

**A STUDY OF THE KEYS TO SUCCESS  
FOR START-UP FOOD CO-OPS IN RURAL  
AREAS**

**A report for Northcountry Cooperative Development Fund**

**University of Wisconsin Center for Cooperatives**

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## **A STUDY OF THE KEYS TO SUCCESS FOR START-UP FOOD CO-OPS IN RURAL AREAS**

The four grocery cooperatives studied for this report are all located in rural communities. Iron River Cooperatives (Iron River, WI) and Root River Market Cooperative (Houston, MN) are located in communities of about 1,000. In both cases, they are the only full service grocery store in the community. Iron River is in Bayfield County, a lightly populated county in far northern Wisconsin. 40% of the employed residents travel to neighboring counties for work, many to Superior and Ashland. Iron River Cooperatives is the only full service grocery store within a 30-mile radius. Houston is in Houston County, where many residents drive about 20 miles to LaCrosse, WI for work, or 30 miles to Winona MN. The co-op's 2000 business plan describes the trade area population as 3,175.

Viroqua Food Cooperative is located in Viroqua, WI, a town of 4,335. It is the only natural foods grocery store within a thirty minute drive of community residents. There are 32,000 residents in the two county trade area, with a growing "alternative" community, attracted to the Walden School in Viroqua and strong organic farming enterprises.

Tower Foods Market Cooperative was located in a rural area on property owned by the Sovereign Oneida Nation of Wisconsin. It was five miles from Green Bay, WI, a metropolitan area of 226,778 residents. A market study defined the trade area as 8,876 residents. The co-op was a project driven and supported by the Oneida Nation, which has 1,083 registered tribal households.

Each case study in this report begins by providing some background on the local community, and why it ventured to start a grocery co-op. What actually drove the process? A chronology of events leading up to opening day will proceed to an update from the fall of 2004. Each case will then be analyzed in terms of five components of the start-up process:

- The steering committee/board of directors
- Consultants and advisors
- The business plan
- The project and general managers
- The members and wider community

At the outset of this research effort, these five "building blocks" were hypothesized to be critical to the successful start-up of a rural grocery cooperative. Upon completion of the cases, further analysis led to a refinement of these components and identified eight common variables which actually go beyond the initial development process:

- Competition
- Support from other cooperatives and the community
- Member support
- Quality of the business plan
- Business growth patterns
- Market niche

- Board and management leadership
- Finance

Following the presentation of the four case studies, a comparative analysis of these eight variables will lead toward the identification of “keys to success” and “potential pitfalls” associated with the start-up and operation of cooperative groceries in rural areas.

## **ROOT RIVER MARKET COOPERATIVE**

This is the first of four case studies that explore the factors contributing to the successful start-up of cooperatively owned groceries in rural communities. Root River Market Cooperative of Houston, Minnesota is a full-service retail store providing a conventional inventory of foods and other grocery items.

### **BACKGROUND and CHRONOLOGY**

The banner on the local newspaper in describes Houston and the surrounding area as “The Best of Bluff Country”. The small city of 1,020 is located in the southeastern corner of the state. The co-op is named after the river that runs through Houston and continues east for twenty-five miles, pouring into the Mississippi River just south of the area’s largest population center, La Crosse, Wisconsin (52,800 residents, 2000 census). From the west, the new 42-mile Root River State Trail ends in Houston and draws tourist traffic to town every summer.

Houston is located in Houston County, about 12 miles northwest of the county seat in Caledonia. The county population of 19,718 is 98.5% white, with a per capita income of \$18,826. About 70% of the land in Houston County is devoted to agriculture. However, with a declining farm population, most area residents are not involved in farming, and many travel to La Crosse or north to Winona, MN for employment. In fact, many farms also send family members to those cities to earn supplemental income and health insurance coverage.

When city hall commissioned a feasibility study for a downtown grocery business, Houston’s primary trade area was defined as the 55943 ZIP code, which was said to contain 3,799 residents and 1,399 households. However, the co-op’s business plan, developed in 2000, would describe a slightly different target market: Houston and the surrounding communities of Houston Township, Money Creek, Mound Prairie, Sheldon and Yucatan—population 3,175.

Materials developed by the city of Houston in the late 1990s declared that 44% of the local population fell within the CACI ACORN neighborhood classification of “*Prairie Farmers*”:

*Prairie Farmers represent the farming community populations of the Plains states. By lifestyle they are classified as practical and conservative. (They) are more inclined to save than borrow at all. They are well insured, health and home, and generally apportion little of their budget for luxury items. Leisure activities include hunting, fishing, picnics, barbecues, and television.*

It is worth noting the two largest employers in the city of Houston are cooperatives: ACE Communication, a telephone cooperative, and Farmers Cooperative Elevator. Both of these would go on make substantial loans to help start the Root River Market. Tri-County Electric Co-op also serves the area, and it was that co-op's attorney who helped develop the incorporation documents. In addition, one of the Root River founding board members and her husband own a True Value hardware store in town, which itself is a member of a national purchasing cooperative. Even the Mound Prairie Mutual Insurance agency adjacent to the grocery has cooperative roots.

Perhaps the predominance of well-established co-ops in the area provided some inspiration when the community suffered the loss of its only grocery store in 1998. Prior to that, the residents of Houston had enjoyed access to a full-service retail food store for "eons and eons", according to Larry Connery, co-founder and current treasurer of the Root River Market. Originally from Chicago, he moved to Houston in 1972, when there were still two groceries in town.

The ten-year-old building in which the latest grocery operated had originally been owned by the wholesale grocery distributor Fleming, a Texas-based corporation. (Fleming would eventually declare bankruptcy in April 2003, after losing its biggest customer, Kmart.) According to Mr. Connery, Fleming had much earlier made a policy decision not to serve rural stores that could not purchase full truckloads. That may also explain the company's decision to sell its Houston property to the local city government in the 1990s.

Mr. Connery also explained that the former grocery closed because its owner, who lived and operated a primary grocery twelve miles away in Spring Grove, had decided managing two stores was too hard on his family.

Nevertheless, the Houston store had done reasonably well. To be exact, it earned a 5.99% net profit, annualized over its last three years. That data is known, because the previous owner shared his final three years of financial information with the city of Houston, which later passed the information along to Mr. Connery, the Root River Market board treasurer. The data was instrumental to projecting the co-op's own financial performance.

But before the co-op idea developed, Houston's Economic Development Authority spent about \$50,000 to attract private investors to re-open the store. It approached a major wholesaler in La Crosse. A couple from North Dakota took a long look at the opportunity but backed out. Another individual who considered it was Tony Densted, whose family had operated a grocery for several decades in nearby Caledonia, but had recently closed that store. He also turned down the opportunity, unsure whether there was sufficient community support. (A year later, the co-op would hire Mr. Densted as its first General Manager.)

After failing to attract a private company, a core of people in the community came together in early 1999 and decided to try a cooperative approach. One was Mr. Connery, a former IRS manager and now a self-employed tax consultant with over 30 years tax law experience. He was joined by Sharon Onsgaard, a retired elementary school teacher, and Peter Denzer, an eighty-year-old artist, author, and potter who had previously taught in Europe.

Mr. Connery explained that as they approached others for help, they did not look for specific skills, but rather they focused on people who shared their commitment to re-establishing a grocery in town. By the end of the spring, at least ten individuals had pulled together, including two farmers, a registered nurse, a former Corporate Account Manager for Hewlett-Packard, an office manager, a hardware retailer, and a pharmacist. While one of the founders had previously served on the board of a food co-op in Duluth, none of their group, Mr. Connery explained, really knew anything about the grocery business.

Nevertheless, they began meeting weekly, sometimes more, and by July they were fully committed to starting a cooperative. They put up a booth at Houston's annual Hoedown festival, and starting collecting membership fees and applications even before the co-op was incorporated. That happened on September 22, 1999, with the help of the electric co-op's attorney, who filed incorporation papers establishing the Root River Market Cooperative, Inc.

But there was still much to be done. Clearly one of the biggest challenges was raising the money to open the store, which they eventually determined would cost \$400,000. They knew that much of that would have to come from member equity, so they incorporated with two classes of ownership stock. Six hundred shares of Class A "voting" stock (one per member) at cost of \$100 each. A memberships covered a household, regardless of the number of individuals.

The Articles of Incorporation also authorized 800 shares of Class B stock, also valued at \$100 each. The organizers hoped the B stock would eventually pay dividends, but the board basically saw the shares as a way to borrow money from members. If all the shares from both classes of stock were sold, they would raise \$140,000 in equity capital.

By mid-February 2000, they had signed up about 310 members, raising over \$31,000 from Class A stock. But their sales of Class B stock generated only about \$5,000, far short of their minimum equity capital goal of \$100,000. At that point, an advisor at the Northcountry Cooperative Development Fund (NCDF) in Minneapolis pointed them to an attorney at the University of Minnesota, who, in turn, helped them establish what proved to be a successful vehicle for attracting member loans.

Her service wasn't free, "but it wasn't too bad," joked Mr. Connery. Among other things, the law professor helped the board to develop a Member Loan



The Root River co-op on Highway 16 through Houston, MN.

Program Information packet, which built on information from an earlier city-sponsored business plan, providing more realistic cost and income projections. The document also unveiled the new co-op's Mission Statement:

*...to meet the needs of the greater Houston Community with quality foods and grocery products at comparative prices in a friendly and helpful atmosphere. The philosophy of Root River is based upon the principles of cooperation and ethical concern for members, customers, staff and environment.*

The loan information packet also presented the “seven co-op principles”, as well as the board members' backgrounds, the terms of the loans, the store's target market and likely competition, and an explanation of what the money would be used for.

But perhaps most importantly, the document clearly explained that the venture would involve “a significant degree of risk.” It stated that their unsecured loans would be subordinate, meaning all other lenders would be paid back first if the co-op experienced cash flow problems or failed altogether. The report also explained that management had not yet been hired, and that the current board had “no direct experience overseeing the operations of a cooperative.”

The legal purpose of the document was to provide all the necessary information to members so they could make informed decisions. And apparently it worked. Before the doors opened, their fund-raising drive had raised \$139,700 in “non-secured promissory notes”, in addition to the \$31,000 in membership stock. The local telephone and farmer elevator co-ops each loaned \$10,000 to the effort. The terms of the notes included:

- Loans accepted only from Root River members residing in Minnesota.
- Notes are non-transferable.
- Loans will have a minimum amount of \$1,000.
- Interest will be simple interest compounded and paid annually.
- Interest rates, once determined, will remain fixed for the length of the note.
- Loans will mature in four to six years.

The final term for the promissory notes explained that the principle amount, the interest rate and the maturity date would be negotiated between the co-op and each individual. The maturity dates were selected as follows: \$26,100 came due (and was repaid) in 2004; \$30,700 will come due in 2005, and more than half, \$77,900, was loaned for the maximum six-year period. There was also a special \$5,000 note for 1 year that came in under special circumstances, and has also been repaid.

As for the interest rates that members negotiated, by way of example, the 2004 loans were distributed thusly: \$5,000 was loaned at 0%, \$1,000 at 3%, \$1,000 at 4%, \$9,100 at 5%, and \$10,000 at 6%. Over the full amount, \$25,200 was loaned at 0%.

Looking back, Mr. Connery said that raising the equity capital was probably the hardest thing, “asking friends and neighbors to trust us.” Both the membership drive and the fundraising campaign relied heavily on face-to-face solicitations, “talking to people we knew”, and through

community events like “chili feeds” and the annual Hoedown. They also did mailings, and put announcements into newspapers and on local radio.

It helped that most people in the area were at least somewhat aware of cooperatives. Most if not all belonged to the telephone and electric co-ops, for instance, and received notices of annual meetings and, in good years, patronage refunds. In fact, when another local farm co-op was bought-out, the farmers received a payout, and some of them turned around and loaned that money to the new grocery.

Once they had raised over \$170,000 in member loans and equity investments, it became easier to approach commercial lenders. First, the co-op went back to the Northcountry Co-op Development Fund, which specializes in loans to cooperatives, particularly in the grocery and housing co-op sectors. NCDF originated a loan for \$225,000 in partnership with the National Co-op Bank and Home Federal Savings Bank in La Crescent, Minnesota.

It is a common misconception that significant grant funding is available to support cooperative development. The experience of Root River is more typical. While Mr. Denzer, the octogenarian board member, was an accomplished grant-writer and did manage to secure three grants to support the effort, taken together they totaled only \$12,500, a small portion of the \$400,000 in total project costs.

The intended uses for the capital they raised were described in the member information packet:

Permanent cash operating minimum	\$10,000
Working capital – Year 1	\$40,000
Overrun allowances (10%)	\$37,500
Inventory	\$120,000
Equipment (POS System)	\$21,000
Equipment and installation	\$109,000
Leasehold improvements	\$32,500
Start-up promotion	\$3,000
Professional and consulting fees	\$10,000
Start-up staffing	\$15,000
Loan fees	\$6,500
TOTAL	\$404,500

It should be noted that one item missing from the list is the cost of the building. Because the city of Houston owned the building and wanted to see a grocery established there, it negotiated a deal with the co-op that included no rent payments the first year. In Year 2, the co-op would pay \$224 per month. In Year 3 they would pay \$224 plus pay the property taxes. Thereafter the rent would rise until it reached \$1,000 per month at the end of 2005. Essentially, the city’s subsidy of the project in the first 3 years totaled \$30,000, not including the foregone property taxes. In addition, the co-op held an option to purchase the building.

Once the funding was secured, it was necessary to begin the work of designing and equipping the store, selecting a wholesale supplier, hiring management, and taking other steps to make opening day a reality.

A few years earlier, when Houston public officials were taking the lead in reestablishing a grocery in Houston, they had called upon Affiliated Foods for help developing the store's layout design and to identify its equipment, inventory and other operational needs. (A wholesale distributor based in Norfolk, Nebraska and serving 12 Midwestern States, Affiliated Foods also happens to be a cooperative, owned by its participating retail customers. "Retailer-owned cooperative" have long played a significant role in the food distribution channel.)

By early 2000, the co-op contracted with Mel Braverman to help further refine the store's layout, design and equipment needs. A consultant with Cooperative Development Services (CDS) of Madison, Wisconsin, Mr. Braverman started with the plans developed by Affiliated Foods, but the 7,200 sq. ft. building was still completely empty when he arrived. They still had to run new freon lines, install a walk-in cooler/freezer, and put new refrigeration system in place, among other things. Mr. Braverman also helped the board recruit its first General Manager.

About that same time, the board approached Affiliated Foods again as a potential supplier. But with its hub in Nebraska, it made only weekly deliveries to the area. They also considered going with Fleming, but as mentioned earlier, they perceived a bias by that company against small rural groceries. Ultimately, they picked a wholesale distributor on the recommendation of Tony Densted.

Mr. Densted had had a good experience working with Certco when he managed his family grocery in nearby Caledonia. Until very recently, he explained, the Madison-based distributor "didn't even have voice mail", which to him was a positive indication that they were an old-fashioned, friendly company that took the time to provide personal customer service. The board also valued the fact that Certco's largest customer, Woodmans, a Wisconsin-based chain of superstores that had just opened a new store in La Crosse. That meant Certco would be just 25 miles away on a daily basis, and they would be able to count on a continuous and dependable inventory.

Mr. Densted had previously declined the opportunity to open a store in Houston himself, because he wasn't sure that the community could it. When 310 households paid \$100 each to join and loaned almost another \$140,000 to the effort, he reconsidered the opportunity. The board initially hired Tony on as a consultant around Easter of 2000. By June he was hired as the General Manager working full-time on the project.

Finally, on Presidential Election Day, 2000, the Root River Market Cooperative opened its doors for business. The store offered 5,200 square feet of retail grocery space and also housed a privately owned pharmacy in the back of the building.

One of the people involved early in the project was Tom Witt, a pharmacist from Iowa who wanted to open a branch business in Houston. The pharmacy would appear integrated into the store's design. Open from 10am-2pm hours in the middle of the day, it was hoped the second

business would draw additional customer traffic to the grocery. Seeing that mutual benefit, the co-op agreed to rent the space to Mr. Witt for just \$200 per month.

### **MISSION ACCOMPLISHED?**

Despite all the planning, Mr. Connery admitted that there was still a lot of uncertainty. They were not really sure what their overhead costs would be, for instance, nor did they have any guarantee of what level of sales they would generate. Their market analysis had projected they would capture 1/3 of the target population, with an estimated 1,058 customers spending about \$30 per week, or over \$1.5 million annually. To be conservative, they lowered the projection for the first full year to \$1.2 million in gross sales, which was more in line with the previous grocery's sales.

As it turned out, they generated \$1.06 million in Year 1—about 12% off the mark. They had also underestimated the cost of operations. “Not a lot,” the treasurer admitted, “but labor costs in particular were higher than expected.” The first manager, Mr. Densted, agreed that the cost of employing one GM and three department managers was more than the store's income could support.

Sales have been split about 50-50 members-to-non-members. Located on State Hwy 16 near a popular state park, their summer business has been heavier as expected. The current average sale-per-customer was estimated at about \$13. That's less than half of the \$30 estimate they used to make their initial financial projections. Presumably they attracted more customers than the 1,058 they predicted, or else they would have achieved only \$715,208 in sales

In recent years, the co-op's gross sales have held steady at just over \$1 million. Net margin or profit has tended toward a loss of 1% or less. Their gross margin held steady at about 25% over the first five years.

Unfortunately, they were forced to eliminate the meat department manager's position, and in subsequent years that salary savings made a significant difference in the bottom line. The foresight to request meat cutting experience from their General Manager proved correct. Mr. Densted now manages that department as well as his general responsibilities. Total labor costs in 2003 were \$146,795, or 53% of operating costs and 14% of gross sales.

In addition to the four managers, they have one other full-time position, and employ up to 15 part-time workers, mainly high school and college students, during the busier tourist season. In the first four years, aside from letting the meat department manager go, there has been no turnover among the full-time staff, though of course the part-time students come and go. Unlike the case of “natural foods” cooperatives in cities like Minneapolis, La Crosse and Madison, they do not have any “volunteer” workers.

The store opened with 310 member households. At the end of November 2004, there were 419. Given Houston County's average 2.58 persons/household, the co-op's membership implies 1,081 individuals.

