

Competition Drives Co-op Improvements

BY PATRICIA CUMBIE

According to most indicators from the past year, food co-op performance remains strong. Food cooperators are not taking their success for granted, however, and the strongest performers are taking proactive steps to meet intensified competition.

Industry overview

Natural Foods Merchandiser (NFM) reported natural products retailers recorded 10.7 percent growth in 2006, but the mass market saw its sales grow 10.5 percent, its biggest increase since 1999. For food co-ops, aggregate was 12.35 percent, with same store growth at 8.7 percent. What's more, industry profits averaged 1.46 percent, according to the Food Marketing Institute's (FMI) Annual Financial Review of 2006. This is the highest profit level that has been recorded in the 37 years FMI has been tracking performance. The reasons they cited for it include efficiency, technology, and consumer-driven inventory management.

While sales for natural products grew in every retail channel, certain retailers also made headlines, drawing attention to business strategies aimed at increasing market share. Wal-Mart declared it would sell organics at 10 percent more than similar conventional products, and is positioning itself to become the largest seller of organic food in the U.S. But some recent reports indicate that Wal-Mart's expansion into organics is faltering.

Whole Foods Market made a move to merge with Wild Oats, which was stalled in June by the Federal Trade Commission to examine the potential for a Whole Foods monopoly*. Whole Foods chief executive John Mackey is also being investigated by the U.S. Securities and Exchange Commission for his anonymous email postings criticizing Wild Oats. Should the deal go through, the largest single segment of the natural products retail trade would be owned by Whole Foods.

Conventional chains Tesco, Safeway, and Super Value all launched new in-store concepts in the past year based on quality, freshness, and healthfulness. Even convenience stores are going beyond junk food to offer salads and fresh fruit cups. How successful these strategies will be remains to be seen, but such activities signal a new level of intensity by competitors attempting to gain natural products market share.

Food co-ops continued to apply themselves to efficiency gains as well, often through cooperative networks. "As a group, food co-ops are performing better than the industry," said Walden Swanson, a consultant with Cooperative Development Services (CDS). He believes that food co-ops should look back at strategic moves made a few years ago as a reason for current success. The National Cooperative Grocers Association (NCGA) was able to secure the approval of its members for a merger of its nine regional associations, subsequently strengthening its purchasing contract negotiations with distributor United Natural Foods, Inc., and creating peer accountability programs that focus on improving operations. Commenting on these moves, Swanson said, "Co-ops have done the right



ILLUSTRATION BY MEGAN SMITH

thing in the last five years, because the industry is changing so rapidly."

Despite the all-time high of grocery industry profitability, the changes in the industry including rapid consolidations and mainstream chain competition have made it harder for independents to operate a profitable store. "Growth is slowing, margins are going lower," Swanson said. "In order to compete, the food co-ops will need better operations and a distinctive niche. It will be tough, but we've done the right things to get ready."

In the food co-op sector, John Eichholz, a member of the general management team of Green Fields Market in Greenfield, Mass., said he thinks that during the past year part of this preparation has been about becoming not only a better retailer but also a better cooperative. Food co-op retailers are improving the tools needed to bring the co-op's message to the average consumer.

"There's been a noticeable emphasis on co-op values, social responsibility, and planning things based on those values," Eichholz said. In today's market, the food co-op sector cannot rely on the strength of the industry or natural products alone being a draw for consumers.

Nor is achieving success in the current marketplace simply about having one perfect formula. Along with strong basic operations, nearly everyone agrees that building a customer base means educating customers and emphasizing customer service.

IDENTICAL STORE SALES GROWTH, 2005-2006



Weighted average identical store Sales Growth for co-ops was slightly less than Whole Foods Market and significantly greater than Wild Oats Market. However, median identical store sales growth for co-ops was 11.6%.

* In August, a judge allowed the deal to proceed.

