LEADer

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Leadership Education and Development Newsletter

A publication designed to promote visionary and forward-thinking discussions between and among the leadership of NCG co-ops

A Study Guide for Co-op Leaders

Dealing with a Downturn

IN THIS ISSUE

Dealing with a Downturn

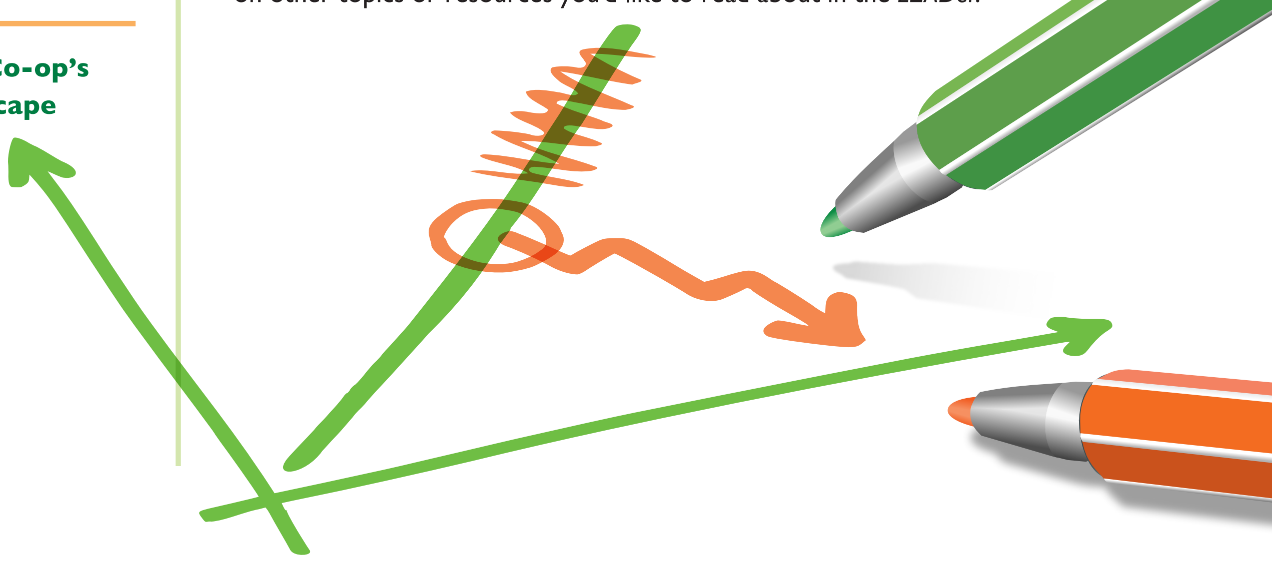
Unfortunately downturns happen. They're even more likely to happen when your co-op is growing and doing its best to serve an expanding membership and local community. No business expansion or growth plan is guaranteed to be successful without *a lot* of hard work. Even the perfect amount of homework, planning, due diligence, and careful execution doesn't ensure a smooth operation.

It's just this fact that can cause a co-op board to hesitate to approve an expansion plan. How many expansion plans have you looked at? How much experience does your board have in reviewing and providing feedback on the real estate, development, financing, and planning work needed to carry off such a project?

At the same time, you know that the long-term success of your co-op depends on its ability to grow—to be relevant to a growing membership and customer base, and to provide food and other benefits to a larger part of your local community. Growth is important for business reasons (so you can have more impact and be a better operator) and is integral to the purpose and mission of your co-op.

In this issue, we look at how boards can deal with a downturn. By downturn, we mean a negative trend in the co-op's performance. Perhaps sales growth drops (or goes negative) due to new or more aggressive (or effective) competition; a new store doesn't meet projections; or a major business disruption contributes to negative financial performance or decreasing cash. Whatever the cause, we want to look at how the board can effectively work with the general manager to deal with these kinds of situations. You'll find three articles about this challenging topic— all fully grounded on actual co-op experiences. We also include an article by Dave Olson of National Co+op Grocers with specifics for co-ops challenged in today's market conditions. Finally, in this issue's study guide, we offer guidelines for a discussion on the current and future competitive landscape for your co-op; we hope you'll find this a useful discussion at a board meeting or board retreat.