Most of the new members joined soon after the doors opened, perhaps waiting to see if it was a sound investment. The cost of membership remains \$100. Customers provide their

“member number” when they pay at the register, although cashiers have many of the numbers memorized.

When the co-op first opened, management set up a table in the front of the store and handed out applications. But they are not pushing memberships very hard now, figuring



The pharmacy in the corner of the store opens 10 am to 2 pm each day.

They do get quizzical looks from tourists and other first time customers when asked for a number.

They offer some member specials, but no discounts. Mr. Densted said the biggest member benefit should come after they get their debt paid off and can start returning patronage dividends. Most of their business is indeed done with people living in the Houston ZIP code. About 25 of their members used to live in town and bought memberships. Some have parents there and want them to have a grocery and pharmacy. Others plan to retire back to Houston and want the same.

As expected, the pharmacy has drawn customers, particularly elderly residents, and Mr. Densted noted that its mid-day hours draw customer traffic at a time of day that would otherwise have less traffic and fewer sales in the grocery business.

The store does not sell beer, wine or cigarettes. Given their dependence on student labor on evenings and weekends, the manager explained the risk and liability would not be worth the added income. The store has a deli, whose manager faxes about 27 menus out to businesses around town. She does trays for weddings, graduations, and other events, and has extensive background in food service.

Perhaps the best indication of the co-op’s success is the fact that they have purchased their building from the city in the summer of 2004. As Mr. Connery explains, “When we acquired the building we also restructured the prior debt. Consequently the new monthly loan payment was less than the old monthly loan payment. The difference will allow us funds to be used towards redemption of the unsecured member loans.”

As the General Manager noted, “The bank must have thought we were doing OK.”

## FACTORS AFFECTING START-UP AND SUCCESS

This case study of Root River Market Cooperative will conclude with an analysis of five components of the start-up process that appear to be critical to success. They are presented in an order, which, in a very general sense, seem to reflect the chronology of the co-op development process.

### A. The Steering Committee/Board of Directors

Incorporation statutes for cooperatives vary from state to state. For instance, in Wisconsin, state statute Chapter 185 requires five individuals to form a cooperative. In Minnesota, Chapter 308 (A and B) requires only one original incorporator, although it requires three-to-five board members depending on the type of co-op.

Regardless of the requirement, one of the first and most critical steps in developing a successful co-op involves pulling together a core team of founders. Prior to incorporation, this group is often called a steering committee. Once incorporated, they may serve as the interim board of directors until formal board elections are held at the first membership meeting. It also becomes their job to hire the General Manager, and then continue to govern the organization after the business opens.

In the case of Root River Market, the co-op was formed fairly early in the development process, so the steering committee evolved quickly into an interim board of directors. Clearly, the make-up and on-going commitment of these founders was among the project's strongest features.

Through two years of development and now four years of operation, many of the original leaders continue to serve on the board. Merle Borchers, who worked for NCDF at the time and provided advice to board early on, agreed that this group of co-op founders was special.

*They had a very good steering committee with a balance of skills. It was not the typical case of one person doing 80% of the work. Larry Connery, a retired IRS agent, understood numbers, figures, and financial statements. Another person was good at getting grant money to support studies and planning; another person focused on store property and worked with city. People had specific responsibilities and they reported back.*

Ranging in age from their mid-40s to over 80 years old, the nine original board members absorbed a lot of out of pocket costs and contributed hundreds of volunteer hours. Mr. Connery estimated that his time and expertise would have cost thousands of dollars. It was not uncommon for him and other board members put in 8-10 hour days at the peak of the process.

The co-op's first manager recognized the strength and commitment of these founders. "The original board was very determined," Densted explained. "They just dug in and they were going to have a grocery store, period."

The co-op has since revised its by-laws and reduced the board to 7 members, and they are now paid a small stipend of \$150 per year. Five of the original founders were still serving on it at the end of 2004, almost six years after the idea for a co-op was first presented.

## **B. Consultants and Advisors**

Another indication of the effectiveness of the Board of Directors was its judicious use of consultants, advisors and other external resources. An “advisor” is defined here as anyone who provides information and advice free of charge.

Clearly, the tax and financial experience of Mr. Connery reduced their need to pay outside consultants. But he and the other board members lacked experience with the grocery industry as well as the cooperative development process.

The board was fortunate to acquire for free the consultation that Affiliated Foods provided the city of Houston prior to the co-op effort. Likewise, the financial records that the former grocery owner was extremely valuable resource that came at no cost. The board also tapped expertise at Northcountry Cooperative Development Fund for free advice on governance.

The board tapped two different attorneys to handle the separate legal issues of incorporation and the drafting of member loan documents. Finally, they contracted with Cooperative Development Services to refine and extend the plans developed by Affiliated Foods.

It appears that the board recognized what areas of expertise and skill it needed but could not provide internally. They paid for the consulting services with a handful of small grants and with the equity and loans entrusted to them by the members.

## **C. The Business Plan**

In some ways, a business plan for a cooperative is not substantially different than it would be for any other type of business in the same industry. True, its organizational and financial structures—member equity contributions, patronage refunds, equity redemption plan, etc.—are unique and require specialized knowledge to develop.

But what every business plan must provide, regardless of the form of business, is a sound analysis of the market, a marketing and operational strategy to succeed in that market, and the means to capitalize the business to carry out that strategy.

The founders of Root River Market Cooperative were able to mine real market information from the financial documents provided by the previous grocery’s owner. They were also able to pour over a business plan that the city had previously commissioned. They tapped the knowledge of consultants and advisors and used their own local knowledge to substantiate and improve upon that data.

The plan stated very clearly who their competition was. People in their target market were already shopping at the Wal-Mart Superstore in La Crosse to the west, or the new HiVee store in Winona to the north. Many of Houston’s residents are employed in these larger cities

and shop there after work. There are also full-service groceries in nearby Caledonia and Rushford.

As they explained in their Member Loan Program Information packet, they hoped to draw customers from surrounding communities as well as tourist traffic anticipated from the soon-to-open state bicycle trail. They hoped that one-third of the target population of 3,175 “will become members and/or patronize Root River Market.” They planned to achieve this goal by providing “courteous, friendly, knowledgeable and helpful management and staff, selection, quality and price sufficient to meet or exceed customer expectation, clean and attractive environment and customer loyalty due to equity investment.”

Their business plan described a product mix of “fresh produce, meats, dairy products, and other dry and canned goods. Our aim is to provide the highest possible quality at the lowest possible price with excellent customer service.” Based on community interest, they planned “to use local suppliers for produce, meats and baked goods whenever possible.” (After the store opened, they tried some natural foods but, the general manager explained, they “couldn’t get enough turn on it.”)

The business plan also had to present a strategy to capitalize the venture. The total cost of the project, not including voluntary labor contributed, was estimated at \$400,000. As mentioned above, the plan established a minimum goal of \$100,000 equity capital. When they raised over \$170,000 from stock sales and unsecured member loans, that was enough to convince conventional lenders to kick in the rest. As Mr. Borchers of NCDF explained,

*The board recognized that the lender was their partner, and they developed a reasonable financial structure—equity-debt ratio, terms of debt, etc. Sometimes a supplier will contribute a certain amount of inventory—for promotional reasons, to secure shelf space—and that was also part of financial structure. The electric co-op kicked in some money. Home Federal got involved. The board also saw a difference between the “macro” numbers that consultants tend to use (“This many people in community means this many square feet, this much for deli, this much for meat, etc.”), versus the “micro” of how is this going to work. And that’s what lenders are more concerned with, the details. The board took responsibility for their plan, which is what a lender likes to see.*

#### **D. The Project and General Managers**

In co-op development projects, the board of directors may contract with an individual to manage development operations. In the case of Root River, the board handled most of those duties, though they did contract briefly with Mel Braverman of Cooperative Development Services to handle development tasks associated with opening a new grocery.

In some situations, a co-op may select and hire its General Manager well before the business actually opens. When that happens, the person may take over the functions of the project manager. However, the skills and knowledge needed to guide a business through the development phase are not always identical to those that are needed to manage an operating business. A new co-op board is fortunate when they find one person who can do both very well.

The Root River Co-op board was prepared to pay a salary of \$25,000-\$30,000 to attract the right person for the GM position. The advertisement they posted in area newspapers described the background they desired and the responsibilities of the job:

***We are looking for an individual with:***

- *Work ethic demonstrating honest and integrity*
- *5 years of industry experience, including purchasing*
- *Excellent planning and organizational skills*
- *Excellent people management skills*
- *Excellent customer service skills*
- *Marketing / promotional skills*
- *Effective decision making skills*
- *A dedication to community service*
- *Meat cutting experience*

***Responsibilities will include:***

- *Regular reports to the Board of Directors*
- *Marketing, advertising, promotional management*
- *Day-to-day operational management*
- *Supervision and training of staff*
- *Meet budget and profit projections*
- *Purchase inventory*
- *Stay abreast of industry and supplier trends*
- *Building maintenance*

Board treasury Connery explained the background of the man they hired:

Tony Densted was raised six miles from Houston, one of ten children. He attended elementary and high school in nearby Caledonia. He got a BA degree, married a local girl and then managed his father-in-law's family-owned grocery for 25 years. The store was well known in the area for quality meat. Tony gained meat cutting and marketing experience. Tony was involved in that city's civic and community organizations. He knows a very large number of people in and around the area and is well liked by everyone. He is very likeable and has a pleasant word for everyone he comes in contact with. It is his requirement of all employees that they are sociable and friendly to all customers at all times.

A site visit to the store in October 2000 confirmed this characterization of Mr. Densted, who took over at the cash register on a busy afternoon for a sick employee. He appeared quite cheerful and familiar with all of the customers, while fitting the interview into the occasional breaks in business.

When asked what Mr. Densted's compensation, Mr. Connery said simple "it is commensurate with his ability, experience, availability of qualified individuals and the area wage scale."

## **E. The Members**

It is first worth noting that the directors of a co-op board are usually the first to join as members. They then try to convince others to join and to raise enough equity capital to finance the business.

There comes a point in the co-op development process, typically during the equity drive, when the support of the members becomes critical. It is clear from the case of Root River Market that the members stepped forward at that juncture, investing and loaning \$170,000 toward the \$400,000 of capital required.

Thanks to its summer business with tourists, Root River Market generates 50% of its business from non-members. But to maintain a grocery year-round, the on-going patronage of co-op's 419 paid members has kept the store in business.

## **CLOSING COMMENTS**

This case will close with a brief consideration of the comparative importance of the five so-called "building blocks" of successful co-op grocery development in rural communities. These conclusions can then be compared with those of the other three case studies.

In considering the nearly two-year development period that preceded the opening of Root River Co-op, it becomes apparent that the strength of the Board of Directors was a major factor in that successful start-up effort. The expertise and many hours that board members contributed saved the co-op thousands of dollars.

While consultants and advisors as a result played a fairly modest role in the development process, they did provide important information and services that were critical to the process.

The co-op's business plan, particularly as it appeared in the member loan document, appears to have been quite thorough and based on realistic numbers. The strength of that document most likely helped convinced members to contribute \$170,000 in unsecured loans equity investments.

After all the hard work of starting the business, everything might have collapsed if the General Manager was not up to the task. The description of Mr. Densted provided by the co-op's treasurer does not provide a complete perspective of his management capabilities, certainly his good rapport with customers and employees have contributed to the store's success so far.



GM Tony Densted emphasizes friendly customer service.

Perhaps on par with the strength of the board of directors, the commitment of the members must be considered a major factor in the development of Root River Market Cooperative. Without their substantial financial contributions early on, and their steady patronage of the business over the past four years, there most likely would not be a grocery store in Houston, Minnesota today.

## **VIROQUA FOOD COOPERATIVE**

This is the second of four case studies that explore the factors contributing to the successful start-up of cooperatively owned groceries in rural communities. The case of the

Viroqua Food Cooperative represents the only “natural food” store in the study. While its niche market status presents very different circumstances than most conventional groceries would face, its story provides an excellent example of the “start small and grow” approach to food co-op development.

## **BACKGROUND AND CHRONOLOGY OF START-UP**

The unglaciated hills and valleys of Vernon County, Wisconsin have attracted successive waves of immigrants over the years. According to the *La Crosse Tribune*, “Norwegian and German immigrants established homesteads there in the 1800s because the terrain reminded them of their native land. Norwegian Lutherans took to the valleys and German Catholics to the ridge tops.”

The county population reached 28,351 in 1900. One hundred years later, it held steady at 28,056. Nevertheless, things have changed.

Near the center of the Vernon County, at the intersection of several well-traveled rural highways, is the county seat of Viroqua. According to US Census, 47% of Viroqua’s 4,335 residents in the year 2000 still reported Norwegian ancestry. 32% were German. But over the past several decades, various new groups have settled in the area— the Hmong, the Amish, and another group for which the US Census does not keep separate data.

In the 1970s, they were known as “back-to-the-landers”. In the 1980s and 90s, they came from all across America to send their children to the Pleasant Ridge Waldorf School, a private K-8 school that was established in Viroqua, based on the teachings of the Austrian philosopher Rudolf Steiner. Others came to work at the nearby CROPP Cooperative, an organic dairy company that started in 1988 that has grown by leaps and bounds.

They describe themselves as the “alternative community”, although after a quarter century, Bill McDonald joked, they have started getting some acceptance from the locals. Trained as an engineer, he and his wife moved to the area in 1990 and bought an old farmstead. She started a home business called Magic Cabin Dolls, selling “Waldorf-style” toys and crafts. By 1996 they had sold the business to a mail order conglomerate, but continued to run the operation along with their fifteen female employees.

Having settled in rural Wisconsin, they sought out a source of “natural foods” that fit their values and lifestyle. The hour-plus round trips to stores in La Crosse and Gays Mills grew tiresome, so for the sake of convenience, Mr. McDonald started “food buying club” in 1991. He coordinated orders with other like-minded neighbors and made bulk purchases from North Farm Cooperative, a natural foods distributor in Madison.

After running the club out of his milk house for five years, he was approached by the manager of another club in nearby Viola. The Viola group actually had a storefront with retail sales, but it was a much smaller community and was reportedly struggling to stay afloat. Mr. McDonald’s group meanwhile had grown to about 40 families, and it was becoming more than he could manage alone.

He and the Viola manager proposed to their respective members a merger and a move to Viroqua, which, with its Waldorf school, had become a hub of the alternative community. While the members of the Viola club voted down the idea, McDonald and his group decided to proceed toward a new Viroqua location.

While there were several cooperatives of long standing in the immediate area (providing electricity, telephone service, credit, insurance, etc), the group was actually guided by the experience of hundreds of natural food co-ops around the country, many of which began in the 1970s.

The new Viroqua group moved quickly to incorporate as a Chapter 185 Wisconsin cooperative. They received free and substantial support from Jerome McGeorge, a local “financial expert” who had earlier been instrumental in the start-up of the successful organic dairy co-op in nearby LaFarge. (His son would later sit on the grocery’s board of directors.)

One advantage to starting very small is low capital requirements. And with less at risk, planning for the business can be somewhat less formal. “A business plan? We might have

gotten a book somewhere that gave us some idea of what we should think about,” explained Mr. McDonald, the co-op’s first treasurer. “But it was a lot like a household budget: this is what our rent is, this will be our utility cost....”

While the new board of directors may not have written a business plan or used professional consultants, they did have five years experience operating a buying club of forty core families, with financial records that clearly showed committed demand for natural foods. Based on some very rough calculations, they determined that they would need about \$20,000 to get the store up and running.

Their incorporation papers had established two classes of stock. Class B shares were the voting stock—one per adult. In an unusual move, the cost of the shares was set at a sliding scale rate of \$18-\$26, which had to be paid annually.

The co-op’s Articles of Incorporation also authorized \$50,000 shares of Class A stock, although it would be many years before they sold that amount. As it was initially set up, the Class A shares would not pay any interest or dividends, but they would eventually be redeemed at par value. “Basically, we were just asking people to let us use their money for free.”



The current location of the co-op, one block removed from Main Street.

According to the US Census, Vernon County's median household income in 1999 was \$33,178, or 24% below the state average. 14% of the population was living at or below the poverty rate. But the city of Viroqua has generally fared better, with its county government jobs, and other employers like the Vernon Memorial Hospital and two utility co-ops. There was also that growing influx of new residents from the east and west coasts, drawn to Waldorf School and its alternative community.

Fully half of the new co-op's financial goal was met when one couple bought \$10,000 of Class A stock. As McDonald said, "They definitely got the co-op off the ground. It helped tremendously." The rest of the necessary funding was provided by smaller contributions from the forty or so families that formerly comprised the buying club.

And so they started looking for property. They found a very modest but suitable building one block east of Main Street. The owner would not sell it, but he offered very cheap rent: \$300 per month for 1,900 square foot building. Without formal authorization from his fellow board members, Tom Jerde went ahead and paid the first two months of rent, which essentially settled the issue of location. Considering this "executive decision", Mr. McDonald said, "Well, we were pretty anxious to get going, and we all got along well enough, so it was OK."

Mr. Jerde was also an electrician, and his skills would be needed. Another board member, Chris Cox was a contractor who found used coolers and other low-cost materials and equipment. As Mr. McDonald explained, "In the very early days, the most important founders were those who had construction skills."

A core of about twenty individuals began meeting on average about twice per month for six months. Many of these were "construction meetings", in the sense that they worked together to remodel the old building, and met afterward to discuss business. Often spouses attended the meetings too and took on various tasks. Cox's wife, for instance, designed the stock certificates. In fact, looking back eight years, Mr. McDonald couldn't readily recall which spouses actually served on that first board.

Regarding their communication efforts, Mr. McDonald said, "Back then, we weren't constantly emailing each other, but there were lots of phone calls. It was ten to fifteen families that were really driving to make it work. We didn't get bogged down with the meeting scenario per se, there was no public notice of meetings, for instance. Nobody (in the rest of the community) probably knew what we were doing half the time."

Nevertheless, as the remodeling continued, people started coming "out of the wood work" expressing interest. "We didn't have a marketing strategy really," explained Mr. McDonald, "We had our original forty buying club members. But there were other people having the same problem we had, having to drive all the way to La Crosse or Gays Mills to buy (natural foods)."

Dave Ware, a volunteer carpenter for the project who currently serves as board president, recalled that it was only days before opening that a decision was made to hire part-time staff, and Sally Colacino and Sue Kastelson became the first "co-coordinators". Ms. Colacino had previously worked for natural food co-ops in other cities, so she chose and developed the inventory for the retail operation.

