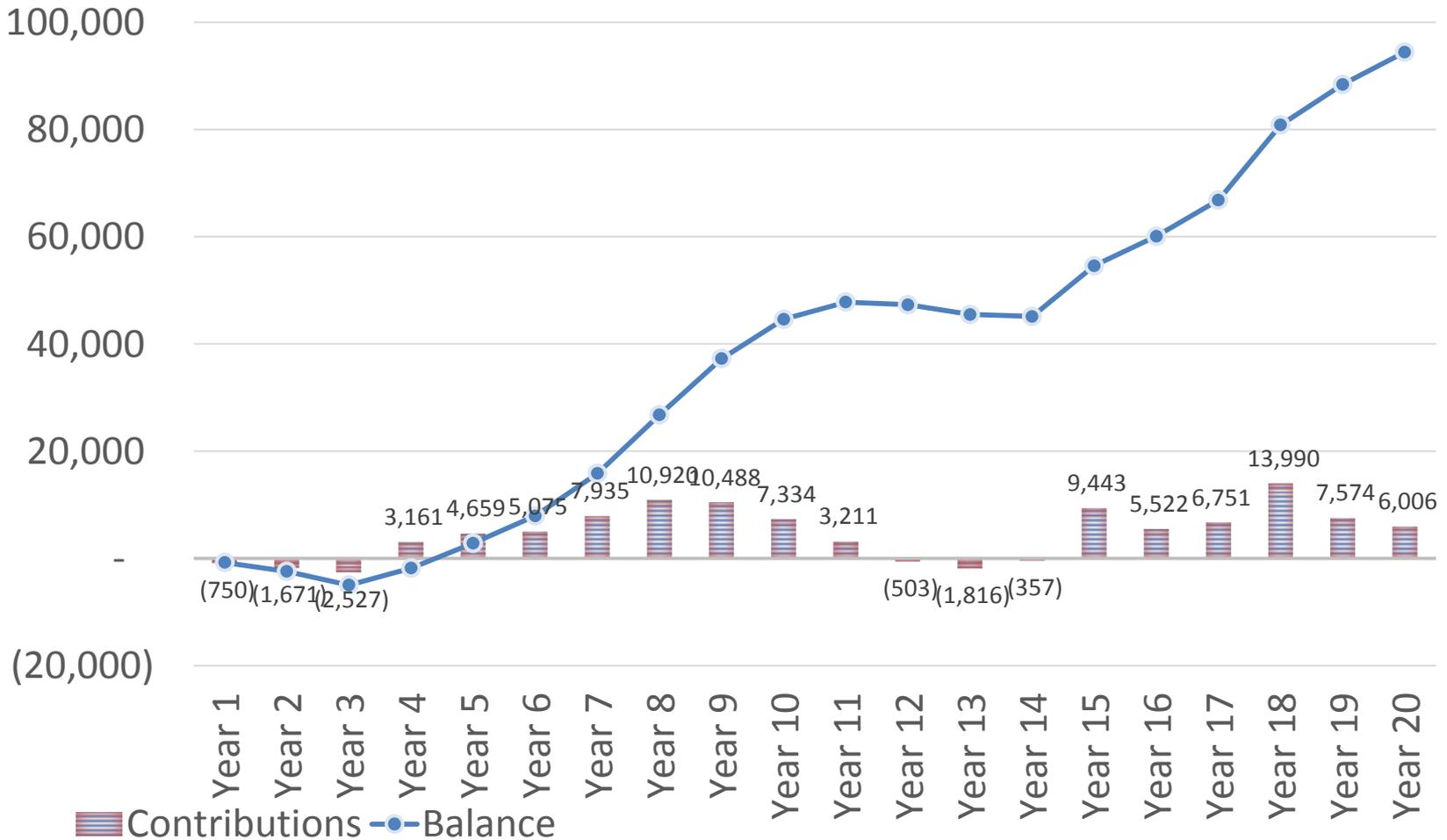
**If the co-op does better, Jane does better.**

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 in 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



# 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**