As always, we welcome your thoughts and experiences, as well as suggestions on other topics or resources you'd like to read about in the *LEADer*.



More about the LEADer

The *LEADer* is a quarterly study guide designed to foster visionary and forward-thinking discussions between and among co-op leaders. The *LEADer* is a publication of National Co+op Grocers (NCG; formerly National Cooperative Grocers Association) and strives to incorporate experiences and voices from all co-ops affiliated with NCG. Each issue is produced by the Board Effectiveness Support Team (BEST), a voluntary committee made up of board leaders and general managers from co-ops around the country. We welcome those who would like to join us in this project.

The *LEADer* is available to all interested co-op leaders. This issue and all back issues are available online. Those wishing to subscribe to the *LEADer* and have issues sent directly by e-mail as soon as they're available should contact Karen Zimbelman.

We welcome your reactions, suggestions, and contributions, as well as questions for us to answer in future issues. For more information about NCG, the *LEADer,* or the BEST, or to send along comments or questions, contact:

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When the News Isn't Great

by Gail Graham

Remember that old adage about how if you put a frog in a pot of hot water, he will hop out, but if you put him in a pot of cool water and gradually bring up the temperature, he won't notice until it is too late? You don't want your co-op to be that second frog.

The news that your GM delivers isn't always going to be good. So how do you, as a board member, develop a context for the news and the ability to understand when it is time to worry?

It can be human nature to blame the messenger—to fire the person behind the desk when a problem manifests itself. Sometimes this will be the right move, but sometimes the problem is a result of a common cause, a situation that is affecting others in your industry and area and something that you may have very little control over. And although your co-op may be seeing a downturn in sales, rising labor costs, or unplanned decrease in margins, the very GM you hold responsible is likely to be the best person to navigate you out of the troubled waters.

W. Edwards Deming, a well-respected business thinker, said, "The aim of supervision should be to help people and machines do a better job." As a director, you aren't exactly a supervisor, but you do have an oversight role. And one of the most valuable things in the midst of difficult times is a good working relationship between the board and the GM—with the board helping the GM do the best job he or she can.

The GM also has a role in helping the board do the best job it can—in part by helping the board understand the current state of outside events, industry wide and area-specific, that could impact the co-op. It's likely that you are already up to speed on what is happening in your community. But if your GM has special information about changes in the competitive environment, it would make sense for him or her to share that with you.

You don't need to be an expert, but your GM should help educate you about our industry. One good resource is the annual *Natural Foods Merchandiser* Industry Update issue, published every June. It is available electronically and easy to share. Also, the CDS Consulting Co-op library has excellent, brief videos; one that our co-op found invaluable was Dave Olson's recent presentation "Understanding the Changing Landscape," part of CDS CC's Cooperative Café program. And NCG provides a vital service by pulling together information from numerous sources and distilling it into an annual trends report. Your GM can also look at broader economic factors—for example, checking to see how the cost of food at home is doing on the consumer price index—to determine how inflation may be affecting your sales growth.

Through your "industry scan glasses," you might see that the competition is heating up. Don't wait until you can see the whites of their eyes to determine your control limits—that is, what key indicators you want to pay attention to and what is an acceptable range of performance. Part of this work will involve developing a shared understanding of what "out of range" means to you: What parameters will be indicators of a serious problem? Numbers compared to budget? To last year? To industry trends? Also, how long will negative results go on before you get worried? And how severe do they need to be?

The board must discuss what is appropriate for your co-op's specific situation, but likely you won't need to start from scratch. Some control limits are established by your bankers in loan documents as your loan covenants. These limits often include such things as current ratio, debt to equity, and EBITDA. I consider it a best practice to report on these as part of a quarterly financial report. If you are a policy governance board, you might have requirements spelled out in your financial limitation policies. And, as was mentioned in an earlier *LEADer* (issue 27), A Deeper Dive into Co-op Finance, you may also wish to compare your finances against NCG benchmarks that are available in trends reports.