When the doors finally opened in September 1995, the store offered about 600 square feet of retail space and the co-op had 95 members. At that time, the board invited the larger community into a “stakeholders meeting” to get input for developing a mission statement and a vision for the co-op. Twenty-five people attended the session, which was facilitated by a former business professor from California who had moved to the area.

Over the years, the document would be refined, declaring “a commitment to natural foods, superior customer service, and the building of a cooperatively run business.” They would achieve that by offering “one-stop shopping for natural food customers, with high quality products, friendly and informed service, and competitive prices.”

### **MISSION ACCOMPLISHED?**

Early on, the store continued to operate more along the lines of the buying club model. Forty to fifty percent of purchases that first year were members’ personal orders for cases of products. Explained Mr. McDonald, “Now we all had a store where we could come pick up our orders. So we had a few things in there that people could grab. To cover our costs, we charged 10% on top of people’s bulk orders, and for items in store we had a flat rate 30% mark-up. We had milk and some local produce. It was like the classic co-op in the ‘the old days’. Bring in your own bags, fill up on bulk flour and grains....”

For the first several months, board member Cox kept the books for the co-op at his home, because there was no computer in the store. “Nowadays no one should have to start out that way,” explained Jan Rasikas, one of the early co-coordinators, “Computers and QuickBooks are cheap and available.” (She was reminded that 1995 was not so long ago.)

While the first four months of business were not presented in the latest computer printout, current records for the first full year of operations in 1996 showed \$174,330 in gross sales; \$138,279 for the cost of goods sold; and a gross margin of 23%. They had about \$19,000 in personnel expenses that year, representing 11% of their sales, and they showed a loss on the books of \$1,343, or less than 1%. Data for subsequent years is shown in Table 1.

According to the Cooperative Grocer, a major trade publication for the natural foods industry, the co-op’s 2003 financial performance was on par with stores of its size. In the category of “small” stores (under \$2 million in sales), the Viroqua store was near the median quartile in both gross and net margins. The number of employees grew to the current level of eleven part-time and six full-time staff. Total labor costs as a percentage of gross sales rose from 11% in 1996 to 22% in 2003, the latter once again on par with stores of its size.

It should be noted that the co-op did not take out any commercial or institutional loans to capitalize start-up. About a year or two after opening, however, they did approach Northcountry Co-op Development Fund for the first of three small loans to finance equipment and other needs for their current store. (Later NCDF would later provide a fourth loan for their new store.)

In the co-op’s first several years, there was considerable turnover in the co-coordinator positions. In 1998 these positions were combined into a single General Manager position. Over the next ten months the co-op’s first GM, Meg Torrence, coordinated a “mini-expansion” which

	Gross Sales	Gross Margin	Net Profit	Labor Cost as a % of Sales	Sales/Sq Ft
1996	\$174,330	23.0%	-0.8%	11.0%	\$290
1997	\$261,280	25.3%	0.5%	10.8%	\$435
1998	\$344,050	26.5%	2.0%	13.0%	\$573
1999	\$435,406	30.6%	1.4%	16.0%	\$725
2000 *	\$533,864	29.3%	0.4%	18.1%	\$580
2001	\$633,997	28.6%	-1.7%	22.7%	\$689
2002	\$854,639	32.6%	2.0%	19.9%	\$929
2003	\$1,072,968	33.7%	1.3%	21.8%	\$1,166

TABLE 1 (\*Expanded store from 600 to 920 square feet of retail space.)

actually shrunk and rearranged office and storage space in order to increase retail space from 600 to about 920 square feet.

While it was becoming obvious that the business would soon outgrow the building, the mini-expansion was a practical way to increase sales in order to justify a move to a larger facility in the future. This next development step proceeded much like the initial start-up process—lots of volunteer labor to install drywall and locate low cost materials. They also raised another \$15,000 in Class A stock, and computerized the office so that bookkeeping could finally be done “in-house”. In addition, the landlord also made some improvements, and raised their rent to \$450, which was still very modest.

When Ms. Torrence left the co-op in October 1998, the co-op asked board member Jan Rasikas to apply for the General Manager position. There were several other applicants but after a full interview process, she was hired.

Ms. Rasikas and her husband had moved to the area in 1996 from Ashland, Oregon to enroll their son in the Waldorf School. They brought along a couple of business plans, including an idea for opening a private natural food store. They soon learned of the co-op effort, and in fact she served for a time as a co-coordinator. She left that role to work for CROPP Cooperative in nearby La Farge prior to taking over management of a grocery business bursting at its seams.

In February 2001, the co-op invested in a computerized point-of-sale (POS) system for record keeping, which would allow them to compare their data and activities to industry standards and trends. That, in turn, would allow them to identify and correct practices that were not profitable. For instance, they were able to manage their inventory more efficiently and strategically, and they also kept a closer eye on the cost of discounts and specials for members and volunteer workers, which were taking a toll on the bottom line.

“We stretched ourselves,” explained Ms. Rasikas. “We were a very small store, but we stretched for the kinds of tools and systems that the larger stores use.” They found and adapted a POS system that they could afford. They often went begging to other companies like CROPP to be allowed into their management training programs, and they joined what was then the Midwest

Co-op Grocers Association. “It was an incredible boost of peer support for us and training opportunities, but it was tough for us because annual dues were high for a small store, \$2,000 to \$3,000, but the training opportunities were well worth it.”

In 2001 the co-op converted from an annual membership fee system to an equity-based system. Each adult is charged \$75 for a share of voting stock, with optional payment plan. This was done primarily to improve their books, because the annual fees were treated as taxable income, whereas the equity is not.

It was all part of an overall effort to generate enough business to afford to move in the future to a larger store offering better service for members. Key to that effort was their relationships with wholesale distributors.

Being such a small store in a rural area, keeping the shelves stocked with natural foods was not easy. The two major distributors at the time, North Farm Cooperative in Madison and Blooming Prairie Cooperative in Iowa, initially came to town only once per month. They eventually increased to twice per month, but that was not enough to keep consistently shelves stocked with perishable goods. Getting fresh produce delivered was sometimes impossible, and they had to send a truck to La Crosse to pick up a pallet. They simply needed to achieve more sales in order to justify weekly deliveries from distributors.

By 2002, there were two major developments in the natural foods industry in the Midwest. North Farm Cooperative went bankrupt, and Blooming Prairie was sold to United Natural Foods, Inc, of Connecticut. Both events were a reflection of the increased competitiveness in the natural foods industry. As a member-customer of BP, the Viroqua Food Cooperative received a substantial cash payment from the “gain on the sale”.

Halley Blessing, the co-op’s current finance manager, points to that sudden windfall as another example of good decision-making by the board of directors. “We could have just applied it to the co-op’s income that year and recognized a sizable profit. Instead, we used the money to pay for help to clean up our books, and we wrote off some past losses. As a result, we ended up with much more accurate financial records, which became very important later.”

By the end of 2004, sales for the year are projected to reach \$1.3 million. The co-op currently has 1,000 members representing 635 households, with 82.5% of sales going to members. Their rent is now \$550 per month. Space is very tight. Extremely limited retail space means employees must be constantly stocking shelves. When deliveries arrived, a “musical chairs” of pallets in the storage areas and coolers almost became comical. The time has clearly come for a new store.

Looking back, board member Jerry McGeorge explained, “We’ve really been starting for nine years, constantly reconfiguring, while we got our financial legs under us so we could support a decent sized endeavor here.”

In 2002, the board had commissioned consultant Pete Davis to conduct a feasibility study for a potential move to a new location. His analysis showed the co-op was obtaining 85% of its business from a trade area that included most of Vernon County as well as Crawford County to the south. Within that trade area, which was home to about 32,000 people, the data showed the

co-op was capturing only 8.9% of the natural food market, and about 1% of the overall grocery market.

Mr. Davis' report said these low market share levels on the store's inadequate size, its poor visibility and lack of "retail synergy" being a block off of Main Street, and insufficient parking. He concluded that the co-op could achieve a market share of 30% or more if it relocated to a better facility.

About that time, Ms. Rasikas was approached by the owners of a building on Main Street that had previously housed an automobile dealership. The new owners intended to develop a "mini-mall" and wanted the co-op to become its anchor tenant. It seemed like the perfect opportunity.

The new location was said to offer about 5,000 square feet of retail space. It would allow parking for least 25 cars on Main Street and in a lot behind the store. Mr. Davis explained that ideally a grocery should provide spaces for eight cars per 1,000 feet of retail space. While the new location would fall somewhat short of that, it was a major improvement over the present location and was close enough to the ideal ratio to be acceptable. He went on to project that the co-op's share of the natural foods market would increase to 27% in the new facility, and do \$2.6 million in sales by the end of its second year.

The estimated cost of the project was \$750,000. Before they could get commercial or institutional loans, they would have to raise significant equity investment from members, and so the board embarked on a major fundraising drive to help finance the move. They established a new system for accepting unsecured loans from members, with options for interest rates ranging from zero to five percent, three-to-five years maturation rates, and a minimum loan amount of \$1,000. By 2003, they had raised \$159,000.

Board member McDonald credited their successful fundraising in large part to "the huge influx of alternative-minded folks, moving here from New York, California, Colorado. They found housing a lot cheaper here, and so many of them came in with enough cash to figure out what they wanted to do once they got here. And they invested in projects they supported."

The co-op spent a year researching the Main Street location, and negotiating for more parking. In the meantime, the co-op's sales and membership grew to the point where the board made the decision to look at buying land and constructing their own new building.

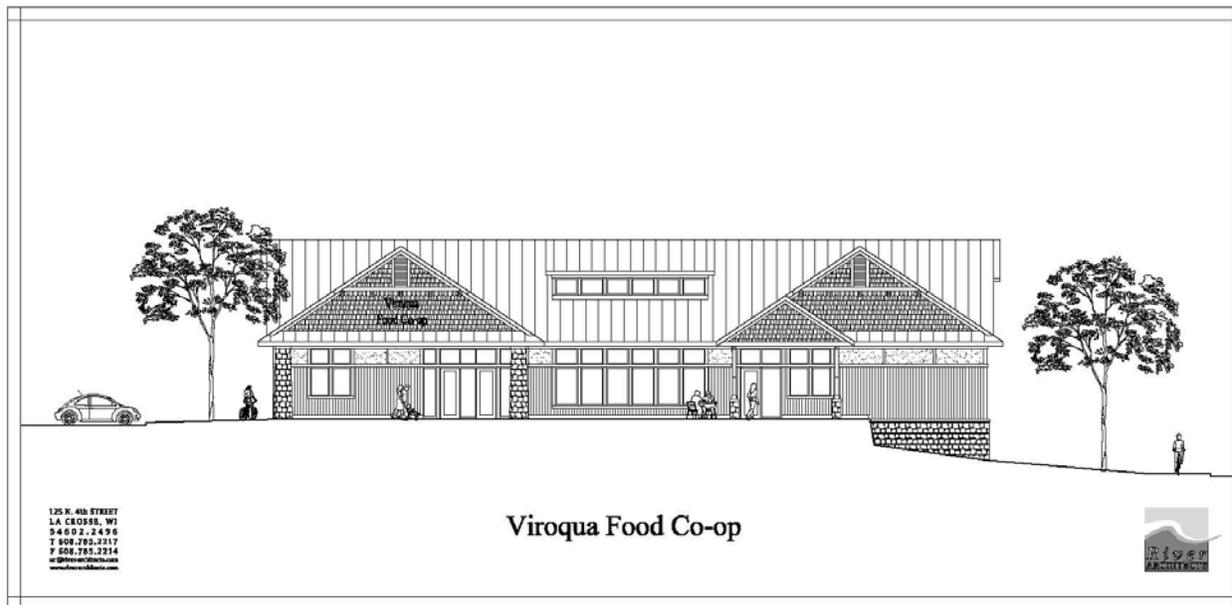
General Manager Rasikas points to that decision as a reflection of the flexibility and patience of the board. She also said that the most recent analysis indicates had they gone forward with the mini-mall location, they would have soon outgrown that building too. In that scenario, the debt they would have incurred to remodel and move would have prevented another expansion for many years.

And so, as Mr. McDonald explains, they scrambled around until they came upon alternative site— an undeveloped corner lot on Main Street, about two blocks from their current location. Fortunately, they were able to purchase the land from the city for only \$30,000.

However, their earlier financing goal of \$750,000 was based on remodeling and renting an existing building. When they decided to build a new facility, the total project cost more than doubled to \$1.6 million. The \$159,000 they had raised from member loans was not going to be enough to leverage the necessary financing from outside lenders.

The board did not feel comfortable going back to members for additional unsecured loans. The biggest problem with the member loans was that, when they came due, they had to be paid. Given the delays that resulted from the change in plans, some of the current loans with three-year maturity rates were due to be paid before the new store had even completed its first year of operations. That could present cash flow problems for a store adjusting to a much larger facility.

So the board came up with a new strategy for raising capital. They authorized \$900,000 of a new class of stock which, unlike their voting stock or their Class A shares, would actually



A architectural “line drawing” for the proposed new store. From River Architects, Inc.

pay dividends. The first series of Class C stock, totaling \$400,000, is fixed at a 5.5% rate of return.

However, unlike loans with their fixed maturity date, the co-op won’t have to return the new equity until people request it. Furthermore, payment of dividends in a given year would be discretion of board, although the interest would accrue. That, explained Mr. McDonald, gives the board the flexibility it will need in the first few years to ensure positive cash flow. The terms of future series of the new class of stock will be determined as the need arise.

The paperwork for the new stock was completed in June of 2004, and people started coming forward. By the fall of 2004 they had raised almost an additional \$100,000 in new stock purchases. They also plan to convert some earlier member loans over to the interest-bearing stock. With these equity investments in place, the co-op was in a position to approach outside

lenders. By the end of 2004 they were negotiating a substantial loan with a local commercial lender using a USDA guarantee, which they hoped to combine with a subordinate loan from NCDF.

The co-op has contracted with a “design-build” firm from La Crescent, MN that is doing the job for 6% of project costs, instead of their regular 16% charge, because they want to develop the experience with “green building” that the co-op has requested. The co-op also will hire its own project manager (not the GM) who will oversee the contracted work but will also manage volunteers for “finishing work.

If all goes well, plans are to relocate to the new location as early as June 1, 2005. The footprint of the new building will be 7,200 square feet, with 4,400 square feet of retail space.

## **FACTORS AFFECTING START-UP AND SUCCESS**

This case study of the Viroqua Food Cooperative will conclude with an analysis of five components of the start-up process that appear to be critical to success. They are presented in an order, which, in a very general sense, seem to reflect the chronology of the co-op development process.

### **A. The Steering Committee/Board of Directors**

While some co-op development projects start off with a steering committee, once Bill McDonald and his fellow buying club members decided to open a retail store in Viroqua, they moved quickly to incorporate. Once incorporated, seven of them served as interim board of directors until member elections three months later made them official.

It is important to note, however, that the start-up effort in 1995 involved more than just the seven-member board. Some twenty individuals, including directors, their spouses and other volunteers contributed brain power, manual labor, time and money to establish the cooperative, remodel and open the new store.

Partly because of the track record of their buying club, and also because of the modest size and furnishings of the first store, the development period in 1995 was relatively short—about six months. However, as some staff and directors explained, it was in some respects a nine-year development project, because only with the opening of the new store next year will they fully realize their goal of a consistent and complete supply of natural foods.

When evaluating the board over that longer time span, it is first worth noting that there was considerable turnover during that period of nine years. Of the original board, only Bill McDonald still serves as a director, and he actually left the board early on, and returned several years later. Directors serve for two-year terms and most serve one or two terms. They never have a problem finding people to run for the board.

While consistency of leadership is generally deemed critical to the start-up process, it may become less important when the process is spread over many years and new members have time to become familiar with the business.

The quality of leadership of the co-op's board of directors was demonstrated by their approval of a "mini-expansion" in 1999 which provided a stepping stone to a larger store, and by their decision to use the Blooming Prairie windfall to write off some losses to achieve more accurate financials, as well as by their patience and flexibility when the first expansion plan fell through.

Merle Borchers, a lender at the time for Northcountry Cooperative Development Fund in Minneapolis, worked with the co-op board as they sought loans to finance their expansion. "They took everything in very reasonable stages," he explained. "The goal was to make money and survive. They got advice about equipment, layout and other issues, but when it came down to decisions, they took responsibility themselves."

## **B. Consultants and Advisors**

Typically, a steering committee or new board of directors taps advisors (who are free) and consultants (who charge) to "fill in the gaps" where their own knowledge and skills are lacking. And so the group first must identify "what it doesn't know, but should", and then shop around for the best available support at prices they can afford.

In 1995, Mr. McDonald and friends tapped Mr. McGeorge Sr. to help draft and submit incorporation papers to the state. They also tapped a skilled community member to facilitate their stakeholders' meeting. But that help aside, not many external resources were brought into the initial process.

With their modest plans and minimal capitalization, the first board apparently felt they did not need formal market studies and sophisticated business plans from costly consultants. However, as the co-op grew, and their vision grew, the board and its management increasingly demanded more diligent analysis of their current operations as well as their future prospects.

They would eventually tap consultants like Pete Davis, who is affiliated with Cooperative Development Services (CDS) of Madison, to conduct "an analysis of sales potential for a proposed relocation." But prior to that, one of the smartest moves by the board and Jan Rasikas was to tap into resources offered by a natural foods industry that began some twenty years ahead of them.

"I was one of the first CoCoPincky stores," explained Ms. Rasikas, referring to a new business improvement program developed for smaller food cooperatives. It is an adaptation of the Common Cooperative Financial Statements (CoCoFiSt) program, developed by CDS consultants, with assistance from the Northcountry Cooperative Development Fund.

Ever since she was hired back as General Manager in 1999, Ms. Rasikas was determined to acquire the same level of technology, training and other industry support available to the larger, well-established food co-ops. She searched out a POS system that her store could afford, and she and her finance manager, Halley Blessing, took the resulting data and analyzed it in comparison to industry benchmarks.

"That was a huge step for a us, being able to analyze that information, get help, and see where we were doing well and where poorly," Ms. Rasikas explained.