Trends in co-op retail operations

This past year, food cooperators trended toward improving the following operational programs based on both bottom line and value-added features:

- Customer service
- Prepared foods
- Buy local campaigns

LaMontanita Co-op Food Market, based in Albuquerque, N.M., operates in one of the more mature natural foods markets in the U.S. The competition is in your face everywhere you turn. “They want the same customers we do,” said C.E. Pugh, general manager of LaMontanita, which operates four retail locations and a wholesale facility. (For more on LaMontanita, see p. 16.) “This means we have to compete.” For LaMontanita, the year 2006 meant a strong focus on retail execution: better equipment and facilities, cleanliness and orderliness, and an emphasis on customer service.

“The days of taking the consumer for granted are coming to an end,” Pugh said. “We need to show concern for the quality of their experience.” In a crowded marketplace, Pugh believes that if you can take care of the customer, “you’ll be fine.” In addition, he thinks that knowledgeable customer service has not always been the competition’s strength, and this is something food cooperators can capitalize on. “The competition may be strong on price, variety, or presentation. We offer meaningful interactions, real humans who care about other human beings,” he said.

Pugh instituted a number of programs in the past year designed to increase the level of customer service at LaMontanita, including investing heavily in staff education, offering employees a gain sharing program, instituting department teams, and monitoring service levels through a secret shopper service. All of these programs have had “powerful results,” Pugh said, but making training a priority has been most beneficial.

LaMontanita now spends as much money on training as it does on its ad budget and looks at it as a means to draw and retain more customers. Department manager training is a particular area of focus because, from Pugh’s perspective, “Everything happens at that level.” He believes that by giving middle managers a better understanding of business principles and training them to train their staff, service levels will improve.

At Valley Natural Foods in Burnsville, Minn., general manager Susan McGaughey also marked 2006 as a year with a greater focus on customer service. Her strategy is to create a welcoming and educational experience that leads customers to be advocates for the co-op. “Twenty-five years ago my idea of good customer service meant knowing the product and being friendly. But we have to realize customer service is everything we do, it’s part of our brand.”

Inspired by Fred Reichheld’s book, *The Ultimate Question: Driving Good Profits and True Growth*, McGaughey looked at strategies for enhancing customer service that would answer the ultimate question: Would you recommend

this business to a friend? McGaughey is a great believer in the effectiveness of word-of-mouth for promoting the business. “Nowadays, people pick and choose what they see, making it harder for us to focus our advertising. We also need to reach people who don’t consume traditional media.”

Not only did she invest in training staff, McGaughey looked at strategic ways Valley Natural Foods staff could be more accessible to customers by keeping them out on the sales floor. For example, she greatly reduced the size of the wellness desk in that department and executed a major reset. Staff no longer stand behind the desk waiting to be approached, but are out in the aisles interacting with customers.

“Creating customers who will promote our business is something we will continue to work on into the future,” McGaughey said, “We’ve done it to a lesser degree in the past, but feel the need to give more personal service into the future.”

Foodservice an operational priority

In recent years, prepared foods and strong store periphery sections have been at the heart of successful natural food retailing. According to FMI, prepared foods comprised nearly 60 percent of supermarket deli sales in 2005, up from 38.5 percent in 2000. In 2006, NFM reported natural meat grew 18.2 percent, produce 11.5 percent, and food service 12.3 percent. Many grocers are redesigning or expanding their store delis and perishable departments to capitalize on this growth and better appeal to the senses and the desire to eat more healthfully.

In an effort to recapture dining-out dollars in favor of new and appealing meal solutions, food retailers including food co-ops have been ramping up their prepared foods departments: grab-and-go salads and sandwiches, heat-and-eat meal solutions, salad bars, juice bars, and cafeteria-style hot tables. Others are adding seating areas that provide a convenient casual dining atmosphere that serves as an alternative to fast-food restaurants.

Food co-op delis have generally tended to generate good sales. However, despite the potential for gaining customers, managing food service operations in food co-ops has also been challenging. Maintaining margin, keeping labor costs in check, offering favorable price points, attracting talented staff, keeping the case stocked, and creating the right mix of products takes commitment and expertise.