Patience is often called for. Don't overreact to one bad report. But do understand how key indicators are trending over a period of time. A business can survive long term and come out of a downturn just fine, as long as cash holds up. In particularly challenging cases, "days in cash" (also called "days cash on hand"; see *LEADer* issue 10, *Healthy Food, Healthy Finances*) will be the most important indicator for you to watch.

No matter what, communication is vital. When results are not what you want them to be, the GM should help you understand why and help you understand what is being done to change them.

It Didn't Go as Planned

What Happened after La Montañita Co-op Opened a New Store

by Martha Whitman

If you've been a director for a while, you've come to understand that while the board is responsible for the well-being of the co-op, the responsibility to achieve that well-being is delegated to the general manager. When everything is humming along like a well-oiled machine, that knowledge tends to run in the background and activity is focused on the usual, such as monthly board packets, member engagement, board recruitment, and strategic visioning.

So what is the board to do when the co-op hits the proverbial bump in the road? In the case of my co-op, La Montañita Co-op in New Mexico, this happened when our new store missed its sales projections and it soon became apparent that it wouldn't reach them for some time. The board expects the general manager to make the necessary corrections, but what is the board's role?

Here's how it played out for us. At first we did nothing. Going into the project, there had been various steps of due diligence. A professional market study had been done, the loan terms were reasonable, the lease was rigorously negotiated, and the NCG Development Co+operative was contracted to advise the general manager through the whole process. Because so many things had been done right, it seemed reasonable to give the general manager time to make the corrections. He made many adjustments, mostly by controlling expenses. At our board meetings, he reported on the challenges and how he was addressing them. We weren't in jeopardy; he was in compliance with all our polices, but the store's performance wasn't good.

"We're still waiting for our new store to reach its goals. I can only imagine the lessons being learned by staff, and the board has great confidence in their abilities."

— *Martha Whitman*

Flash forward two years. The store's sales are still weak, and we're still not in jeopardy. But the finance committee spoke up when presented with an annual budget showing a net operational loss for the upcoming year. Our policies require the general manager to provide quarterly financial statements, an annual budget with a cash flow statement, and specific financial ratio targets. We were receiving all those reports, the manager was in compliance, but the consolidated statements didn't allow us to see the full picture. With six stores and a warehouse, it wasn't apparent how deep the losses were at the new store and how the profitability of two other stores was holding us together. That in itself isn't a bad thing; it's a benefit of multiple business units that when one store struggles, the others can help carry the load. But the board didn't have a deep enough understanding of our financial position, and it was correct for the finance committee to throw up a red flag.

Because we're a policy governance board, our approach was to review the policies we already had and to determine what else was needed to address a downturn scenario. Our new policies kicked in when a certain financial marker occurred. For us it was two consecutive quarters of combined operating income less than 0.5 percent of net sales. At that point we asked for monthly financial reporting, in a format providing specific details of each operating unit. In addition to this financial reporting, the general manager was asked to report on measures being taken to increase operating income. All of this reporting is done in executive session.

We're still waiting for our new store to reach its goals. I can only imagine the lessons being learned by staff, and the board has great confidence in their abilities. The board has learned a valuable lesson as well—that operating during a downturn requires a review of how we receive information and what benchmarks trigger what actions. The duty of care for us as a corporate board requires us to be fully informed. While no one can guarantee the success of any given venture, the board can demonstrate due diligence by increasing its monitoring of the general manager and asking many questions. It's from such education that a board will have the confidence to make the difficult decisions that come its way.

Board Navigation of a Sales Downturn

*by Cindy Owings **

Today, grocery store competition is brisk and relentless. National corporate natural food stores target new openings in many vibrant communities. Your co-op may experience negative sales growth because new grocers grab for customers through aggressive marketing, low-price deals, and loss leaders. Internally, co-op directors must come to an understanding of their store's position in the local food market in preparation for the vagaries of market volatility, possible erosion of customer loyalty, and a decline in sales.