### **C. The Business Plan**

Typically, once a co-op steering committee or new board of directors comes together, and they have tapped the consultants they need to complement their own knowledge and skills, they begin to develop a written business plan which they can present to potential members and commercial lenders. Often a feasibility study is a step along the way.

As mentioned, the founders of the Viroqua Food Cooperative did not bother with formal market studies or business plans. The fact of their success might argue that less planning is necessary in the “start small and grow” approach to food co-op development.

While there may be some truth to that, there were also special circumstances involved in Viroqua. First of all, by comparison with conventional food stores, the margins on natural foods are typically much higher, which provides at least somewhat greater capacity for absorbing mistakes. Furthermore, there was a total lack of natural foods retail outlets in the area, and an influx of new residents who were clearly a potential market.

In looking back at the record keeping, the lack of planning, and other loose practices in the early years, Ms. Blessing, the current financial manager, declared, “We succeeded in spite of ourselves. We were in the right place at the right time. However,” she added, “we were out there fishing for it too.”

Certainly as the co-op grew, the board and staff became more sophisticated. They fully analyzed and planned their expansion project. As Rasikas explained, “We would have been shooting from the hip if we built a new store based on what we thought we knew about ourselves. And we would have built too small. When we told Pete Davis, who did our market study, all about our alternative community, and how special we were, he said ‘I don’t do special’. It was based on the science of studying the market.”

### **D. The Project and General Managers**

When they lack the time or the skills themselves, and if they can afford it, a new co-op board will sometimes hire a person to manage the development process. A project manager can provide the consistent attention to details that large, complex development projects require. Back in 1995, that obviously was not necessary or affordable in the case of Viroqua.

Once they opened, the co-op’s sales grew quickly in its earliest years, under the direction of a rotation of co-coordinators. The initial success probably had something to do with the hard work and commitment of those first employees, and something to do with the size of the market niche the co-op grew to serve.

But as current board member Bill McDonald describes, in those early years “the co-op was doing OK but not great by any means. We were not in danger of going under, but we weren’t really expanding all that much either.” He was speaking of the membership. We hit 100 in that first year but then we grew very slowly. After three years maybe we had 200 members.”

He then went on to describe the impact that Jan Rasikas has had as General Manager the past five years. “Once she came as GM, she had the drive and background knowledge to get the

systems in place that we really needed—managing inventory, managing margin. It's since she's been there that things have really taken off, to the point where now it's so cramped when you try to shop in the current store. Four years ago I wouldn't say that was the case."

He went on to say, "She takes on (the job of running a grocery) and makes it an enjoyable experience for the customers so they come back. And she gets things done. She expects things to get done well. What she's done more than anything is steer us in directions so that things run smoothly, while adapting to rapid change and still managing to get huge numbers of new members, large volumes of sales. It's really pretty phenomenal."

Ms. Rasikas herself frequently complimented other staff. She introduced everyone who appeared on her guided tour of the small store. At one point she explained that many of the employees had college degrees, which she later may reflect that "in small, rural communities, meaningful work is not always available. (Nevertheless,) working at a community-owned cooperative with its positive impact on our local economy can be very satisfying, especially if we can be a model for decent wages and benefits and healthy working environments."

Throughout a lengthy interview in the crowded office, she turned often to finance manager Halley Blessing for information, which was always rapidly retrieved from the computer system. Afterwards, on a tour of the storage rooms, she laughed as she described the labor intensive and therefore costly and frustrating procedures of constantly stocking shelves and shifting piles in the storage rooms.

It was quite clear that Ms. Rasikas was driven to make the co-op a success, and the long-awaited expansion into the new store would be a collaborative achievement.

When asked if their GM's pay was commensurate with the local market, Mr. McDonald replied, "Well, we just gave her a big raise," he joked. But he went on to say, "As a board, we've been doing really well as far as overseeing store operations, making sure things get done,



Viroqua Food Co-op General Manager Jan Rasikas, right, with a store employee and her daughter.

but we haven't done as well training ourselves and learning about the larger world of co-ops, so you ask 'is her pay commensurate?' We're certainly bringing her up to that level."

"But you have to make sure your other employees get brought up too, and she's very OK with that. She makes less than a commercial retail grocery manager, but she's right in there for a natural food store of the size we'll soon have. We're working toward a system where some of her pay is based on results. This is where our board will really have to step up, to establish the results we want to see."

## **E The Members**

The role and impact of the membership can be evaluated at two critical points in the co-op development process. First, did they put forward sufficient equity capital to start the business on solid enough footing? While grants, gifts and loans can sometimes cover a large portion of the total capital requirements, commercial lenders demand to see owners put some of their own capital at risk. Second, once the co-op opens, the membership enjoys the ultimate control over the fate of the business—as customers. Will they patronize the business sufficiently to

Simply stated, the members of the Viroqua Food Co-op responded favorably in terms of both capitalization and patronage.

## **CLOSING COMMENTS**

This case study will close with a brief consideration of the comparative importance of the five so-called "building blocks" of successful co-op grocery development in rural communities. These conclusions can then be compared with those of the other three case studies.

Certainly the role of the co-op board of directors was critical, during both the short start-up stage, as well as throughout the prolonged nine-year development toward the new store on Main Street. While there was notable turnover on the board over that period, there were several examples and references to the hard work and good judgment of the various directors.

While they only tapped a few advisors in the earlier days, the co-op increasingly turned to paid consultants and industry resources to guide them through their expansion. Likewise, formal business planning was not critical to getting the co-op started in 1995, but clearly a great deal of planning guided strategic decisions since the time of the mini-expansion in 1999. In the "start small and grow" approach that this case represents, it appears that the judicious use of consultants and formal business planning becomes more critical with growth.

It would appear that the role of the General Manager in this case was extremely critical to the co-op's success, particularly when viewed over the nine-year period. Ms. Rasikas' commitment and abilities are very apparent, and certainly enabled the business to adapt to meet the growing opportunity.

Arguably, in this case, the most critical component of success has been the commitment of the members to patronize and support the store. Over 80% of sales in 2003 went to members. They have provided over \$300,000 in loans and equity to support the move to the new location.

More to the point, as a community of like-minded consumers, the thousand or so individuals who joined the Viroqua Food Co-op since 1995 represent a substantial and continually growing niche market. They demanded a convenient source of natural foods in their rolling corner of western Wisconsin, and they got it.

## **TOWER FOODS MARKET COOPERATIVE**

This is the third of four case studies that explore the factors contributing to the successful start-up of cooperatively owned groceries in rural communities. Tower Foods Market has the misfortune of representing the only “failure” among the four cases studied. It is a tremendous credit to the people involved that they were willing to share their story, and they have expressed a sincere interest in learning and building from the experience.

### **I. BACKGROUND AND CHRONOLOGY OF START-UP**

Tower Foods Market was a project driven and supported by the Sovereign Oneida Nation of Wisconsin. The store was located about five miles from Green Bay, Wisconsin, a metropolitan area of 226,778 people (US Census, 2000). Despite its proximity to a large urban area, urban development has been limited, and the landscape is largely agricultural.

The Oneida tribe migrated to Wisconsin starting in 1821. Initially they shared five million acres with two other tribes. However by 1929, the Oneida’s portion had been reduced to only a few hundred acres through treaty, allotment, and scandal. More favorable U.S. policy stopped the loss in 1934, but it wasn’t until the 1980s that the court settlement of a boundary dispute with three local governments, followed by the Indian Gaming Regulatory Act, enabled significant progress toward land reclamation by the Wisconsin Oneida.

Today, the tribe owns and controls 16,689 noncontiguous acres within a 65,000-acre rectangular territory that covers about ten miles of Duck Creek watershed.

It would require far more background knowledge to fully understand the dynamics behind the story of Tower Foods Market. Examples of important factors that are at best only touched upon within this study include: the institutions and politics of the tribal government; the impact of casino economics; competition between large families and clans; and a set of cultural values distinct from the non-Native local population.

Other limitations of this study deserve mention. One is that the key informants do not represent important perspectives. In October 2004, a meeting was arranged that primarily drew only representatives of the Oneida Community Integrated Food Systems (OCIFS) program, which took over the co-op in its final months. Contact information was not provided for the former project manager, the members of the first steering committee and early board members, or for the four General Managers who served during two years of business.

Another limitation of the study is that, because the store was closed and empty when a site visit was made in October 2004, first-hand observations of the store’s image, design and inventory could not be made. Within these constraints, this report will examine the process that led to the opening in July 2002 of a cooperatively owned, full-service grocery on Oneida Nation

land— and its subsequent closure two years later. Because of the sensitive nature of a failed business experience, personal names have been avoided in this report.

A timeline of the development effort, provided by project staff, traced the motivation to start a co-op back to April 1995, when the non-Native Schroeder family closed its private grocery in the area. Later that year, the tribe’s Economic Development Department considered a proposal to start a new grocery on the reservation. The Schroeder facility was evaluated in November but was not pursued.

In December a survey of elders was conducted to collect their input. 65% of respondents favored a grocery store within the tribal boundaries. A similar sentiment was shared by the staff and participants in the OCIFS program, which itself was started in 1994 to address issues of poverty and health on the Oneida reservation.

The OCIFS mission was driven by some disturbing statistics. 80% of families in the Oneida Nation School System were reportedly classified as low and very low income. Unemployment on the reservation was seven times higher than the closest municipality. An estimated 65% of Oneida youth were said to be overweight or obese, contributing to a 300% increase in incidence in diabetes. The disease was said to strike one of two tribal members, and led to related complications such as heart disease, blindness, dental disease and amputation. (This data was presented in a revised 2004 business plan for the co-op grocery.)

While the growth and success of the Oneida casino in the 1990s improved the tribe’s economic well-being, there was concern about over-reliance on the “golden calf”. As one project leader explained, “In a healthy economy a dollar should circulate seven times. It basically doesn’t circulate once in Oneida. We felt we needed to stop sending hard earned dollars to Green Bay and everywhere else.”

Interestingly, in 1995 the Green Bay Area Chamber of Commerce listed the Oneida Nation and its collective tribal enterprises as the number one employer in the area, with 3,391 employees. However, many of those employees were non-Native, and many tribal members remained economically disadvantaged.

The idea for a new grocery in Oneida Nation became a vehicle for achieving a number of greater goals: economic development and job creation, tribal self-



An undated exterior shot of Tower Foods when the store was still operating.

sufficiency, improved diets and better health, food security for elders and young children, even environmental stewardship.

In January 1996, the tribe commissioned a study from the Texas-based wholesale distributor, Fleming Companies, Inc, which is named in this report only because it went out of business in 2003. It was the first of two market analyses conducted by major wholesale suppliers that would later prove to be substantially over-optimistic.

This first study defined a trade area of 10,660 persons, comprised of the noncontiguous Oneida reservation and their non-Native neighbors. From the start, the organizers hoped to attract both Oneida and the general public to patronize the grocery.

Based on a 10,000 square foot facility, the Fleming report projected a 19% market share, per capita weekly expenditures (PCW) of \$27.59, and gross sales of almost \$3.3 million in the first year of operation.

Bolstered by these projections, the Economic Development Department conducted another survey in June 1996, and by October, according to the project's historical timeline, they generated a "Plan of Action". However, no details of the plan were made available, and at that point timeline jumps forward three years to 1999.

In December 1999, the tribe's Community Development Department took up the task of restarting the tribe's grocery initiative. A "needs assessment survey" was sent to all 1,083 registered tribal households in the area. 256 people responded (a 23% response rate). Of those, 75% expressed strong interest in having a grocery located in the Oneida Nation. The top reason given for wanting the store was convenience, followed by the need to "keep money on the reservation".

On the issue of ownership, the survey asked simply, "Who should own the store?" 36% of survey respondents voted for "community" ownership, but separate from the tribal government. 28% did favor Tribal ownership, 26% said it "doesn't matter", while others favored individual ownership by a Native American (19%) or by a non-Native individual (2%).

Asked what they felt would be "the biggest obstacle blocking a Tribal Grocery", 33% selected the answer "not enough community support". A slightly higher percentage checked "other" explanations not specified, while 17% indicated "limited tribal resources", 8% said it "does not fit into the master plan of Oneida", and 8% felt that present area stores were adequate. The survey also found that almost 75% of respondents wanted a store the size of Don's Supermarket in nearby Seymour (18,000 sq. ft.) or larger.

Between June and October 2000, at least nine meetings were held, bringing together various tribal agency staff, outside resources and the wider tribal community. After some analysis of alternatives, a core group of individuals settled upon a co-op model of ownership. A co-op development specialist from the USDA began attending meetings.

In September, the Oneida Business Committee, the governmental unit which oversees all tribal business, passed a resolution to provide \$250,000 to the grocery store project in the 2001 Tribal budget. A subsequent project document would explain, "This was a remarkable

decision... because it was the first time (the committee) separated tribal politics from economic development.”

Attention then turned to grant opportunities. Two public meetings were held for the expressed purpose of gathering names to a list to support a grant application. Soon afterwards, an application was submitted in September to the USDA requesting \$500,000. The Oneida tribal government would ultimately receive the grant, which was to be used as a revolving loan to provide debt financing to tribal businesses. The co-op would become its first borrower.

The minutes from the meetings in 2000 reflect a chaotic phase of discovery that may well be common in co-op development projects. Various people were attracted to the project, then withdrew, some to return later. A series of outside experts brought new, sometimes conflicting perspectives. Divergent ideas surfaced about store location, design, and product mix. Along the way, actions were proposed, estimates made, opportunities lauded, threats posed, details debated... and much of it based on too many assumptions and limited information.

To make some order out of the chaos, it is generally recommended that groups get their ideas on paper, conduct a rigorous feasibility study and, if that is favorable, proceed to develop a formal business plan. The Oneida had previously taken steps in this direction-- the market study by Fleming in 1996 and the more recent needs assessment survey.

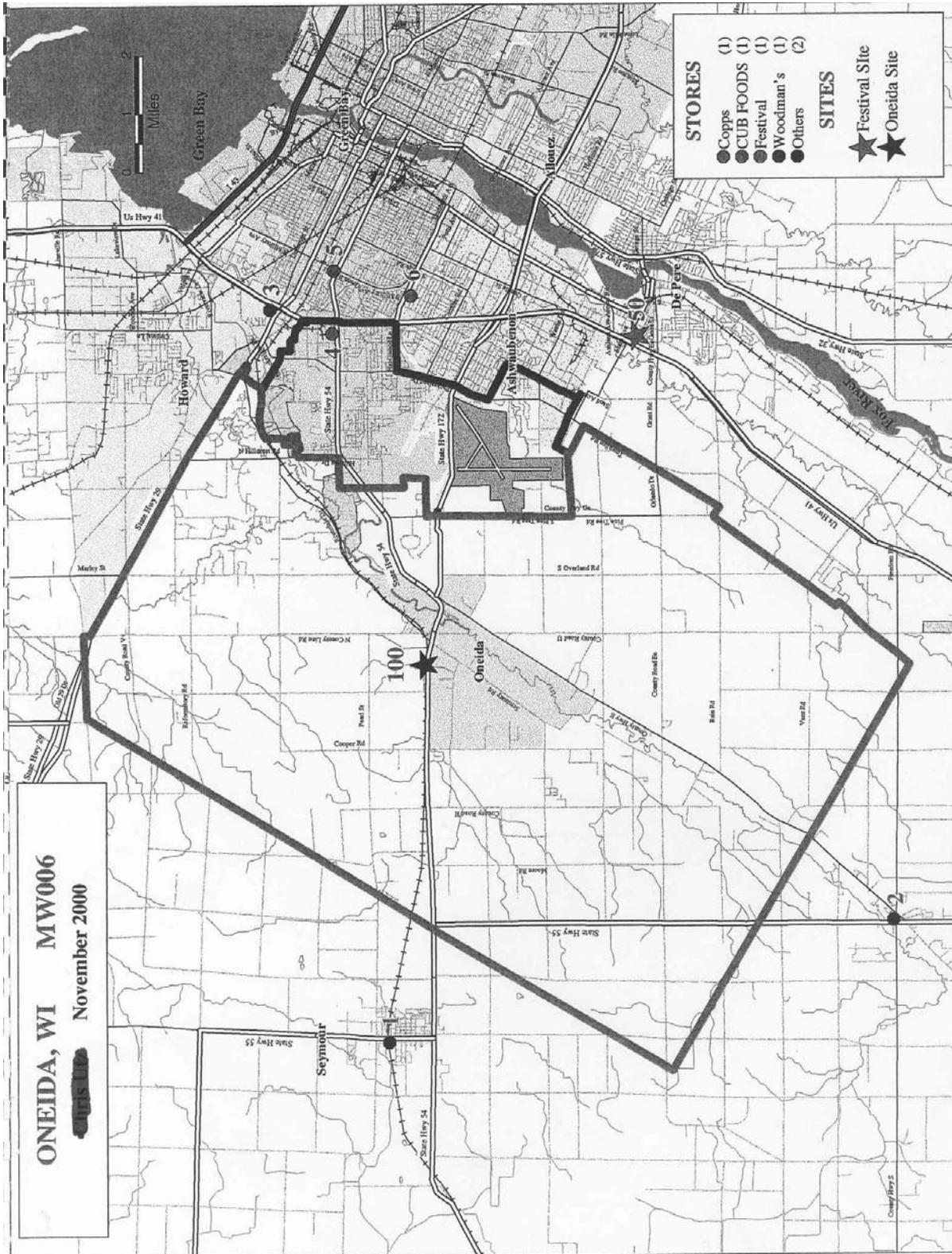
In early October 2000, three project leaders met with a representative from a wholesale distributor in the region. He described a “menu” of services his company could provide, including store layout, shelf management, market analysis, décor packages, and an “operational business plan”, which the minutes explained was a “free service, and will only be necessary if the retail sales are not doing well”.

Later that month, the same three project leaders met with the General Manager of a thriving natural foods co-op in Milwaukee. She explained that her 14,000 sq. ft. store (9,800 sq. ft. retail) served 7,000 members, with 50% of sales to non-members, and 6,500 shoppers per week. She also shared some information about their board of directors and member policies.

Shortly thereafter, the organizers contracted with the fore mentioned distributor to conduct an updated market analysis for \$5,000. The study the company delivered two months later was apparently enough for the project’s leaders to deem the idea feasible, and the report’s financial projections would play prominently in a business plan completed six months later. Unfortunately, those projections would ultimately prove to be grossly incorrect.