At Weaver Street Market in Carrboro, N.C., the co-op is in the process of opening a third location and launching a separate prepared-foods facility. The co-op also operates a restaurant, Panzanella. The demand for prepared foods has grown exponentially for Weaver Street, and that’s a positive trend. But as general manager Ruffin Slater puts it, “We can’t keep up.” As part of the answer to this issue, the co-op has developed an off-site production facility to alleviate pressure on the store kitchens as well as refocus the retail staff’s energy on the in-store experience.

Buy local campaigns

Many co-ops around the country are launching “buy local” campaigns that demonstrate the co-op’s commitment to community, the local economy, and sustainable food systems. Local food is also a strong trend for other grocers and chefs. The National Restaurant Association listed locally grown produce one of its top trends for 2007. Farmers’ markets have also been on the upswing and grew over 100 percent from 1994 to 2002, according to the United States Department of Agriculture.

Consumers recognize locally grown food is fresh, nutritious, and a logical choice for supporting local farmers. The idea of “food miles” has entered the food lexicon, and many people believe that food traveling a shorter distance is better for the environment. Consumer concern for how food is grown and where it comes from has begun to enter the mainstream, and conventional supermarkets are advertising their local connections. In recent months, high-profile food safety scares (spinach, peanut butter, pet food) have spurred even more concern for how food is produced.

Most food co-ops’ “buy local” campaigns attempt to reach beyond the feel-good factor for the substance behind their support of local food. At Green Fields Market, the co-op created an advisory board of distributors and growers to look at how to develop a sustainable food system. John Eicholz said, “We’re not just ordering off a sheet.” The co-op is seeking not only economic leverage but to create links up and down the supply chain based on relationships.

In the food co-op sector, people concur that “buy local” is a positive development and potentially a good niche for food co-ops, but some also express concern that it is a market advantage easily duplicated by competitors. In order for the co-ops to manifest their long-term vision of a truly sustainable food system (a concept that turns up in a lot of board ends policies), more work needs to be done to develop it as a marketplace position.

“We don’t do a good enough job explaining the ways we are better,” said Slater from Weaver Street. “For example, at Whole Foods you’d think everything there is local, because of their signage and such. It’s not, but they are better at telling it to customers.”

Growth and development

Most of today’s successful food co-ops are in their third or fourth decade. They have matured as retailers and as sector with evolving national program and support. Over the past three years, more than one-fourth of those co-ops have opened a new store, relocated to larger facilities, or undertaken a major renovation.

In addition, the focus of many of co-op expansions has changed. During the last decade, co-op expansions have concentrated on updating store formats—adding prepared foods or modernizing facilities—because chains like Whole Foods have raised the bar.

◀ ■ Ben Nauman, central corridor director for the National Cooperative Grocers Association (NCGA), believes food co-op expansions are entering a new phase. Price tags on expansions and relocations are getting higher, as co-ops seek to find the best possible locations and look at ways to make their stores distinctive. “Our member co-ops are not seeking to keep up with the Joneses, but responding to their members and what they want.” This includes considering alternative business formats and doing something innovative, including home stores, cafés and restaurants, or bringing in bakeries and wood-fired pizza ovens.

Another trend in some recent expansions includes Leadership in Energy and Environmental Design certification (LEED) or “green” stores. The cost savings in energy efficiency is attractive, and the expression of a co-op’s values is important in the community. But building a green store from the ground up is still an expensive prospect. Some cooperators struggle with what is the right balance of financial risk on these projects.

“I see a lot more remodels and state-of-the-art green stores, but I’m concerned they may be spending too much on fixed assets,” said John Eichholz of Green Fields Market. “On a macro level we have to be cautious of a real estate bubble. We don’t want to build a \$5 million dollar store that’s only worth \$3 million. Yet the competition is gaining market share because they are taking those risks.”

Time will tell if going for A-list properties and building “green” is a wise strategic investment in fixed assets. Green or not, expansions are risky endeavors. But it’s also possible to be too conservative. That’s a risk that increased competition has forced on food cooperators now.