Competition is not breaking news to an informed co-op board, but how does a board navigate member and staff communication within the churning waters of local market volatility?

For instance, if members perceive that co-op leadership is in a panic because of a sales downturn, the reputation of the store can be damaged. A co-op board must develop a thoughtful strategy for handling the press of competition and all that it implies. Communication can be tricky and nuanced. Following are some guiding principles.

In the face of negative sales growth, the board must keep the message positive but honest. Invite members to check out the competition but remind them that the co-op has been there for them over the years, so "Come back and enjoy the benefits of co-op membership!"

The board cannot rest on a hope for change through a sales downturn. Leadership must be proactive in its approach to negative numbers. If management seems blasé in its response to negative sales growth and new competition, the board must step in to make sure the general manager approaches the situation in an intelligent manner. Expectations of the GM must be clearly laid out and monitored by the board. Some of these expectations are:

- Active and regular communication with staff so that they know what is coming and so that fear is dissipated
- Creation of a plan *well* ahead of competition opening, including a SWOT analysis of the co-op and department-level plans
- Regular and close price checks, with general spying on the competition
- Readiness for how to handle layoffs, should they be necessary
- Gathering input from members on what they want to see change in the co-op through open forum meetings or other formats

A board's role is to support management through a negative-sales-growth crisis. If necessary, the board must also push management to effectively address

**This article was informed by a conversation with Kelly Wiseman, general manager of the Community Food Co-op of Bozeman, Montana.*

the downturn. Board and management must carefully consider what information is to be shared with the membership. It may be best to share information through only the annual meeting, a time when members are accustomed to hearing yearly sales figures and other such details. At no time should there be a cry of alarm from the co-op leadership.

The board must be proactive in its vision of how changes can be made through remodel, additional parking, and general store improvements. Key departments must be examined and improved. In tandem with store improvements, the board must support an increase in marketing expenses. An in-depth examination of the income statement may require a drop in margins where appropriate. A board must be open to hiring outside consultants to help where necessary.

FINALLY: Do your board members shop the co-op? It may sound goofy, but members like seeing directors shopping by example. A director's basketful of groceries is a simple, quiet message that tells members that leadership believes in the co-op, no matter what.

WATCH THIS!

"Being Really Great Grocers"

Kelly Wiseman addressed the question: What do you do when the competition is planning to move in next door? The Community Food Co-op of Bozeman took a hard look at its entire co-op to make sure it was fully meeting shopper needs and injecting excitement into the store every day. Here's an eight-minute video (click the green link in the title) of Kelly providing a summary of how the co-op created a new sense of urgency and an eye for continuous improvement, filmed as part of the CDS Consulting Co-op's Cooperative Café series.