To its credit, the firm’s report was only about half as optimistic as the Fleming study that preceded it, although it did base its calculations on a smaller store (8,000 sq. ft). A target market area was mapped (see previous page), which was said to be home to almost 9,000 residents. The report projected that the store would capture 16.5% of this target market, with each shopper averaging weekly expenditures of \$30.33, generating \$1.7 million in gross sales the first year.

It is interesting to note that much of the text that accompanied these figures was quite discouraging, particularly on the subject of competition. Prospects for attracting “strong acceptance and patronage from the local tribal community... is dampened by the existence of four large dominant supermarkets (in Green Bay) with combined sales of \$2 million per week.”



The report further admitted that that figure did not include smaller stores in Seymour (\$7.8 million in gross sales) and Freedom (\$2.3 million), nor a 68,000 sq. ft. grocery that was

scheduled to open soon just five miles south in DePere. Finally, after acknowledging rumors that a new Wal-Mart Supercenter may be on the horizon, it suggested that the success of the larger supermarkets will likely close the smaller conventional stores. It presented that as an opportunity for recruiting freshly unemployed store managers.

Furthermore, on a scale of scale of 1-10, the proposed Oneida grocery rated just 5 in terms of “accessibility to site” and “traffic flow”. It rated even lower on “proximity to population density” (4) and “visibility of site” (3). The report concluded: “The small size of the (store) and its location, away from the highway and lacking a major crossroads, would normally relegate it to a convenience store status.”

In the face of these inferior attributes and fierce competition, the consultant explained that the Oneida store would have to achieve the following:

- Overall pricing... competitive with small markets in Freedom and Seymour.
- An aggressive advertising and promotional plan....
- Key management personnel will have a strong supermarket background.
- Merchandising for the local Oneida community will be significant and pervasive through all departments.
- It is assumed that there will be an appropriate and effective response to all competitive challenges.

It also advised a large attractive pylon sign, although the cooperative was restricted from taking this step because of local county and Tribal regulations.

All of this analysis was based on a grocery to be located in a “business park” near the center of the Oneida territory. The site had been suggested repeatedly early on in the process, presumably because of the investment the tribe had already made at that location. The park was already home to a post office, a tribal office building, and a half-empty 20,000 sq. ft. warehouse. Set back about 300 yards from a state highway with moderate traffic, half of the warehouse housed a new food pantry for low-income tribe members.

With the market analysis report in hand, the project leaders would spend 2001 developing a business plan, recruiting board members, incorporating the co-op, developing by-laws, and holding community meetings. In February they met with a university co-op specialist who explained the basic responsibilities of a co-op board of directors and described various supporting resources.

A community meeting in April 2001 drew at least 51 people and was revealing in several ways. First, one organizer from the Oneida Community Integrated Food Systems explained that the idea for an Oneida grocery resurfaced in 1999 simply because someone found files from 1996 that “stated that a grocery store in Oneida was one of that organization’s goals.”

The organizer went on to describe an option that receives no other mention elsewhere, namely, to open a grocery as a joint venture with Sav-A-Lot, a private store chain. He also explained that “the Lac du Flambeau and Menominee have tribally-owned cooperatives, while our store would be owned by the community people.”

The debate over ownership that was still unsettled by April 2001 was accompanied by hard questions from the community. One person asked, “Four groceries have already failed. Why could a co-op be successful?” The meeting leader answered, “We now have an economy, when in the past we really didn’t,” and he added, “We would start out small and expand as the demand and support increased.”

At this notable April meeting, nine individuals signed up to serve on the board of directors. Furthermore, a survey of 38 meeting attendees showed 34 still desired a grocery store for the Oneida community. 53% indicated they would do all their shopping there “if reasonably priced”. 18 out of 30 favored the business park location.

By July 2001 the minutes describe a series of board of director meetings. They elected officers, voted on by-laws and established five committees. Technically speaking, these decisions were premature, for the co-op had not yet been incorporated. But in practical terms, it was progress. When the co-op finally incorporated in September 2001, the board was reduced to seven members.

As the facility was prepared, a serious effort was made to publicize the forthcoming store. The co-op was also advertised via radio, direct mailings, TV calendars, newspapers, and posters. Much of this outreach effort targeted both Oneida and non-Native target markets. From January to July 2002, at least twelve community meetings and information booths were put together. Minutes for one meeting indicated 97 attendees.

At that event, one community member commented that the present location was too far off the road, and that a new location should be found immediately. A board member answered that they would never attract a grant to build a new building until the business proved it could attract a sufficient customer base. Their hope, he said, was to achieve that measure of success in 3-5 years, and at that point they would build a new building closer to the road.

By April 2002 extensive renovations were finally underway to convert the empty warehouse space in the business park into a modern, full-service grocery. The long lag time was partly related to delays in processing the USDA grant to the tribal government, establishing a revolving loan fund that would provide \$460,810 in financing to the co-op. It is worth mentioning that well into the project, this money was interpreted as a grant, not a loan, as one of the organizers explained, “Originally, the funds were requested as a grant, however, the USDA required that we utilize the funds as a revolving loan fund to help support future small businesses. It was a great idea in theory, but the profit margin is significantly low for this type of business and created a hard ship for the store.”

The misinterpretation severely affected the co-op’s financial projections and “started us off on the wrong foot,” according to one former board member.

The debt load at start-up also included the \$250,000 contribution from the tribe. Membership fees were treated by the co-op as income, not equity, and they equaled less than 1% of total project costs. No commercial bank loans were taken out to finance the opening of the store.

Most of the engineering, design and remodeling of the facility was done under contract with various tribal departments. All new equipment was required, because of a tribal policy that forbade purchase of used equipment (put in place to discourage dishonest dealings of the past). The lack of flexibility to bid out the work and to purchase second-hand equipment was said to be the cause of rather severe cost overruns.

However, one study informant noted that there were some issues of alienation with the first project manager, which may have negatively impacted the community buy-in with this project.

The co-op would also hire another non-Native man to become its first manager. An older gentleman with significant grocery management experience, he was hired well before opening day and took over much of the project management. However one observer noted, in hindsight, that while the man's previous background provided the knowledge and skills required to manage an operating grocery, he was not as well suited to the process of developing and opening a new store.

Despite all the delays and doubts, and thanks to the hard work and determination of a core group of leaders, and finally Tower Foods Market opened for business on July 18, 2002. The store was named after a prominent water tower located at the edge of the business park. While several Oneida language names were considered, the organizers settled on something more generic that would not dissuade the general public.

The store actually occupied 8,000 sq. ft. of the 10,000 available in the warehouse. Two thousand sq. ft. in the front of the store were reserved for Oneida entrepreneurs or groups for marketing tribal crafts and goods. Minus storage, the store offered about 6,000 sq. ft. of retail space. By all descriptions, the store was modern, well lit, clean, and new looking.

The co-op would rent the four-year-old facility from the tribal unit that owned it. In keeping with the Oneida's commitment to environmental stewardship, they invested money in solar energy panels to help power the grocery store.

Members had an option of paying a \$20 annual fee, or \$100 for a lifetime membership. Records show the store had 266 members when the doors opened. Around the time of opening, a whole new slate of directors took over the board. While the 2001 business plan included an allocation of \$12,000 for board training, that money was not spent, and a very inexperienced Board of Directors took over governance responsibilities for the new business.

## **II. MISSION ACCOMPLISHED?**

Nothing in the projects' records indicates that a formal mission statement was ever developed. Various tangential goals have already been mentioned as associated with the Tower Foods project: economic development, job creation, tribal self-sufficiency, improved diets and better health, etc. While left unstated, the central mission was evidently to establish a full-service grocery that would serve the Oneida community for years to come. That mission, unfortunately, was not accomplished.

With the tribe's permission, the co-op's accounting firm faxed 80 pages of financial records for this analysis. The most recent 12-month Income Statement covered the period of August 2002 through July 2003, which nearly coincided with the first year of operation.

Over that year, the grocery achieved \$452,589 in gross sales. The cost-of-goods-sold (COGS) registered \$355,372. Subtracting freight costs and fees (\$33,824), the statement showed a total gross profit of \$63,292, representing a gross margin of 14%.

The salary of the manager was listed as \$26,973, and the assistant manager earned \$21,781. In addition to these two full-time staff, there were 13 part-time employees. The total payroll expense, including salaries, wages, payroll taxes, workers compensation and benefits, was \$144,530, or 32% of gross sales and 28% of total operating expenses.

Other major expenses included advertising and in-store promotions (about \$32,500), utilities (\$30,700), accounting (\$9,000), depreciation on equipment (\$129,000), depreciation on leasehold improvements (\$24,000), intangibles amortization (\$18,100), interest (\$51,000), and rent (\$25,000). Total operating expenses were \$509,923. Including the COGS and taxes, the overall expenses that first year totaled \$897,800, resulting in a loss of \$437,600, nearly 97% of gross sales.

The co-op's most recent balance sheet was dated May 15, 2004, about two weeks before the business closed. At that time, records showed only \$60,678 in current assets, two-thirds of which was inventory. Fixed assets, including store fixtures and equipment and leasehold improvements, totaled \$423,866, after depreciation.

On the other side of the balance sheet, liabilities included a short-term loan from a local bank was listed as \$417,681. Since commercial loans did not appear on initial balance sheets, this loan was apparently taken out in early 2003 to keep the business afloat. Long-term debt included the \$737,030 loan from the Oneida tribe, which by May 2004 had accumulated over \$80,000 in unpaid interest. The majority of the loan represented the original USDA grant to the tribe. Apparently the tribe also approved several "influxes" of cash as the business struggled, in addition to its original contribution of \$250,000.

Finally, member equity, which is added to liabilities to balance assets, was reported as minus \$762,976. That figure represented negative earnings from nearly two years of unprofitable operations.

Aside from these disappointed financial figures, another sign of trouble was the turnover in management. They went through four managers in two years (3 non-Native, 1 tribal). Of the four, the first manager was most qualified in terms of grocery management experience. However, not long after the business opened, he decided that at his age he could not put in the long hours required to get a new store off the ground.

As late as May 2004, the co-op's leadership was still trying to save the business. Two months earlier, a small number of members appeared at the annual meeting and voted to turn over the board of directors to the leaders of the OCIFS program. Notably, they also voted to refund the \$100 lifetime memberships that some of them had purchased.

The five individuals from OCIFS who served on the final co-op board were listed as co-authors of a revised business plan dated May 2004. However, it contained much of the same text as the 2001 version, with some updated financial figures. For instance, it stated that the store was averaging about 100 customers per day, each spending about \$9 per visit.

The 2004 business plan offered a host of strategies to turn things around, including (a) reducing the annual membership fee to attract more customers, (b) converting to a 501c3 non-profit to attract more grant support, (c) vastly increasing the marketing budget, and (d) adding more natural foods and Oneida-produced products. Even projecting moderate sales growth well into the future, the store was expected to still lose 30% by 2012.

In June 2004, unable to attract further support from grants, the tribe, or local banks, Tower Foods Market shut down for good. By October, a site visit found the store completely empty, although a large sign still hung above the doors, advertising what might have been.

### **III. FACTORS AFFECTING START-UP AND SUCCESS**

This case study of the Tower Foods Market will conclude with an analysis of five components of the start-up process that appear to be critical to success. They are presented in an order, which, in a very general sense, seem to reflect the chronology of the co-op development process.

#### **A. The Steering Committee/Board of Directors**

The fact that the various organizers of Tower Market Foods stuck with the project through two years of development does indicate a level of commitment and determination. Nevertheless, some shortcomings with respect to the steering committee and board of directors may be observed.

Over the course of the project there was considerable turnover among the project's leadership. From late 1999 through June 2004, a rotation of at least twenty-five individuals had roles on the steering committee and a series of self-appointed and elected boards. This may be a partial cause of an apparent inconsistency of "vision" that is discussed further below.

The key organizers clearly had some difficulty finding people to serve on the board, as evidenced by a long period of director recruitment. This may explain why the four committees they established-- Governance, Owner Relations, Nominations, Finance-- were never filled.

It was reported that up until opening day, most if not all of the directors who served on the board were employees of one tribal agency or another. Once the store opened, a new slate of directors took over, only two of whom were tribal employees. Perhaps the organizers felt that the best practice in cooperative governance is to have "regular members" serving on the board. Or maybe the tribe felt that it had subsidized the co-op enough through the organizers' salaries. Regardless of the reason, the repercussions of installing entirely new and inexperienced directors at such a critical juncture almost certainly impaired the board's ability to guide and evaluate management.

Perhaps the shortcoming that had the most significant consequences was the collective leadership's inexperience with the business of starting and operating grocery store. Or perhaps, more to the point, it was a case of "not knowing what they did not know". This becomes apparent in the discussions of consultants, advisors, board training and the business plan below.

## **B. The Use of Consultants, Advisors and Other Resources**

Perhaps it is logical that when a group decides it wants to start a cooperative, regardless of the industry, they seek out co-op development expertise. However, it is equally and arguably more important that they follow sound business practices and seek out expertise specific to their industry. The Oneida case clearly demonstrates how critical it is to obtain appropriate outside assistance to complement the organizers' knowledge and skills.

The Oneida took several steps in this direction. They tapped specialists from the USDA and the UW-Madison to provide basic co-op education. They met once with the manager of a successful natural foods co-op to explore that niche market. And they contracted with two different wholesale suppliers to conduct market analysis.

While the leadership garnered enough co-op knowledge to get incorporated and operate within a basic cooperative framework, they did not receive the level of co-op board training that was readily available in Wisconsin. The UW Center for Cooperatives offers an affordable and intensive 3-day board training program that the tribe did not tap, despite the allocation at one point of \$12,000 for such purpose.

However, the failure to tap unbiased and competent expertise with respect to the grocery industry may have been even more consequential. The details of the market analysis conducted by the two separate wholesale distributors will be discussed in the following section. However, regarding their selection, a question was raised about the objectivity of these consultants.

On that issue, one key project leader remarked, "Yes, they both had something to gain if we went with their distribution company. I met with (one company representative who) told me right out that the biggest theft from grocery stores come from the Distributors, with employee theft being second." In addition, a private independent industry consultant who reviewed one of the market reports observed that "obviously (they) have an interest in opening new customers."

Even presuming that the companies' market studies were unbiased, market analysis is only one component of a business plan, and shortcomings in other sections of both the 2001 and 2004 version of the co-op's plans indicate that further outside advice and consultation was needed but not acquired.

Some of those interviewed also indicated that the co-op did not take full advantage of the knowledge, capabilities and assets of the tribe. For instance, someone observed that the Oneida's email system was not fully utilized for promoting the store. It was also said that certain tribal members had been involved with co-op efforts in the 1970s, but their experience and knowledge was not exploited.

That the tribe was considered an "outside" resource reflects the oft-stated position that the co-op was a separate and independent entity. Of course, the co-op's dependence on the tribe

was apparent in the significant financial resources and staff time that the tribal council and its departmental managers authorized. The tribe also purchased gift certificates for grocery and distributed them to its 3,000-plus employees as a holiday gift. Still, some argued that tribe could have done more. The complicated issue of the interplay between the tribe and the co-op probably cannot be fully understood by outside observers.

### C. The Business Plan

The inadequacy of the co-op’s business plan was arguably the fatal flaw in the Tower Foods Market project. If the market analysis and financial projections not been so inaccurate, the organizers might have decided against starting a grocery co-op, and the tribe’s own financial resources, its staff time, and the USDA revolving loan fund could have been directed to other needs and opportunities.

It must be noted that the organizers did make repeated efforts to collect necessary information to determine feasibility and guide the project. They regularly collected “primary” data with the mailed surveys in 1995, 1996, 1999, at community meetings from 2000 through 2002. Certainly much of this data indicated interest by tribal members in establishing a grocery in their community.

However, on several occasions community input raised doubts that were apparently brushed aside. People indicated there was “not enough community support.” They showed a preference for a store twice the size as what was developed. They displayed price sensitivity. They expressed dissatisfaction with the location.

The “greater goals” that the grocery came to embody—economic development, tribal self-sufficiency, improved nutrition, etc.—and the fierce determination that is characteristic of “project champions” may have prevented the objectivity or detachment that is necessary when evaluating a business opportunity.

This tendency was also exhibited in the leaders’ acceptance of the financial projections provided by Fleming in 1996 and a second wholesale distributor in 2000. Table 1 presents the two market feasibility reports alongside the actual records from the first year of business.

In terms of gross sales, the more recent analysis was roughly half as optimistic as the Fleming study, though the latter was based on a somewhat larger store. Meanwhile, the second report projected a higher “per customer weekly” (PCW) expenditure.

	Target Population	Store Size (Total Sq Ft)	Year 1 Gross Sales	Average PCW	Avg Market Share	Sales/Total Sq Ft
1 <sup>st</sup> Market Analysis, Jan 1996	10,660	10,000	\$3,256,552	\$27.90	18.6%	\$326
2 <sup>nd</sup> Market Analysis, Nov 2000	8,876	8,000	\$1,762,748	\$30.33	16.5%	\$220
Actual results, Year 1	8,876	8,000	\$452,556	\$9 (est.)	4.2% (est.)	\$56

**Table 1: Comparison of projected and actual financial data.**

The co-op's business plan casually referenced an "outside market base" including Brown and Outagamie Counties, with a total population of over 388,000 residents. But for the purpose of projections, it used the second report's target population. The actual PCW was estimated at \$9, less than a third of the second consultants' prediction. An actual market share of 4.2% was calculated from a \$10.7 million total market that can be inferred from the data, though it was probably a lower percentage given the growth of the market since November 2000.

A private independent consultant with considerable experience in grocery market analysis was asked to review the more recent market study and to explain how its analyst generated the projections, and why they were so far off.

He explained that the distributor used a "gravity simulation model" for predicting sales of supermarkets, based on premise that a store operates like a magnet, with "iron filings" spread across the landscape representing grocery customers. The larger the magnet, the greater the customers it will attract. The model also takes into account competitors and their sizes, each pulling customers according to their respective "power".

The model, he said, "works surprisingly well with conventional groceries." However, he emphasized that the accuracy of the model works depends on the decisions of person operating it. For instance, the analyst must "balance the model" to reflect the relative power of each competitor. That usually entails the use gross sales per sq ft., but also the presence of unique inventory or special departments that will provide a stronger draw of consumers.

