FACTSheet

On Co-op
Lead. Cultivate. Connect.

FINANCING A CO-OPERATIVE

2012 International Year of Co-operatives

Introduction

Under the Ontario *Co-operative Corporations Act*, (referred to as the Act) co-operatives have two different forms to choose from when incorporating: with share capital and without share capital. Each structure offers different options and benefits for raising money or carrying on operations. For the most part, which form to choose will be decided based on the purpose of the co-op and what types of financing are required.

The decisions around share structure and corporate structure can be complex and will depend on having a fairly good idea of what the co-op's purpose and business plan will be. It may also be advantageous for a group to seek the guidance of an accountant and lawyer familiar with co-ops to assist them with the decision making process and determining an appropriate share structure.

Determining Financing Needs

Understanding what financing will be needed for the co-op's operations will dictate whether or not the group needs to incorporate with share capital or without.

Before making the decision about share structure, a group should try and answer the following questions about their business and what their financing needs might be.

1. Will the co-op need to purchase equipment, land or other assets before being able to start operations?
2. Will the co-op have to purchase supplies or maintain inventory on an ongoing basis?
3. Will the co-op need working capital during start-up or in the early project stages?

In many cases, both a share structure and a non-share capital structure may be able to provide the co-op with the funds needed for its particular situation. However, there may also be different benefits or restrictions in choosing one form over another that may make different options available as time goes on, or restrict the co-operative from choosing other options. Some banks and financers may not be comfortable with the non-share capital structure, which may limit the ability of the co-op to raise money. A co-op developer, lawyer or accountant can help advise a co-op on how to proceed with making the choice of structure.

Corporate Structure

Share Capital

Share capital refers to shares offered by the co-operative to members or to outside investors. Co-ops with share capital can offer membership shares and preference shares. Membership shares are available only to those people wishing to become members of the co-operative. Preference shares are available for purchase by both members and non-members (outside investors).

Share capital is generally referred to as equity, and the proceeds thereof are usually used to buy equipment, land, buildings, or provide working capital that the co-op might need. When members or investors buy preference shares, they receive a return on their investment in the form of dividends – provided the co-operative has earned enough surplus to justify them.

Without Share Capital

Incorporating without share capital means that the co-op may have to rely more heavily on debt financing in order to get money. Shares cannot be offered to members or investors to raise money. Co-operatives without share capital can issue securities like debentures and other debt instruments to both members and non-members. Co-ops without share capital can also use member loans, which are loans required for people to pay in order to be members in the co-operative, or loans that are paid out of the patronage that a member is eligible to receive.

This type of co-op structure is suited to covering operating expenses such as supply purchasing, generating working capital or inventory requirements. It is possible to purchase equipment and fixed assets using debt, but it can be more difficult to do so.

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What Does Capital Mean?

Capital is the money used by a co-op to do business – it generally refers to the amount available to the business as assets like cash or property, minus the liabilities that the co-op has. The Act refers to two types of capital: authorized capital and issued capital. Authorized capital is the maximum amount of capital that a co-op can have (expressed as the maximum number of shares that can be sold), while issued capital refers to the shares that have actually been sold, from which payment has been received. The amount of issued capital can never exceed the amount of authorized capital in a co-operative.

Offering Securities

In addition to the material contained in the Articles, there are additional procedures and regulations associated with the sale of securities. The sale of shares and other securities (like debentures) is dictated by the *Co-operative Corporations Act*. If a co-op wishes to raise money through the issuance of securities, it must issue an "Offering Statement" which is similar to a prospectus offered by a business corporation that is offering shares. An Offering Statement is not required if the co-op has less than 35 security holders. If a co-op has more than 35 security holders, it may still be exempt from having to do an offering statement if it meets one of the following conditions:

- Will be raising less than $200,000 in the offering (and the first $200,000 of any offering is exempt from requiring a statement)

OR

- Will sell less than $1000 of securities from any one member per year, or $10,000 total in the members' lifetime (but securities that are distributed as a part of patronage returns do not count towards this limit).