Stronger Together Avoiding the Downward Spiral Starts Now

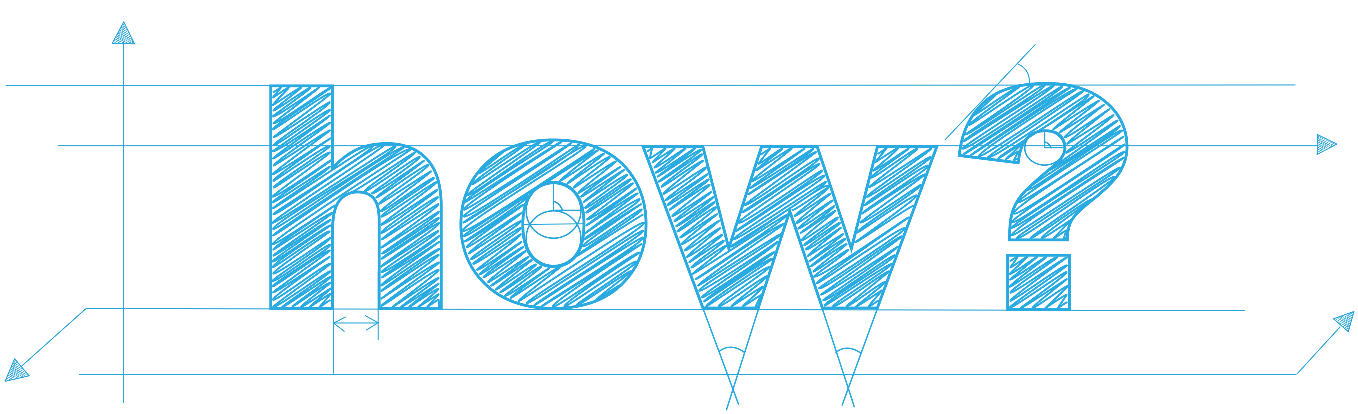
by Dave Olson

Over the last year, NCG has delivered a presentation called "The New Normal" to a variety of audiences. We show data that clearly demonstrates that the strong, consistent growth co-ops have known and become accustomed to is no longer the reality for most co-ops. Our growth came from consumers making lifestyle changes: an expectant mother seeking out healthier food and nutrition; a health scare prompting a consumer to eat better and exercise; seniors seeking out foods to support the lifestyle they wished to maintain. In each of these cases, shoppers left the conventional grocery store for a source of natural and organic foods. That used to be us; food co-ops benefited from those lifestyle changes, and shoppers sought us out, even when we didn't make it easy.

Today, shoppers making lifestyle changes don't need to seek us out. There are more natural and organic retailers than ever before, racing to open more stores nationwide and in markets of all sizes. These are strong retailers going out of their way to appeal to "mid-level shoppers"—those interested in natural and organic products and wanting to incorporate them into their lives. They may become "core shoppers"—those with deep familiarity with natural and organic foods—or they may not. Regardless, mid-level shoppers are driving growth in the industry; they are seeking out natural and organic foods now. Today they don't even need to leave conventional retailers like Kroger (including Harris Teeter, Smith's, and Fred Meyer), Hy-Vee, Safeway, Publix, and others. These chains all offer strong natural and organic selection, often at much lower prices than traditional natural foods retailers like co-ops. The end result is that co-ops are no longer growing; our competition has taken that from us. That is the new normal.

At this point in the presentation, most of the audience is nodding. They recognize the situation because this is exactly what's happening in most markets; they've seen this play out at their co-ops. But once we start talking about solutions to the problem, the reception to our message changes: we start to see brows furrow, people shift uncomfortably. The reason? Our solutions require change, they require work, and there is no easy fix to the new normal.

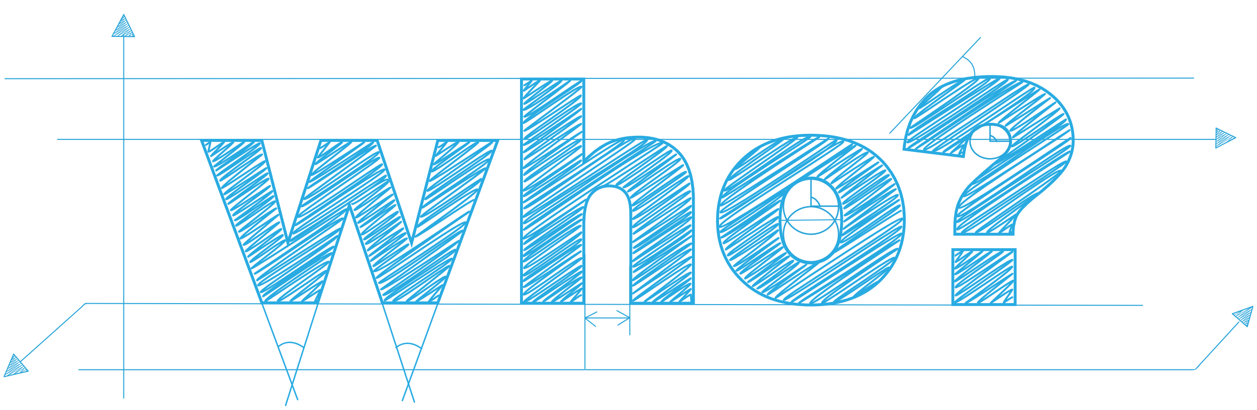
NCG is optimistic, though, that needed changes are possible and that co-ops can continue to thrive, be market leaders, and have a lasting positive impact in their communities. Why? Roughly one-third of NCG co-ops have already experienced increased competition. It came early to some markets, and the co-ops in those markets made the necessary, tough changes and are now doing great. Once these co-ops became accustomed to what it takes to thrive in the new normal, they flourished. We know that most NCG co-ops can make the same changes and that there are more resources for support. The first step is to recognize that things have changed. While it is possible that a few