When asked how the study concluded, for instance, that the Oneida store would capture 30% of the market in a defined "Sector 2" but only 5% of "Sector 5", the consultant replied, "That's the 'voodoo' of the model." When asked why the projections were so wrong, he suggested that perhaps the analyst did not do a good job of balancing the model.

When it was explained that many of the residents of the area are employed in Green Bay and some presumably shop near their workplace, he said the model "does not really accommodate for travelers." Again, it would be up to the analyst to adjust the balance by lowering the mathematical estimate of the primary store's "power"—a calculation used in gravity models that a mathematician would call it a fudge factor.

The particular consultant interviewed said he stopped using gravity simulation models 20 years ago, and instead bases his analysis on interviews with actual customer in stores to find out how much they spent, where live, and he maps the information to census tracts. The information is used by companies to inform their decision about where to locate new stores, and, he added, an inaccurate analysis can really do damage to a business plan.

In defense of the second market study, it must be acknowledged that it did include a detailed discussion of the competitive environment, and it was critical of the store's proposed location, which it warned might "relegate it to a convenience store status." It also conditioned its conclusions on several assumptions, including competitive pricing, aggressive advertising and promotions, and significant management experience. To the extent that the co-op did not meet these assumptions, the incongruity between projected and actual gross sales can be attributed to its own failures of management.

Nevertheless, when yet another private, independent consultant was asked to review the market report, she concluded that the study was “inadequate” and “superficial”. “Market share seems to have been pulled out of the air. ...I feel like this analysis was done without talking to the Oneida people at all.” Furthermore, there was a “disconnect” between the report’s admission of fierce competition and the rosy sales projections. The report “doesn’t really address this,” she added.

While the market analysis portion of the business plan may be called into question, several other issues deserve mention. In particular, the decision about where to locate the grocery has major implications.

While the location of the grocery was frequently debated, numerous indicators suggest that the selected site was heavily favored by the organizers from the start. In the revised 2004 business plan, the location is touted as “a distinct advantage in supply terms”, because of its proximity to the Oneida food and craft producers. Such an argument downplays the store’s less than ideal proximity to customers. According to one informant, “there really was not great place to put it, because there is no downtown Oneida, but rather five clusters of homes throughout reservation.”



An interior shot of the co-op when it was still operating.

A site visit to the store after it closed confirmed others’ impressions that it was set too far back from road. At an estimated

900-1,000 feet, it looked bit of three football fields. Restrictions about signage on the state highway also limited visibility. The post office, tribal office building, and food pantry that were scattered throughout the large business park attracted very little traffic that morning.

The business plan offered a solution to these challenges: “Location of the store is an issue for some customers, however if we are able to provide excellent products at a competitive price this issue will be minimized.” This is one of several examples where the problem was not the business plan per se, but the failure to implement its components.

On the issue of price, after the store opened a tribal employee was directed to conduct a price comparison of 22 similar products of the co-op and two of its competitors. While the report concluded that Tower Foods’ prices were equal to one of the competitors, interviews with former shoppers disagreed. One woman said she spent \$249 at the co-op and the next week \$130

bought the same groceries. There was certainly a perception of higher prices at the co-op, particularly when compared to larger discount supermarkets in the area.

Another disconnect between the business plan and the actual operation involved the product mix. Despite the frequent connections made between tribal members' poor diet and diabetes, and the purported better quality of "natural foods", the store would ultimately stock an inventory of almost exclusively "conventional foods". The revised 2004 business plan's list of vendors continued that policy despite even greater emphasis on natural foods elsewhere in the text.

The business plan also frequently indicated that Oneida food and craft products would be a central feature of the store's inventory, including Oneida-raised Angus bison and hand-crafted corn husk dolls and blankets. Ultimately that did not occur. One explanation pointed to the failure of one key organizer to deal diplomatically with certain families who were involved in producing these products.

Yet another issue related to the facility was the design or décor of the grocery. Several tribal members indicated that it had a generic quality of the store. One called it a "neon store," adding that "the name, the feel was not Oneida. It was not a comfortable place for Oneida who walked in. It just felt a regular store. Not inviting." At the same time, because it was on tribal land and set far back from the road, "people thought it was for tribal members only. We basically had an identity crisis from the very beginning."

One final aspect of the business plan that deserves mention is its financing strategy. Almost the entire cost of the project was covered by loans from the tribe and a large USDA grant. One tribal member framed this issue in terms of a book on Native American policy called "The Gift That Hurts."

There are two implications worth mentioning. First, the availability of tribal and USDA money meant that organizers did not have to press members hard to contribute equity. A successful equity drive is a good indication of the commitment of members to support the store as patrons.

Second, the ready availability of start-up capital meant that organizers did not have to go to commercial banks or other private lenders. These institutions likely would have demanded more rigorous research into the feasibility of the business. That in turn might either have resulted in far better business plan, or else it might have prevented what might have been inevitable failure.

#### **D. The Project and General Managers**

The lack of diplomatic skills on the part of one project manager has already been mentioned. The resulting ill will that was generated within the tribal bureaucracy and among certain tribal families certainly may have contributed to the store's problems, including cost overruns during development, and decreased community support during the store's two years of business.

However, it should be noted that project management responsibilities were often shared by several people. As one person noted, “It was a wagon running by itself, and every once in a while it had a different driver.”

This inconsistency of leadership which was present from the start, continued after opening. Furthermore, the rapid turnover of managers—four in two years—and the decreased grocery management experience after the first GM left shortly after opening, undoubtedly was a major reason for the co-op’s failure.

Examples of management mistakes included the fact that an entire year passed before the store certified to participate in the USDA’s supplemental nutrition program for women, infant and children (WIC). That meant many low-income community members—one of the target markets— were less likely to shop at the store.

One individual who approached the GM with simple ideas for improving the décor to make it more inviting for tribal members said it became clear he was completely overwhelmed and could not even absorb input, let alone implement new ideas.

Even more damaging, one former board member explained that the inexperienced managers consistently purchased much more product from the distributor than could be moved through the store, resulting in huge losses. Ironically, the food pantry next door to the grocery (which several people indicated was not a source of competition) became a convenient way to dispose of perishable items that became too outdated to sell retail.

## **E. The Members**

When a cooperative succeeds, it may be appropriate to give the credit to the members, for it is their continued patronage that keeps the store in business. However, when a co-op fails, one must ask whether the organizers developed a grocery that met the members’ needs and expectations, or indeed whether the community ever needed another store in the first place.

In other words, one can hardly blame the Oneida community for shopping for groceries where the price, selection, quality and convenience met their individual needs best.

Some of the co-op’s leaders and supporters suggested that the “community wasn’t ready” for the idea of a cooperatively owned grocery. Perhaps more co-op education would have made a difference. Others explained that “changing people’s buying habits harder than expected”, adding that “much more marketing was needed to change people’s shopping behavior.”

The store’s best period of sales were reportedly in the final weeks when word spread of a close-out sale and exceptionally low prices. “The parking lot was never so full,” someone observed. When organizers asked people why they had not shopped at the store more often, people often replied, “I forgot about it.”

This lackluster support should raise doubts about the numerous surveys that indicated community members’ strong support for a grocery on the Oneida Nation. As market researchers often explain, what people say they will do, and what people do, are two different things. Survey

questionnaires need to be carefully worded to solicit respondents' most accurate and specific self-evaluations—and even then the results should be viewed with some skepticism.

On the subject of membership, a final observation concerns the issue of Oneida identity and the local non-Native population. The 2001 business plan reported a goal to achieve a membership base that was “40% Native, 40% White, 15% Hispanic, 5% Other Races.” It was later reported that the actual membership was about 80% Oneida.

It is open for speculation whether the Tower Foods Market might have fared better if had honed a membership drive, marketing strategy, store design, décor, and inventory that attracted both Oneida and non-Native people.

In fact, the co-op's revised 2004 business plan presented an idea for grocery that sold natural foods at higher margins and drew customers from throughout the Green Bay area. That more profitable inventory would help subsidize a “convenient store” section that stocked the fifty items most popular among local shoppers.

Together with a redesigned “Oneida décor” that attracted both tribal members and natural foods consumers, this “hybrid model” was perhaps worthy of consideration. At least one industry consultant with extensive natural foods background reported a rising trend in crossover or hybrid stores that offer natural and low-priced conventional foods. By way of example, he cited a store in Portland, Oregon that took this approach as was grossing half a million dollars per week in a new 24,000 sq. ft. store.

Unfortunately, the idea came too late for the organizers and members of Tower Foods Market. Just two months after the revised business plan was completed, the store closed its doors in June 2004.

#### **IV. CLOSING COMMENTS**

This case will close with a brief consideration of the comparative importance of the five so-called “building blocks” of successful co-op grocery development in rural communities. These conclusions can then be compared with those of the other three case studies.

This analysis of Tower Food Market concludes that the project demonstrated serious weaknesses within all five components of co-op development.

The frequent turnover among members of the steering committee and board of directors, along with their inexperience with the grocery industry, were major factors contributing to failure. The first and second market studies, which should have identified the potential loss of this project, led to a seriously flawed business plan.

The plan presented overly optimistic financial projections, as well as marketing and operational strategies that were either inappropriate or never fully implemented. Furthermore, financing plan was so heavily dependence on tribal loans—including a revolving loan supported by a USDA grant of nearly half a million dollars—that it likely contributed to less diligence in business planning and less need to develop and guarantee member support.

The turnover and inexperience of the store managers gave the business little chance to succeed in the fiercely competitive grocery environment. Finally, the membership was not interested in patronizing the store at a level that could sufficiently cash flow the heavily indebted business.

Once again, it is a tremendous tribute to the organizers of Tower Foods Market and the Oneida people that they have been willing to share their disappointing experience. Hopefully, the lessons this case provides will assist them and others enjoy greater success in future cooperative endeavors. In a final review of this report, an Oneida representative added the following comments:

To end all hunger and food-related illnesses in the Oneida Community will continue to be a priority for Oneida Community Integrated Food Systems as well as the Oneida Tribe. The Diabetes Registry for the Oneida Community Health Center continues to grow at astronomical rates, with **349** new diabetic patients in 2004. OCIFS . . . will continue to pursue all avenues to secure a means of bringing needed food onto the reservation to eliminate hunger. This (co-op failure) is but a brief and momentary setback that we are all ready moving forward from. We learned a significant amount from this experience, and now have the policies, procedures and the development of a revolving loan fund that can grow and expand in the future. The OCIFS members would like to “**wholeheartedly thank**” the United States Department of Agriculture, the Oneida Tribe and the Oneida community. (This report) gives Oneida an assessment of its past work and a starting point for the future.

## **IRON RIVER COOPERATIVES, INC.**

This is the last in a series of case studies that explore the factors contributing to the successful start-up of cooperatively owned groceries in rural communities. The preceding three cases were comparatively recent projects—one starting in 1996; two in 1999. This fourth co-op provides a different perspective. It was started more than ninety years ago, on March 22, 1914.

Offering more than historical appeal, the formation the Farmers Co-operative Mercantile Association, as it was originally known, provides certain insights into the contemporary process of co-op development. The more recent activities of this northern Wisconsin grocery are also informative, as it progresses toward a \$2.5 million expansion/relocation.

### **I. BACKGROUND AND CHRONOLOGY OF START-UP**

The first white settlers of Iron River, Wisconsin were employees of the Northern Pacific Railroad Company. The town developed rapidly in the late 1800s in conjunction with the massive commercial harvest of the state’s virgin forests. According to a reprinted newspaper article in a recent centennial publication, the year 1891 “saw hundreds of people rushing into the new boom town and homes and businesses sprang up almost overnight.” (Savage, 1967)

As the 1900s began, the town boasted a cement block plant, a wagon factory, two pickle factories, as well as

...three churches, a Chinese laundry, two banks, two lawyers, two dentists, two or three doctors, two drugstores, three department stores, five hotels, two schools, a millinery shop, a funeral parlor and thirty-eight saloons. At the height of the lumber boom as many as thirty-five hundred people were residents of Iron River. (Snilesberg, 2002)

According to local legend, "...if there ever was any key that came with the locks upon the doors of those thirst parlors they were forthwith thrown away as useless equipment." (Savage, 1967)

But the good times would not last forever. By 1912 the closing of the town's largest mill marked the end of the timber boom. Nevertheless, "forward looking business men were trying to prepare the way so that something of a village could be maintained after the milling quit." (Savage, 1967) One strategy of the town leaders, as well as the land speculators, was to attract Finnish immigrants to the area to purchase and convert the "cutover" timber lands to agricultural uses.

Late arrivals to Wisconsin in terms of European immigration, the first generation of Finnish-Americans left behind a country that had fallen under hard times and the harsh rule of the imperialist regime of Czarist Russia. They fled compulsory military service, crop failures and famines, overpopulation and mass unemployment, and a highly stratified society that precluded most of them from farmland ownership. They were predominantly unskilled peasants and entered this country "at the bottom rung of the employment ladder." (Knipping, 1977)

Described at the time as "stiff-necked, having the strength of a bear, the endurance of a mule, and disciplined in the Old Country to perform even the most dismal jobs," many of the Finns were attracted to the extractive industries of northern Minnesota and Wisconsin and the Upper Peninsula (U.P.) of Michigan. "A hardy set of men, steady of purpose and habit, frugal, sober and industrious," they built the railroads, cut timber and toiled in mines 4,000 feet deep as a means achieving personal independence.

"One of their proverbs aptly summed up the Finnish spirit, '*Oma tupa, oma lupa*'—'One's own home, one's own master'" (Knipping, 1977). Land speculators and industrialists were quick to exploit this dream, as one promoter advertised: "Take hold, Finland man, of the earth's surface, from which you made a living in Finland. Be your own master and boss! Let the inferior bow to the lord and listen to the blasts of the whistle!" Another advertisement concluded, "All letters answered in Finnish."

One cluster of Finnish agricultural settlement was located just north of Iron River, in a farming community known as Oulu township (named after Finland's largest and poorest northernmost province.) The settlers built single-room *tupas* (dwellings) from roughly hewn logs, and immediately after (or sometimes before) they constructed *saunas* (bathhouses), which often doubled as a smoke house or childbirth facility. According to a Finnish proverb, "If sauna and brandy cannot help a man, death is near at hand" (Knipping, 1977).

As they struggled to clear ground and grow crops from the area's hard clay soil, they traded farm produce with local merchants in return for farm supplies and household goods. A grocery store was started in Oulu out of a farmer's homestead at the turn of the century. It had a rocky beginning, and subsequently went through several owners and locations. Furthermore, there was a shortage of many needed goods, and barter with more distant merchants offered unfavorable exchanges rates for the farmers' produce. In short, "the settlers were not quite satisfied... with the retail store services in the community" (Snilsberg, 2002).

On March 22, 1914, a meeting was held at the local school to organize a cooperative grocery. Five farmers signed on as the first directors of the Oulu co-op. Eventually they would allocate to themselves director compensation of \$1.50 per meeting. But first, they set out to “start business as soon as capital of \$2,500 had been raised” (Snilsberg, 2002).

Foreseeing future capital needs, they authorized \$10,000 in stock, and began selling shares at \$5 apiece. An account of the co-op’s early years was presented in a commemorative report from the co-op’s 2002 annual meeting:

When the merchants learned of this movement they cut off all credit and stopped trading butter and eggs for groceries. Money was very scarce and only \$640 in share capital had been accumulated. But, impelled by the determination and “sisu” (Finnish word for ‘guts’) of the immigrants, a decision was nevertheless made to start the business, and on November 11, 1914, the grand opening was held. An old hotel building in Iron River was rented for \$10 a month. Matt Jaakkola offered the loan of a safe, a stove, a clock, and some electric lights with an option to buy after six months, if needed.

The first manager, A.W. Bergman of Ogema, Wisconsin, was hired for \$65 per month plus free living quarters. A clerk was also hired for \$8 per week and free living quarters. In 1915, a horse was purchased to haul merchandise from the railroad and to make deliveries. Two years later the horse died. ...Credit business and the lack of working capital hindered operations. In 1916 the directors decided to discontinue credit business, except in limited cases and to collect all bills if possible.

In 1916, a branch store was organized in Oulu because of transportation difficulties. A half acre of land was purchased... for five dollars and a building for fifteen dollars. The (branch) manager (was paid) 7% of sales as his salary. ...The Oulu branch was very successful and was very much a factor in the success of the entire cooperative venture in the early years. Another branch was started in Herbster in 1917 but because of insufficient patronage it was discontinued in 1923.

...There were many difficulties faced, none less than the shortage of working capital and the lack of business experience! Mistakes were made such as the purchase of a whole carload of women’s shoes. This proved to be a burden on the business for years” (Snilsberg, 2002).

The experience of the Oulu cooperators was shared by many of their fellow Finns across the northern Lake Superior region. In company-owned mining towns and remote farming communities, “private storekeepers, who often held a virtual monopoly in isolated centers, would charge excessive prices for their wares.” In response, “altogether during the 1903 and 1917 interim, about sixty-five Finnish-sponsored cooperatives were developed in the three states. Despite the extremely difficult conditions faced by many of the societies, very few cooperatives experienced ultimate failure during this period.” (Alanen, 1975).

It is worth noting that the Finns’ success was in stark contrast to the widespread failure of the cooperative stores started by “Old Stock” Americans across the Midwest and Northern Plains in the early 1870s. Developed in conjunction with the national Grange Movement, a primary reason given for the failure of the earlier stores was “lack of solidarity.” There were “no bonds of union except that of buying cheap” (Keillor, 2000). As an 1874 Granger publication explained, to succeed, a members of a co-op “must belong to the same class; must have many interests in common, and must be drawn to each other by such ties that they will feel a deep interest in each other” (Keillor, 2000).

While the solidarity of the Finns may have been a major reason their stores survived, another key element was the support they received from their cooperatively owned wholesale supplier, the Central Cooperative Exchange (CCE). In fact, this federated co-op grew directly out of a meeting in 1917 that was initiated by the Iron River co-op and another store in Hancock, Michigan. In the letter of invitation sent to other co-ops in the region, they wrote:

Why shouldn't we gather our purchases into one? We could buy sugar, salt fish, and canned fish in quantities of many carloads. Canned and dry fruits could be ordered by carload and divided. We could buy flour, or even grain, and have it milled ourselves. We could buy soap, coffee, and other merchandise direct... (Alanen, 1975)

In the back room of a Finnish-language newspaper in Superior, Wisconsin, a hat was passed around that collected \$15.50 to begin capitalizing a grocery and dry goods wholesale cooperative (Karni, 1975). One month later, the CCE was officially incorporated. Given the influence that the wholesale firm had in the development of local co-ops like the one in Iron River, a brief overview of CCE history is pertinent.