The regulations to the *Act* provide a more detailed description of the conditions required to be exempt from creating an Offering Statement. As of April 2007, there are a number of regulation changes pending with the Ministry of Finance that will make significant changes to the exemption limits. Co-ops are urged to review the requirements carefully before beginning the capitalization process.

If the co-op will exceed any of the above limits through its offering of securities, then an Offering Statement has to be prepared. This is a document that outlines the securities being offered along with the risks and details of the co-op's operations and financials. This Offering Statement must then be submitted to the Financial Services Commission of Ontario (FSCO), where it is then reviewed and receipted. Once the receipt has been given, then and only then can the co-op start selling securities.

An Offering Statement is never valid for more than 12 months and updated Offering Statements must be submitted to FSCO each year to allow the co-op to continue selling securities.

Financing Through Other Sources

Debt Financing

In addition to the ability to raise money from the membership and community investors, co-ops can also take on debt financing from financial institutions like credit unions or banks in order to finance their projects and operations. This can include obtaining a mortgage or loan to purchase property or equipment, opening a line of credit for the co-op to use, or other types of shorter term loans. The ability of a co-op to obtain financing of this type will depend on several factors, including:

- The available equity or collateral that the co-op can bring to the table
- The perceived risk of the investment or the business of the co-op on the part of the financial institution
- The amount of money required

Business Plan

The co-op should have a business plan that outlines the co-op's financial situation or the proposed financials. A business plan contains standard information about the co-op or the project. Business plans can be presented to commercial lenders to help them understand your business and properly assess your needs and their ability to help you. A business plan should identify:

- revenue or potential revenue associated with the project or the co-op's operations – usually through the inclusion of financial statements or pro forma financials, *(continued)*

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Business Plan *(continued)*

- key personnel involved in the co-op;
- timelines and status of the project
- risks associated with the project and how the co-op has addressed them;
- an assessment of the market that the business is operating in and what the co-op's ability to succeed in this market will be (their competitive advantage)

The business plan is a tool that can be used to demonstrate that the co-op has the skills and ability to move forward successfully. It can also show a lender or potential investors that the co-op can manage the project and can mitigate any risks that exist or might occur.

Grants

Some co-operatives, usually only those operating with not-for-profit or charitable status, can also access grants from charitable foundations or government agencies like the Ontario Trillium Foundation. There are some granting programs that are open specifically to co-operatives, regardless of their tax-status.

Grants are usually project-based and provide funding for a finite period of time. They usually do not provide ongoing operational funding, but may partially cover staff costs. Grants will generally require an application and approval process and not all applications will be successful.

On Co-op maintains lists of co-operatives and other organizations providing loans, grants and technical assistance funding.

Government Subsidies or Support

Some co-operatives are eligible to receive government funding that does support their operations. This can be the case with co-ops that are providing a social service that is subsidized by the government, as in the case of some not-for-profit housing co-ops or some child care co-ops.

References:

Comparison Chart of Co-ops, Businesses and NFPs – Created for the Ontario Co-operative Association by Brian Iler, Iler Campbell LLP and Russ Christianson of Rhythm Communications.

How to Talk to Lenders – Created for the Ontario Sustainable Energy Association by Jens Lohmueller

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More resources are available at:
CoopZone Network
www.coopzone.coop

This is one of a series of FACTSheets created by On Co-op. *BP03*

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Quick Facts About Co-operatives in Ontario:

- There are over 1300 co-operatives, credit unions and caisse populaires incorporated and operating in Ontario, with 1900 locations in 400 communities.
- The co-operative sector in Ontario represents a very conservative $30 billion in assets (2007). Non-financial co-ops had revenues that totaled more than $2.1 billion in 2004.
- Ontario co-ops employ and provide benefits to 15,500 people (greater than the total number of Ontarians employed in production of goods).
- 1.4 million Ontarians are members of a co-operative, credit union or caisse populaire (more than 10% of the population)
- Over 10,000 board members are actively involved in governing and leading co-ops, credit unions and caisse populaires in Ontario.
- There are some 49,000 co-operative volunteers across Ontario, including board members.
- 50% of Ontario's co-ops are located in central Ontario.
- Housing is Ontario's largest co-op sector (45%), followed by Financial Services (17%), Child care (17%), and Agriculture (6%).

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