isolated co-ops may never experience this new situation, the reality for most co-ops will be much different, and the sooner co-ops come to terms with that reality, the sooner they can adjust to the new normal.

The next step for most co-ops will be to challenge conventional thinking. For co-ops to be successful, they will need to operate as better businesses, remove barriers that keep consumers from shopping at the co-op, and actively reach out to new shoppers and a broader market. What follows is a short list of the most critical changes a co-op needs to make to be successful in the new normal. This is not a complete list, but if a co-op commits to the following concepts, it should help pave the way for real, substantive improvement. Work now to:

- **Put the first bottom line first.** With growth gone, co-ops need to make sure the economic engine is healthy and sustainable. Being successful in all three of the co-op's bottom lines (profit, people, and planet) depends on being profitable. Co-ops need to channel more resources and put more emphasis on profit so that other good work can continue and will be sustained for the long term.
- **Reinvest.** When co-ops experience new competition, the gut reaction is to be defensive—to tighten the purse strings, hold off on capital expenditures, and defer reinvestment. Our experience shows that successful co-ops do the opposite. New competition should be a cue to invest in your store—to fix obstacles that shoppers may find frustrating and to enhance those areas of the store that will allow the co-op to compete and differentiate.
- **Make sure systems and policies work in the new normal.** Most co-ops are accustomed to operating with strong, sustained growth. This is the context for our policies, procedures, governing practices, and even assumptions. But those approaches often aren't appropriate for today's conditions. We need to scrutinize how we do business, including governing practices, to make sure that our efforts will sustain co-ops in a no- or low-growth environment. If bylaws don't allow the co-op to be effective, it may be time to update them. If governing practices are loose or undisciplined, it's time to adopt a more professional approach.
- **Broaden the circle of "we."** According to recent national research on co-op shoppers, the base that co-ops are best at appealing to—core shoppers—today represents 13 percent of shoppers at the average co-op and 25 percent of *all* retail sales. These are committed and informed individuals, and we will always value their support and participation at our co-ops. However, at 13 percent, these individuals (and their interests) are only a small fraction of our overall shopper base. If we wish to thrive and stay relevant, we need to effectively meet the needs and interests



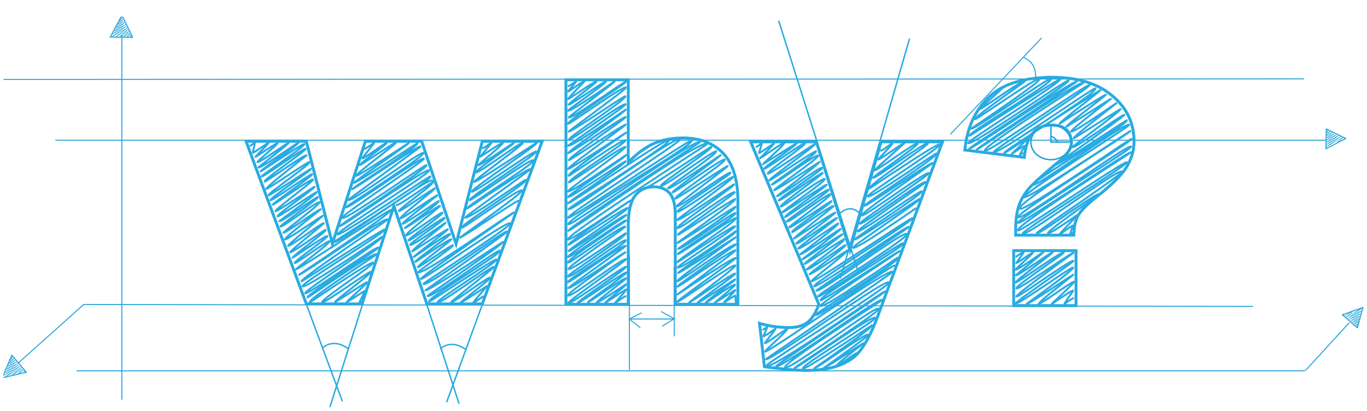
of all shoppers, including mid-level shoppers, who represent 62 percent of shoppers and 65 percent of sales. To do this, co-ops may need to broaden their appeal. This will present challenges to boards—keeping the co-op true to its values while broadening its appeal; welcoming all shoppers without alienating the core. Core shoppers are more likely to let you know when they are displeased; mid-level shoppers are much more likely to buy less or come less often. This puts an extra burden on the co-op to understand a wider range of needs. Member or shopper surveys conducted at least every other year are a good start but still won't give a complete picture. Co-ops need to offer and monitor new and diverse mechanisms for getting feedback and input, especially social media.

