

Why (Some) New Co-ops Fail

BY STUART REID

The mayor spoke at the co-op's ribbon cutting, and it seemed like the whole town turned out to celebrate. The local paper wrote excitedly about the new grocery store. The future seemed bright.

Nine months later, the fledgling store was begging members for additional cash infusions. Before its second anniversary, the co-op closed its doors.

This story is a familiar one, and we all know the unfortunate reality. Even with the resilient foundation of community ownership, not every new food co-op will survive. As we enjoy unprecedented growth in startup efforts, it is important that we understand why some co-ops fail so that others can avoid their mistakes.

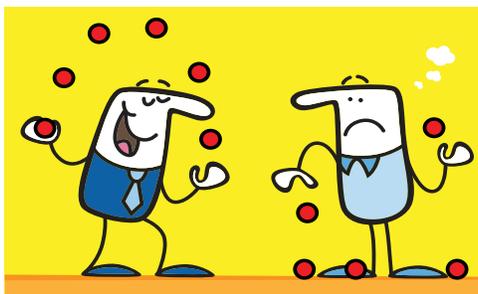
This article is based on co-op stores that opened during the past six years, encompassing almost all of the "Third Wave" startups. During this same period a few older, established, co-ops also folded. Although in some cases these established businesses faced issues similar to failing startups, the established co-ops' available resources were much different, and I have not included them in this analysis.

Our success rate is high!

While this article is about those co-ops that did not make it, I want to point out that the success rate of startup co-ops is actually very high. Of about 63 new retail co-ops that have opened since 2006, only 12 closed, or 19 percent. If you compare this to typical failure rates for new small businesses, it is a stellar record. (Established co-ops also continue to open additional stores, with a high rate of success.)

There are a few reasons co-op advocates may have the wrong impression of co-op success rates. Perhaps we pay more attention to bad news, or we are not doing a good enough job celebrating our successes. Almost all new co-ops struggle at the outset, and it is rare for them to be profitable until they have been in operation for three years—sometimes longer. This is to be expected and is typical of small businesses in any industry, but to outside observers it may look like imminent failure.

Not every co-op organizing effort proceeds to opening a store. Some realize that they do not have a viable opportunity; others have trouble maintaining community engagement through a long and demanding volunteer effort.



Whether they go on to create an online buying club or simply throw in the towel, we don't count them as new retail food co-ops or as failures.

Twelve closures is a small sample to work with, yet there are some clear patterns to be found. These patterns are reinforced when we look at co-ops that remain open but are struggling to achieve long-term viability. Co-ops that fail have common characteristics. Often, several of these aspects are seen, which should not be a surprise when we see how they are linked together.

Very small retail spaces (500–1,500 square feet)

There are many reasons why co-op steering committees are drawn to small retail spaces. In small rural markets, a lack of potential sales volume might seem to justify such a choice. (Population alone is not an indicator of high risk. Many successful co-ops are found in communities with populations of 10,000 or fewer.) Inner-city co-ops in high-density environments face genuine constraints on finding suitable retail space, and smaller convenience store formats may be the accepted norm. Yet, even in medium-to-large cities with a variety of site options, co-ops still seem drawn to small retail spaces.

Founders do not typically start out thinking small. They have other successful co-ops as models and want their own co-op to provide a comfortable, welcoming setting, a bounty of choices, service departments, a community room, etc. It does not take long to realize that this vision will require years of hard work and a startup budget of over a million dollars. Since startup costs are directly proportional to store size, a new co-op can open small with much less capital; raising less capital means fewer owner-members are required, and the timeline

can be shorter. Organizers tend to justify the reduced inventory and service capacity of the small store with the expectation that the co-op's mere presence will stimulate membership growth, provide basic services to the community, and springboard the co-op to realization of its ultimate potential.

Can these "downsized" co-ops succeed? Yes, and many of the newer food co-ops do have sites with minimal retail space. However, they often face financial challenges, weak owner support, and lack of competitiveness. One unavoidable consequence of being a small grocery store is the higher cost of goods that distributors charge for low-volume purchases. Perishables become loss leaders when you cannot sell them before they expire. There is not enough room to carry everything your customers want.

Sometimes, when a community truly supports their co-op, the new business can find a viable niche and survive. However, these survivors are still not likely to experience the growth and expansion that was expected to enable them to evolve into their original vision. How important is store size to success? Only one of the co-ops that failed had projected annual sales of over \$1 million. (Store size is an imperfect indicator of sales volume, but startups should not base financial assumptions on above-average sales per square foot.)