During the early 1920s, the CCE gradually grew in membership and sales. By the mid 1920s there were sixty "store societies" claiming nearly 20,000 members in Minnesota, Wisconsin and the U.P. (Karni, 1975). By 1928 the movement had grown to 84 stores whose sales totaled well over one million dollars. (IHRC, 2004).

The August 1929 issue of the CCE's monthly publication, *Cooperative Pyramid Builder*, announced a sales goal of \$1,750,000. Each of the wholesaler's 123 members stores were assigned a "quota" which they were supposed to achieve that varied by store size. The quota for Farmers Co-op Mercantile Association in Iron River was set at \$37,000, and by August they had achieved \$22,487.56. In fact, their sales for August ranked 10<sup>th</sup> best among all the member societies. Their 1930 quota of \$40,355 made it the 15<sup>th</sup> largest store in terms of projected purchases (CCE, 1929).

Besides its bulk purchasing function, the CCE established "a remarkable curriculum for teaching would-be managers and employees the rudiments of business and the principles of cooperation." It also developed "a simple but effective method of bookkeeping that allowed even the most amateur cooperators to keep their books straight and their stores solvent" (Karni, 1975). This technical support must have been invaluable to stores like Iron River's, given the immigrants' "lack of business experience."



The original stock certificate from 1914.

Furthermore The CCE established a member education department “which carried cooperative organizers and their copious literature into nearly every home in every Finnish community in the western Great Lakes region” (Karni, 1975). Traveling productions of theater, dance and song combined with co-op and worker education to fill local halls.



An undated photo of a neighboring Finnish co-op in Maple, Wisconsin, sixteen miles west of Iron River. (Wisconsin Historical Society)

The CCE and its local Finnish co-ops were inspired and informed by a common ideology. “Although the Finnish American consumers’ cooperative movement embraced all segments of the Finnish community, it had been started largely by... the Socialists, who viewed cooperativism as an economic adjunct to the working class movement.” (IHRC, 2004).

In fact, the cooperative groceries they started were known interchangeably as “Finn stores” and “Red stores” by the non-Finns in the area (Karni, 1975). These co-ops’ socialist orientation stemmed partly from the grassroots labor unrest of Finnish miners, particularly in Minnesota and Michigan. However, “in Wisconsin, the direct influence of labor unrest was more peripheral” (Alanen, 1975).

Another major source of socialist ideology came from Finnish intellectuals who had fled the Russian Czar’s tyranny back in Finland. Many of them became leaders of the Workers’ (Communist) Party of America, and they saw the cooperative movement as a powerful— and profitable— vehicle to achieve their militant political goals.

However, “a much larger, less homogenous group of (Finns had) come to believe their prosperous movement should attempt to reform capitalism through economic means rather than to serve as an arm of a revolutionary political party” (Karni, 1975).

By 1929 “an irrevocable split” had developed in the CCE and across the local Finnish-sponsored co-ops. Communist leaders in New York and Moscow were attempting to bring the CCE under its tight control, “demanding at one point a “loan” of \$5,000 from CCE to be paid immediately (Karni, 1975). After a fierce organizational battle, those favoring a more neutral, non-political direction prevailed by a decisive majority in at an annual meeting of the CCE I April 1930.

“The struggle signaled the beginning of the end of Finnish-American radicalism as an ethnic movement... which had begun thirty years before as a reaction against American values and culture,” and the thereafter the Finns “were drawn into the mainstream of America, away from purely ethnic concerns” (Karni, 1975).

In subsequent years, the CCE changed its name to Central Cooperative Wholesale, and its more radical leaders left the company. The co-op also modified its Red Star trade label, abandoning the Hammer and Sickle logo for the Twin Pines symbol of the politically neutral “Rochdale” consumer co-ops. (Keillor, 2000)

While some of the local co-ops clung to leftist politics, most of these failed to survive through the decade. Meanwhile, having broken from its Socialist origins, the revamped CCW prospered and flourished, even in the midst of the Great Depression. By 1940 its 100-plus member societies combined sales totaled over \$14 million. The majority of these were still dominated by the Finns (IHRC, 2004). In fact, is remarkable to note that the minutes of the CCW were kept in Finnish through 1941, and the last bilingual session of the CCW took place in 1948 (Alanen, 1975).

The progression of the CCW and its member stores after World War II puts the Iron River co-op into context:

The cooperative complexion of the region was transformed by new developments in agriculture and technology, general economic transitions brought about by World War II, and the broader horizons and new relationships resulting from military experience. ...The flush of overall cooperative growth which ushered in the post-war era was tempered quickly by the agricultural recession of the late 1940s and early 1950s. ...Consolidation, and even retreat, now became more evident.... Not only did many stores feel the pinch of population declines within their market areas, but the spatial configurations of local trade areas also was changing with improvements in the road network and ubiquitous automobile ownership. ...Recognizing that the lure of the supermarket and shopping center was too great to be ignored, the CCW, during the 1950s, began to develop several such facilities in key cities throughout the region (Alanen, 1975).



The Red Star Chorus, from a 1929 issue of the CCEs' *Cooperative Pyramid Builder*.

While some thirty local Finnish co-ops failed between 1945 and 1963, the cooperative wholesale firm grew to almost \$20 million in gross sales. However, it too faced increasing competition, and in December 1963 it voted to merge with the larger agricultural supplier, Midland Cooperative, Inc. The CCE leadership had concluded that they “could be more effective in furthering their objectives and improving their services if they ultimately amalgamated into one central organization” (Alanen, 1975).

The merger effectively ended the Finnish-sponsored cooperative federation. By the mid 1970s, of the approximately 175 cooperative stores, branches and buying clubs served by the CCE, only about a third continued to exist (Alanen, 1975). Midland itself merged with Land O’ Lakes in 1982. By 2004, Iron River Cooperatives, Inc. was the only confirmed case of the old Finnish grocery co-ops still in operation in Wisconsin.

## **II. MISSION ACCOMPLISHED?**

The histories of the previous three co-ops in this four-part case study concluded with updates on their progress through the fall of 2004. In each case, the question was posed as to whether the co-ops accomplished their respective missions.

Ninety years later, it is difficult to fully ascertain the original mission of the Iron River co-op. It is not clear whether its founders shared the militant goals of the Finnish Socialists of their day. Certainly the co-op would have provided a familiar haven for Finnish settlers and helped preserve their ethnic culture and community, and that may have been one intended purpose.

If the co-op’s fundamental mission was to provide a price competitive source of groceries to the local community, it would appear to have met that goal for 90-plus years. And so today, as the co-op approaches its own centennial milestone, its board of directors and management strategize how to carry that success into the 21<sup>st</sup> century.

By the year 2000, the town of Iron River had become home to 1,059 residents, of whom 96.5% were labeled White Non-Hispanic (2000 Census). Remarkably, the U.S. Census Bureau’s extrapolated ancestry data reveal no residents of Finnish descent in Iron River. Nevertheless, the presence of a sauna dealership (still pronounced “SOW-na” by many locals) at the entrance of town would seem to contradict the Census data, as would the proliferation of Finnish surnames in the local phone book.

Iron River is located in northwestern corner of Bayfield County, which in the year 2000 held a population of 15,013. It is the second largest of state’s 72 counties in terms of area, but is the 3<sup>rd</sup> least populated, with just 11 residents per square mile. However, the population increased 3.7% from 2000 to 2004, and the net migration rate in Bayfield County of 4.1% was more than double the state rate of 1.6%. The in-flow is largely “older residents looking to enjoy a less hectic life” (DWD, 2004).

While agricultural output is comparatively low relative to the warmer, more fertile counties further south, the USDA reported 468 farms in the county, averaging \$6,383 each in net

cash farm income, or \$2,987,000 total in 2002. Manufacturing plays a small role in the county, although a forestry equipment company in Iron River employs about 60 people.

One third of all jobs in the county are with government, including all tribal governments, school districts, and state and federal agencies. The annual average wage for these jobs was \$24,152. Tourism businesses provide a quarter of county jobs, but these pay only \$12,778 on average. (DWD, 2002). Four out of every 10 residents travel to neighboring counties for jobs. 59% of those work in Ashland, 30 miles east of Iron River (DWD, 2004)

The town of Iron River at one time supported three groceries. Today, the co-op is the only full-service grocery within a roughly thirty-mile radius. Its competition is in cities like Ashland and Superior and other communities where Iron River residents travel to work. Currently, there are no “super-stores” in the area, although a Super Wal-Mart is rumored to be on the way in Superior and possibly Ashland too.

The plural of Iron River Cooperatives, Inc. reflects the fact that the co-op owns and operates a grocery and a hardware store in separate locations. Previously the co-op sold groceries, hardware, clothing apparel, and other necessities out of one location. The grocery on Main Street, one block off of State Highway 2, contains 7,000 square feet of retail space in a 10,600 square foot building.

The Hardware Hank store is 6,400 square feet and fronts the highway about a mile and a half west of the old downtown. The business bought the hardware store from a local family in 1996, as a means of increasing retail space and sales in all product lines. They paid off the loan on the second establishment in six years. The son of the former owner now manages the hardware operation.

In the fiscal year ending January 31, 2004 (referred to as simply 2003 below), the grocery and hardware store achieved gross margins, after cost-of-goods-sold, of 26% and 39%, respectively. The profit from the two operations, before indirect administrative costs, was \$167,640 for the grocery and \$63,327 for the hardware store, representing net margins of 5% and 8%. Labor costs were lower for the grocery (14% vs. 20% of sales).

About 86% of grocery sales was to members in 2003, with sales-per-customer around \$18. The grocery employs 10 full-time year round and reaches a peak of 17 part-time employees in the busy summer months.

While the books for the grocery and hardware operations are kept separately, they are brought together to share certain administrative costs and miscellaneous income, pay tax as one entity, and distribute patronage refunds based on their combined performance. The financial activity for the single co-op entity over the past four years is presented in Table 1.

In 2003, the shared “indirect administrative expenses” of the two operations totaled \$144,394. That figure included director fees and expenses (\$2,622); salaries, payroll taxes and benefits for the General Manager and two office staff (\$114,208); office supplies and postage costs (\$7,983); service contracts on computers and office equipment costs (\$10,229); and professional services costs (\$9,352).

	2000	2001	2002 *	2003
Gross sales (million)	\$3.74	\$3.78	\$3.75	\$3.88
Gross margin	24%	25%	27%	29%
Profit before distribution	\$88,870	\$79,072	\$73,698	\$79,769
Profit margin before distribution	2.38%	2.09%	1.97%	2.05%
Current ratio	2.74:1	2.63:1	1.97:1	3.48:1
Debt-to-equity	55%	42%	35%	27%
Cash patronage refunds	\$13,083	\$12,535	\$10,500	\$10,000
Retained patronage refunds	\$53,230	\$50,137	\$42,000	\$40,000
Unallocated equity	\$22,558	\$16,400	\$21,198	\$29,760
Retired equity	\$6,562	\$9,383	\$20,698	\$7,147

Table 1: Financial Highlights 2000-2003 (\*2002 data omits one month of sales, when the fiscal year was permanently shifted to a 2/1-1/31 cycle.)

Also combined were interest expenses and miscellaneous income, which netted minus \$6,592 in 2003. A patronage refund of \$7,901 that the hardware store received from its cooperative distributor (United Hardware) was also factored into the combined books of the cooperative entity.

Taken together, the net margin (or profit) for the combined business was \$88,082 in 2003. Based on their auditor's advice, they retained \$29,760 of that as unallocated equity and paid \$8,322 taxes on that portion (28% tax bracket). 20% of the remaining profit (\$10,000) was distributed to the members as cash patronage refunds, and the rest (\$40,000) was allocated to members' equity accounts in proportion to patronage.

Table 1 shows equity-related activity over the past four years. Their equity redemption strategy is primarily to redeem estates at the discretion of the board. All equity dating before 1976 has been returned to members and their heirs.

Currently, the membership of the co-op stands at roughly 4,000 households, about 3,500 of who are "active". In 2001 these members approved a major revision of the co-op's by-laws. Prior to that year, member equity was allocated in capital shares. They switched to an equity account system, which puts equity on the books as one lump sum. Customers are now issued a number with their first purchase, and that gives them member status. However, to achieve and maintain voting rights, members must do \$500 worth of business with the co-op each year.

The by-laws revision addressed several financial issues, such as the handling of unclaimed property, and it strengthened the co-op's balance sheet. It also represented one of several steps the co-op has taken in recent years that facilitated the forthcoming expansion of the grocery into a new location.

The current grocery facility, built in 1929, appears “well-worn” on the interior, and the exterior reflects the “frontier architecture” of Wisconsin’s relatively undeveloped North Woods. Despite the appeal that may offer some visitors, at least one potential customer (the author’s unnamed aunt), reports that from her home in Herbster, she could either travel to the co-op in Iron River or to a private IGA store in Washburn to buy her weekly groceries. While they are roughly equal distance, she generally patronizes the latter, dissuaded by the “dingy” décor of the old Finn store.

The co-op’s membership presumably shared her preference for a “modern” store. Back in 1998 they voted overwhelmingly to relocate the store to a larger, new location. After a period of preparation, the board of directors finally authorized the purchase of a tract of land on November 29, 2000. Debt free at the time, they bought the property for \$190,000 with a cash down payment and a loan from a commercial bank that held their existing assets as collateral.

About six months earlier that year, the board made another important decision when it hired Patrick Dooley to become general manager of the co-op. While his background was in the hotel industry, he soon made the adjustment to the grocery industry, and has since played a critical role in the process toward expansion and relocation.

Mr. Dooley’s oversees the both the grocery and hardware operations, and as such his salary and benefits appear as indirect administrative costs. The manager of the hardware store reports to him, while he has day-to-day responsibilities for the grocery. In 2001, he implemented the board’s decision to invest \$100,000 into a computer system for the business.

More recently, he managed a difficult transition to a new distributor. The Iron River grocery was one of many across the country that were adversely affected by the bankruptcy of Fleming Corporation in 2003. That company had previously supplied a major portion of the co-op’s groceries for decades, but in the latter years its service had declined significantly, often leaving the co-op short on products, which led to customer dissatisfaction.

This past summer, in the peak of the business cycle, the co-op made the switch to Nash-Finch, a private distributor out of St. Cloud, Minnesota.

Mr. Dooley expressed much satisfaction with Nash-Finch thus far, noting in particular that the company’s advertising program for their “Our Family” private-label brand has been a major improvement over the Fleming experience. Previously, they sold under the IGA-brand, but with Fleming gone there is no longer a distributor of those



The current grocery facility, built in 1929.

products. So while the co-op currently remains an IGA store, and has access to the purchasing power, training programs and other support of that organization, it may discontinue its IGA ties when the grocery finally relocates.

When asked to explain the reason for the big move, the Mr. Dooley replied, "It's what people want." Getting there, however, has been long, drawn-out process. As of December 2004, the co-op was still negotiating with the major commercial bank in town to obtain financing to build a new 15,000 square foot building-- a \$2.5 million project.

When asked to explain the long delay, the general manager said that the switch of distributors contributed to the hold-up. "First we had to develop our relationship with Nash-Finch," he explained, "and we had to get the bank had to get comfortable with them too."

Jane Snilsberg, who currently serves as a director on the board and previously served as its president, noted that despite the members' expressed interest in relocating to a larger store, nothing could move forward without the local bank's support. "Banks outside the area wouldn't lend to us," she explained, "either because they were unfamiliar with co-ops, or because they wanted to see local lenders get involved first."

Part of the issue, according to Mr. Dooley, was getting a bank to see members' equity not as debt but as an ownership stake in the business. Furthermore, they need "to recognize that the board had control over when it's redeemed," he explained. The way a bank sees it, "the liability is so spread out amount members, and the board of directors can just walk away and the bank is afraid of being left holding the bag."

Part of the challenge, Mr. Dooley noted, is that "a co-op can't save up great sums of capital to finance an expansion. First of all, while the store needs to make a profit, it can't out price the customers. And when there is a profit, you either have to pay it out as patronage refunds, or pay tax on it, or make big purchases and expense it out. But you have to develop an equity structure if looking to expand."

Thus far they have not pursued selling equity shares to members, nor do they intend to ask members to make unsecured loans-- two strategies that other co-ops have used successfully to finance expansions.

As 2004 drew to a close, prospects for obtaining the necessary financing from the local lender were improving. Part of the deal would require the co-op to purchase and build upon a parcel of land owned by the bank. The land they bought in late 2000 would be held as collateral, as well as the hardware store, and, "basically everything else we own," Mr. Dooley explained, "The bank wanted to see the co-op with at least a 25% equity position, and I think we've met that and then some."

Ultimately it is a question of the level of debt load a store can support. In recent years, the co-op's debt-to-equity ratio has improved as it first paid off the hardware store and more recently the loan for the land purchase (toward which it still owes \$70,000). But the burden of the next mortgage will be significantly.

“As a co-op, we’re just looking to pay the bills,” the GM continued, “We aren’t aiming for a serious return on investment. But the bank wants to see a return on investment because they’re afraid if we run it too thin they’ll have to loan more money to keep it going, and if we still go broke they’re stuck with a building that may or may not cover the default on the loan.”

However, Ms. Snilsberg pointed out one of the reasons the bank pushed for the co-op to build on its land. “It lowers their risk. We’ll improve their property if they do get it back.” Still, she acknowledged that market studies have been positive on the latest location. That analysis, conducted by an independent company that Nash-Finch recommended, took into account tourist traffic and a parking space that would accommodate large RVs. They also collected geographic data from customers for three days late in the summer of 2004.

“Basically we’re looking to put a store where someone else wouldn’t invest,” Mr. Dooley observed, “but it still must be profitable.” The key, he said, would be location and management. “People are looking for service and convenience. Patronage refunds are not the hook.”

Plans for the new store include refurbished but newer equipment. There will be a deli and a limited service bakery. They will also expand frozen, fresh and specialty departments. Compared to current per-customer sales of \$18, they will be looking to achieve \$22 or \$23 in new store.