- **Avoid dichotomous thinking.** Too often we see co-op stakeholders fall into a trap of dichotomous thinking: we either serve mid-level shoppers or core shoppers; we are either for-profit or nonprofit; we are either "pure" in our product selection or conventional. This thinking traps directors and managers into a status quo that is increasingly less tenable and ultimately does a disservice to all co-op stakeholders.

We encourage co-op leaders—whatever their role—to adopt a nuanced perspective that values plural and even contradictory identities in order to serve the long-term health of the co-op and its community. We serve all shoppers and actively reach out to the community to invite new shoppers. We value profitable operations because that allows us to have a bigger impact on our community, be better employers, and operate sustainably. Our product selection is carefully curated to meet the diverse needs of our community, from those seeking high-quality organic and fairly traded goods to those who want healthy but affordable options.

It hasn't gone without notice that the new normal has arrived just as many co-ops are celebrating their 40th anniversaries. We don't like being the messengers of difficult news, but the better co-op stakeholders understand the new normal, the better equipped they will be to face it. We should be proud of how far our co-ops have come, even as we recognize and adjust to the challenges at hand. The new normal is here, and it means that fulfilling our missions and meeting our ends will be a little more difficult and challenging. But co-ops that are willing to meet that challenge by adjusting to the new market realities can continue to thrive, serve more members, and have more impact for decades to come.

Dave Olson is NCG's national co-op development manager.



STUDY GUIDE

Your Co-op's Competitive Landscape

It's important for your board to have good awareness of the competitive pressures that the co-op is currently facing and to be realistic about potential future competition. We suggest you set aside at least 60 to 90 minutes to review, as a group, the video from Dave Olson's presentation as part of the CDS Consulting Co-op's Cooperative Café program. In this video, "Understanding the Changing Landscape," Dave describes key trends visible in the natural and organic markets as of early 2015. (Note that a version of this video with more detailed proprietary information is available to NCG co-ops; NCG designated representatives (DRs) can contact their account managers for the password and link to that version.)

After reviewing the video, here are some questions for discussion:

1. What is the current market situation for your co-op? Who are the co-op's competitors? What are stores in your market doing to increase their appeal to co-op shoppers? What are your co-op's sales trends for the past five years? Are you seeing any impact from local competitors?

2. What do you know about what will be changing in your market? What do you know about new potential stores that may be coming to the co-op's trade area or about current stores that are doing remodels, revising their product offerings, or marketing in a more aggressive way to compete with the co-op?

3. What is the co-op doing in the face of these competitive pressures? What initiatives are managers working on to make sure the co-op remains an attractive and desirable shopping location for member and nonmember customers?

4. What is your elevator speech to co-op members or shoppers about why the co-op is still relevant in its market? Why is it important for your co-op to continue to compete and thrive for the next 10, 20, or even 40 years when many of the products it sells are more and more available?