Startup budgets significantly below the co-op average

When new co-op organizers tell me that they can open for business with far less capital than other co-ops have required, it is time for a reality check. The typical cost is \$250–\$275 per square foot for a new retail co-op in a leased space. While a few successful co-ops have done it for less, this estimate is remarkably consistent across the country and for co-ops of many sizes. In order to reduce its budget, the co-op must benefit from substantial in-kind donations of professional services and labor, or it must cut corners.

Every line item in the expense budget has been underfunded by a startup somewhere, and more than a few co-ops have tried to open without enough funds allocated to any category. While used equipment might be acceptable, your working capital is likely to get tapped for higher operating costs and repairs. Skimping on renovations and store décor saves money up

front but may reduce efficiency and customer appeal. Bypassing a professional market study can save \$10,000–\$12,000—but it can also cost you your co-op. (This was a major contributing factor in several co-op failures.)

Unusually short or truncated development timelines

It takes a long time to organize a community to plan, capitalize, and open a new food co-op. Very few successful co-ops have done it in less than two years, and three–five-year development timelines are most common. Food Co-op Initiative has had a goal of helping to reduce the time it takes to open new co-ops by providing better training and resources to co-op organizers. Although we have seen a big improvement in the viability of many new co-ops and a less chaotic path to opening, typical timelines are still a protracted commitment for the volunteers that do most of the work.

It simply takes a long time to do everything that must be done, to recruit hundreds of owners, and to raise the necessary capital. When a co-op plans an opening after less than two years, it is important to know whether they have been exceptionally efficient or have skipped over essential development milestones.

The truncated timeline seems particularly prevalent when privately owned stores are converting to co-ops. There is often time pressure from the owners to complete the transaction and perhaps an overly optimistic assumption that a co-op can succeed where the existing business is struggling. Acquiring an operating business means that many of the organizing steps, strategic decisions, and renovations are already determined—for better or worse. Organizing community support, building membership, and raising capital still require significant time. This creates a tension that can result in co-op organizers taking shortcuts before the opportunity to acquire the business is lost.

Over-reliance on member labor

Member labor continues to be an attractive option for many new co-ops. With the promise of hands-on member engagement, lowered operating expenses, and discounts offered to attract interest in joining the co-op, it is not always apparent that member labor comes at a cost.

The arguments for and against owner-labor programs have been made many times, and this is not an attempt to bolster either side. Using member labor is not, in itself, an indication of a co-op at risk. However, when a new retail co-op makes financial projections based on a high percentage of volunteer labor, it is often indicative of an attempt to keep ►

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◀ operating costs low enough to show viability. Retail business is difficult, competitive, and sophisticated. Over-reliance on member labor is indicated when a dependable, skilled management team is not included in the labor budget.

Other warning signs

A store with limited hours of operation or half-empty shelves is clearly at risk and might be expected in a co-op that has run out of working capital. When a new co-op opens for business without enough capital to stock the shelves and pay staff, there is little hope of future success. These scenarios are probable outcomes of an inadequate startup budget.

Poor site selection can override all of the good organizing and business planning in the world. Sites that are too small have already been mentioned, and these are often exacerbated by other location issues such as poor visibility, difficult access, inappropriate neighbors, and inadequate parking. Finding an ideal site is often one of the most difficult tasks that founding teams must face. After a long search or lease negotiations that fall through, organizers may feel pressured to take whatever is available. As hard as it is to keep an anxious membership waiting, the best option is patience and

STUMBLING BLOCK:
We cannot convince people
to join anymore; they all want
to see the store first.

perseverance. Co-ops that use appropriate professional support to identify potential sites and evaluate their desirability are more likely to end up with a space that supports the mission rather than hinders its success.

All of these scenarios can be characterized as inadequate business planning and execution. Most of the co-ops who succumb to these shortcuts have been advised to use more reliable approaches and warned about the risks. Why don't they listen? Call it burnout, frustration,

FALSE ASSUMPTION:
The community will support us
(no matter what) because
we are a co-op and our mission
is so important.

impatience, or expedience; the reasons almost always revolve around inability to garner sufficient community support.

Co-ops often, perhaps almost inevitably, hit a member recruitment plateau after enlisting their friends and the most fervent co-op advocates. Some organizing teams are blessed with people who have the skills, talent, and enthusiasm it takes to organize their community around the co-op's vision. Others will struggle along, sometimes painfully, to get the job done. Ideally, these co-ops will seek training in member and community engagement or hire a project manager with these skills.

It is important to realize that a co-op is not likely to be able to generate enthusiasm for a poor business plan, regardless of how well it conducts its community outreach. Both aspects of organizing a new co-op are critically important.

Why do new co-ops fail, even when we know that shortcuts and poor business plans create undue risk? It may be that the organizers want their co-op so badly that they are willing to dismiss those risks and ignore experienced advisers, in the well-intentioned yet mistaken belief that the co-op can succeed—must succeed—because it is too important to fail. ■



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