“Do we want more people served by co-ops?” asked Walden Swanson of CDS. From his perspective, mitigating risk by not taking action isn’t an option. “We need to get better at positioning co-ops to take that risk, from a management and financial capacity.” Cooperators are taking steps, especially through NCGA and CDS initiatives, to prepare themselves for a future that may be very different from today.

Co-op as marketplace advantage

Food cooperators have begun revisiting ways to differentiate themselves in a crowded marketplace that go beyond products and get at the heart of cooperation. “Independent grocers are most vulnerable to supermarkets,” Nauman said. “So if they carry the same things, the face of the co-op in the community has to be very different.” Consumer ownership and the values inherent in that is the one thing competitors cannot duplicate.

“The co-ops bring connection to the consumer. That’s our biggest marketplace competence,” said C.E. Pugh from LaMontanita. “They are owners and connected to the business in a way no one else has. Frequent shopper programs? Junk. We speak to our members and they speak to us.”

As such, trust is part and parcel of that marketplace competence because cooperatives are community-owned businesses. As much as food co-ops recognize that as a competitive advantage, a lot of consumers don’t necessarily understand it. “It’s a good direction,” said Ruffin Slater from Weaver Street of “co-op” as a differentiator. “The challenge is to link it to things people care about. You can’t just say co-op is a better model. You need to focus on what that is specifically.”

In 2006, the NCGA began a cross-sector process to investigate messages that can help build awareness of the co-op advantage and find out what resonates with consumers in order to give member co-ops the tools they need for communicating “co-op” with their customers. (For more on this, see page 8.)

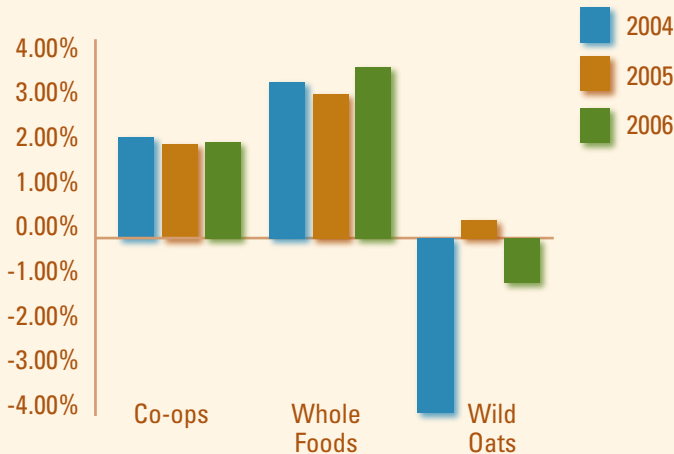
The other component to the “co-op advantage,” beyond reaching consumers, is leveraging the cooperative system as a whole to support individual co-ops in their quest to find meaningful differentiation. Some in the sector believe this is going to require a level of cooperation that goes beyond “I’ll take what I need from this program,” and shifts toward standardizing those operational matters that don’t affect the consumer or contribute to a unique marketplace positioning.

Many people envision utilizing co-op resources to develop more integrated management training programs at the regional and national level, creating modular formats for running similar-sized stores, offering expansion support, operational education, and improving networking capacity. It is through such steps that co-ops will be able to maintain the right scale and be effective leaders in their communities.

Just as many food co-ops joined forces five years ago through the NCGA, it’s time to make another big move to invest in food cooperatives’ success. “We need to invest collectively at a more aggressive level. It’s time for a bold step forward. It’s a real critical time right now,” said Ruffin Slater. “If we’re about just buying soymilk at 50 cents off, it’s a very reduced vision of what we can do. We need to ask, how can every single co-op be a leader in its community?”

COMPARISON OF OWNER EARNINGS, 2005–2006

(WFM and WOM net income; Co-ops net income plus patronage refunds and member discounts)



Co-ops weighted average owner earnings compare favorably with those of Whole Foods and Wild Oats.