The co-op is meeting with bank again in early January 2005. Mr. Dooley is cautiously optimistic the loan will be approved. “We’ve really worked at going over the numbers to show that the store can pay for itself, and that’s given the bank more confidence. We used Nash-Finch numbers, not just pie in the sky numbers.”

He added that the arrival of a Wal-Mart SuperCenter in Ashland might not occur as early as previously expected. If true, perhaps the co-op will have time to prove itself and develop customer loyalty. Mr. Dooley’s background in the service-oriented hotel industry may pay dividends if his insights are correct: “The grocery business is becoming a service industry. People are looking for knowledge, how to cook a roast, how to fix this or that. Some of the larger stores get away from that.”

The Iron River co-op, with four score and ten years of history behind it, is risking everything to meet the changing needs of its members. Will this old Red Store of the “stiff-necked” Finnish immigrants succeed? Only time will tell.

### **III. FACTORS AFFECTING START-UP AND SUCCESS**

The previous three case studies concluded with an analysis of five components of the start-up process that appear to be critical to success. This unique case of Iron River Cooperatives, Inc. will consider these same components in the context of its early history as well as the recent effort to expand and relocate the business.

#### **A. The Steering Committee and Board of Directors**

Apart from their names-- Laure, Jaakkola, Kiviso, Kamarainen, and Maki-- little is known of the five Finnish men of Oulu township who, in 1914, founded the Farmers Co-operative Mercantile Association. Probably they were farmers with scarcely any wealth and precious little business experience.

The modern concept of a “steering committee”-- meaning simply the “quasi-board” that makes decisions prior to incorporation and formal board elections-- would have to these five founders for about eight months. After their initial meeting in March, the co-op was incorporated in November of that same year.

As the first directors, they made a number of astute judgements and critical decisions. For instance, they judged that the capital necessary to start and establish a co-op grocery would be roughly \$2,500, and they set out to raise it.

When they fell 74% short of that goal, they had the *sisu* to plow forward anyway. While that may have demonstrated more determination than good judgement, nonetheless they went on to address some of the fundamental issues of co-op governance, such as:

- hiring and incentivizing management (recall “7% of sales”)
- questions of expansion and investment (a new branch in Oulu on a five dollar half-acre)
- and balancing the interests of the members and their co-op (e.g., discontinuing credit when it hurt the business)

Occasionally their decisions were wrong, as the failed branch in Herbster does reveal with 80-plus years of hindsight. As for the horse that died, all investments carry risk.

Perhaps the most important decision of those early years (because it would ultimately affect over a hundred other co-ops) was to send the letter that spawned the formation of the Central Co-op Exchange in Superior. While the idea may very well have come from management, without board support it is unlikely the local co-op would have become such a substantial customer of the wholesale society.

Research uncovered perhaps even less about the contemporary board of directors, but again it appears that these men and women are proving equally critical to the success of the cooperative.

It was discovered that some members on the current 7-member board have served for 15 years or more. And while there has not been a great deal of turnover over that period, one new director came on board last year, and another two rotated on this year. They include schoolteachers, state government workers, a builder, and most recently an employee of the bank that may soon finance the co-op’s expansion. One current board member has a “significant grocery background,” and in fact he stepped in as interim manager just prior to Mr. Dooley’s current tenure in the job.

It would appear from a cursory examination of both the earliest and the most recent boards of the Iron River Co-op, that their leadership and commitment were critical to the start-up and success of the business.

## **B. Consultants and Advisors**

It appears that the most important external support that the Finnish co-ops received in the early years came from the Central Co-op Exchange that they started themselves. The CCE provided management and employee training; it developed a simple bookkeeping system that each local store could adopt and adapt; it provided member education in the form of monthly publications and travelling road shows.

By contrast, the modern-day co-op in Iron River appears to operate with less reliance on external support. Mr. Dooley reported that the board of directors has received some training from “CENEX”, referring to the agricultural co-op out of Minneapolis now known as CHS, Inc. He also said that the board get an independent audit each year from co-op specialists at Carlson Highland, also in Minneapolis.

Both he and Ms. Snilsberg indicated that they approached Northcounty Cooperative Development Fund and the National Bank of Cooperatives for financing, but they currently do not carry loans from any cooperative lenders.

If anything, the external resource that upon which the co-op depends most heavily is its distributor. When service from Fleming deteriorated, so did the co-op’s service and its sales. They have been very pleased with Nash-Finch thus far and have leaned on that firm very much to forecast their current expansion.

It is clear that the advice and support from the CCE was critical to the early development of the Iron River co-op. External support appears to be necessary today as well, but much of that support has come from a private source within the industry.

## **C. The Business Plan**

Nowadays, most if not all lenders ask to see a formal written business plan before they will consider a loan to a new business. There were no lenders for the Oulu Finns to turn to in 1914, so there were no such requirements. How much research and planning the five founders conducted to come up with their \$2,500 capitalization goal, for instance, is hard to know.

As a co-op grows it will continue to need a disciplined approach to gathering and presenting information, and with good record-keeping valuable information can be gleaned from the business the co-op does. The CCE’s bookkeeping system would have facilitated this process.

As for the current expansion project, Mr. Dooley reported that they “are currently in the process of putting



GM Patrick Dooley and Board President Lee Ruska.

together a formal business plan using information that we have obtained from wholesalers, customers, board members, and our employees.”

Several market studies have been conducted. They have adjusted their marketing and operational strategies to better target the summer visitors. They have done numerous renditions of financial projections, continually going over their numbers to get them right.

The fact that the expansion project has proceeded this far without a completed business plan may stem from the local lender’s familiarity with the long-standing business, and it probably does not detract from the case for start-up co-ops’ need for a formal written plan.

#### **D. The Project and General Managers**

A project manager is responsible for activities that precede the opening of a new co-op business, or that relate to a major expansion. The general manager may manage start-up or expansion projects, whether or not they not have the skills or the time in a given situation.

The Oulu farmers probably shared project management responsibilities in their 8-month start-up phase, although the contributions of director Matt Jaakkola (loan of a safe, a stove, a clock, some electric lights) might reflect an added commitment and more prominent role.

They ultimately hired A.W. Bergman out of Ogema. The salary of \$65 per month and free living quarter must have been incentive enough to travel the distance to get there (about a 3 hour drive by today’s standards.) We know little of his or his subsequent managing capabilities, aside from business decision to which the board likely contributed (branch expansions, the short-lived horse).

If the mistaken shipment of women’s shoes happened to be the fault of a clerk, the GM would share responsibility for that too. But whatever mistakes management may have made over the years, they clearly kept the business in operation.

More recently the hiring of Patrick Dooley has made a “very big difference,” according to board member Snilsberg, who added, “At the moment we have extremely experienced good management. He ran a major business outside of town. He’s got marketing experience, personnel experience, financial experience.”

Prior to Mr. Dooley’s arrival there had been some troublesome turnover in management. But in his first five years at the helm, he has implemented several major investments, including the land purchase and the computer upgrade, through a major supplier transition, and now through lender negotiations and a \$2.5 million expansion. He currently serves as Treasurer for the board. “I’m an officer,” he explained, “but not a voting director.”

The scant record of management performance in the Iron River co-op’s start-up phase provides little evidence to evaluate the importance of the general manager in that phase of development. However, the integral role that Mr. Dooley plays today in an expanding co-op confirms the notion that at a general manager is a critical component of success.

## E. The Members

No co-op can survive long without members who consistently patronize the business. Several generations of members have made the Iron River co-op the oldest cooperative grocery in the state, and one of few that provide full-service, conventional groceries to rural Wisconsin residents.

The co-op's 3,500 active household members far outnumber the Iron River population of 1,100 residents.

That is because the members live in the surrounding rural area and neighboring towns, and also because many returning tourists and summer residents apparently meet the minimum membership quota of \$500 per year. With 86% of sales to members, only 14% of customers would fall under that threshold.

The general manager reported that there are no member benefits aside from the cash patronage refunds when the store is profitable and the board approves the allocations, which they have done each of the past four years. The on-going retirement of equity shows that retained patronage refunds represent a postponed but real benefit as well.

As Mr. Dooley further explained, "The members do have some sense that this is *their* co-op. They feel they can complain if they're unhappy. Two hundred members showed up at annual meeting."

When a visitor shops at the store they are asked for their "customer number." If it is not provided, the cashier presumably punches in a generic "guest" account. Mr. Dooley admitted, "We haven't done a good job of marketing the co-op. In new store we plan to do better."

Some concerns may be raised about the current level of member support. When members are asked to make equity investments in a new or expanding co-op, even if they are small in nature, it can provide a measure of customer loyalty and even a test of financial projections. Because members were not asked to make capital contributions, either in the form of loans, preferred stock purchases, or other mechanisms, their level of commitment to the store will not be known until the new store opens.

It is also important that a co-op receive support from the wider community, meaning those individuals and institutions in town and the surrounding area that are in a position to help or obstruct a cooperative venture. In the early days, local merchants tried to punish the founders and original members of the Iron River co-op by discontinuing credit and bartering options. As a predominantly Finnish-American endeavor, the new business undoubtedly leaned on its ties



The future site of Iron River co-op should be resolved early 2005.

within that ethnic community, and that of course included the cooperation across the western Great Lakes region in the form of the Central Cooperative Exchange.

More recently, the co-op has faced difficulties with its expansion project. Board member Jane Snilsberg strongly emphasized that it is not enough to have member support. “Members voted to approve this move back in 1998. We have their full support to go ahead and build a new store. But here we are in 2005 and still no store. Why? Local politics have weighed so heavily on the ability of the co-op to make any move.”

Unfortunately, the sensitivity of current situation precludes a detailed discussion of those “politics.” The general manager also preferred not to elaborate on the obstacles that the co-op has faced. However, with a meeting scheduled for early January, he was optimistic that the project would go forward and construction of the new store would finally begin in 2005.

#### **IV. CLOSING COMMENTS**

This case of Iron River Cooperatives, Inc. provides a unique perspective to the question of what makes for a successful co-op grocery in a rural community. Both the distant and recent history confirms that the board of directors and general manager are critical components of co-op success.

The role of the Central Cooperative Exchange in supporting Finnish stores all across the western Great Lakes region exemplifies how much external resources can be shepherded to greatly increase the likelihood of co-op success. In this case, having a centralized “second-tier” organization dedicated to management and member education seemed to have been critical to the growth of the Iron River store and dozens like it all across the 3-state region.

The important role of business planning in the current expansion project confirms that it is another critical component, particularly when approaching lenders for debt financing.

Finally, the importance of the members in a co-op’s success is obvious in the sense that without their patronage the business will fail. However, this particular case study does not provide evidence that it is critical for members to provide new equity capital for an expansion of that already has substantial assets.

The solidarity of the early Finns helped them build hundreds of co-ops in the first half of the 20<sup>th</sup> century. For Iron River Cooperatives, Inc to succeed after its latest expansion is complete, it will have to do so less on the solidarity of members, but rather on its ability to provide competitively priced groceries and good service to its rural community.

#### **COMPARATIVE ANALYSIS OF THE FOUR CASE STUDIES**

At the outset of this research effort, five components were hypothesized to be critical to the successful start-up of a rural grocery cooperative: the steering committee/board of directors; consultants and advisors; the business plan; the project/general manager; and the members. Upon completion of the cases, further analysis led to a refinement of these components and identified eight common variables that extend beyond the initial development process:

- Competition
- Community and industry support
- Member support
- Quality of the business plan
- Business growth patterns
- Market niche
- Board and management leadership
- Finance

## **COMPETITION**

Three of the four cooperatives faced direct competition from grocery stores in nearby larger communities. In each case, many members of the local community commute to work in these cities, and often buy groceries on the way home. Root River Cooperative is the only grocery store in Houston, but there are two full service grocery stores in nearby small communities, plus a Wal-Mart Superstore in La Crosse, and other large groceries in both La Crosse and Winona. Iron River Cooperatives is the only full service grocery store within a 30 mile radius, but they are concerned about a planned WalMart Superstore in Ashland. Tower Foods Market Co-op faced the closest competition, with four dominant grocery stores in nearby Green Bay and a new 68,000 square foot store in DePere (5 miles away).

Viroqua Food Cooperative differs because it's a natural foods grocery store, with the closest competition over thirty miles away. Viroqua is four times the size of Iron River and Houston, and it's more isolated from large population centers.

## **SUPPORT FROM OTHER COOPERATIVES AND THE COMMUNITY**

All of the cooperatives received support from the cooperative community as advisors or consultants. Two of the co-ops, Root River and Viroqua, benefited directly from the presence of strong cooperatives in their community. The two largest employers in Houston are cooperatives, and each of them provided loans to Root River during its start-up phase. An attorney from the local electric co-op helped the steering committee file the articles of incorporation.

In Viroqua, a local resident who had helped start the successful organic marketing cooperative, CROPP, served as an active advisor to the food cooperative. A long-time CROPP employee serves on the board of directors and provides valuable experience with marketing and operating a co-op. The Viroqua co-op also benefited tremendously from support of the regional and national natural food co-op network.

Iron River was part of a movement to develop cooperatives across northern Minnesota, Wisconsin and Michigan. The board and management were instrumental in starting and supporting a cooperative wholesaler (CCE) in Superior, and benefited from its services for years. Currently, they occasionally attend trainings provided by CHS, Inc., but don't seem connected strongly to the co-op community. The current situation is similar to Tower Foods Market, where they had sporadic assistance from cooperative advisors and other food co-ops in the region, but no consistent relationship with a local supportive cooperative.

Both Root River and Tower Foods Market had significant support from local officials. The City of Houston commissioned the initial feasibility study for a downtown grocery store, after the previous store closed. They had also contracted with a grocery wholesaler to do develop a layout design and identify operational needs. The co-op steering committee benefited from these studies. They were also able to get the support of a local lender for their needed debt capital.

Tower Foods Market was supported by the Oneida Nation from its inception, and certainly received grant/loan support based on their relationship with the Oneida. The cooperative was located on tribal land, next to several service offices. They didn't seek conventional funding from local banks, and there is no evidence that they received support from Green Bay or other nearby communities. The 2004 business plan recommended a strong marketing plan to the larger trade area, but the store closed before the plan was implemented.

## **MEMBER SUPPORT**

Iron River and Viroqua both make over 80% of their sales to members. Viroqua opened with 95 members in 1995, and had 1000 members by 2004. Members support allowed Viroqua to open debt-free in 1995, and member support has continued in the form of equity investments and loans. Iron River has 3,500 active members, 200 of whom attended their last annual meeting. They are not asking members to invest in the relocation project, either through loans or equity.

Root River sells 50% to non-members – many of them tourists, who are an important component of their profitability. They had 310 members when they opened in 2000, and these members raised over 40% of the funds needed to open the store. Membership has increased by 35% in four years, to 419.

The organizers of Tower Foods Market held a number of community meetings to gather support and feedback from potential members and customers. It seems clear that they received overly optimistic feedback from surveys and interviews. They opened with 266 members in 2002, among a target population of 8,876. The per customer weekly expenditure had been estimated at \$30, but was actually only \$9.00. While they had aimed to garner 60% of business from non-Natives, an estimated 80% of their sales were to Oneida customers.

## **QUALITY OF THE BUSINESS PLAN**

Each of the cooperatives in this study differed considerably in their experience with business plans. Viroqua, which grew from \$290 in sales per square foot in 1996, to \$1,166 in sales per square foot in 2003, was started without a business plan. After start up, though, subsequent expansions have been well researched and planned.

The organizers of the Viroqua never wrote a business plan, but they had the advantage of five years of experience running a food buying club for 40 members. Like many 1970s-era natural food cooperatives, the co-op was an outgrowth of buying club's desire for a storefront grocery. Because they were able to self-finance the start-up, they didn't need to write a business plan for a lender.

The Root River Coop didn't start as a buying club, but the organizers were basically re-starting a grocery store that had been reasonably profitable in the same location. The former owner shared all of his financials with the steering committee, and they also had access to a business plan commissioned previously by the city of Houston. Along with the substantial commitment of equity and unsecured loans from members, the business plan helped to convince a local bank to lend them the balance of the needed start-up capital.

The founders of Iron River Cooperatives may not have written a business plan before the co-op opened in 1916, but the co-op is in the process of putting together a detailed plan to support their request for the capital needed to relocate. They have conducted member surveys, and worked with their distributor to create accurate sales and operating projections.

Community members began planning for a grocery in the Oneida area in 1996. Two market analyses were conducted by wholesale suppliers (in 1996 and 2000), and both were significantly overly optimistic. A needs assessment survey was conducted among community members. It showed mixed support for the cooperative, and the 2000 market study identified potential problems with the size and location of the store. In spite of these concerns, the study predicted profitability in the first year.

## **FINANCE**

The start-up financing for each cooperative differed considerably. One of the co-ops, Viroqua, met its financial goals solely through member investment. They needed \$20,000 to open the store, and received a major boost when one member bought \$10,000 worth of stock. Root River financed their start-up with a combination of member stock (310 members @\$100 each) and unsecured member loans (\$137,700, including \$20,000 in loans from two local co-ops), in addition to a loan from a local bank.

Iron River was financed by its members at its start-up in 1914, but it is working with a local bank to finance its \$2.5 million relocation. Although the members voted overwhelmingly to approve the expansion, there are no plans to raise funds from its members. Members invest through their patronage, and the co-op regularly pays a patronage refund.

Tower Foods Market was funded through a \$250,000 contribution from the Oneida Nation, along with a \$460,810 revolving loan from USDA (via the Oneida). Member equity was less than 1% of their financing at startup, and there were no bank loans. The availability of relatively institutional dollars meant that organizers did not have to press tribal members to contribute equity, nor did they have to subject their business plan to the rigor of commercial lender.

## **BOARD AND MANAGEMENT LEADERSHIP**

The three successful cooperatives have had good continuity of experienced managers. The original manager at Root River is still there, after four years. Viroqua has had the same manager since 1998, and Iron River's manager has served since 2000.

On the other hand, Tower Foods Market had four managers in two years. They also experienced high turnover in community leadership. Twenty-five individuals served on the

steering committee and board between 1999 and 2004. When the store opened, a completely new and inexperienced board took over.

Viroqua has had regular board turnover, but no trouble finding new people to run for the board. When the cooperative was getting ready to open, a core group of 20 members put in hours of sweat equity to renovate the space. As board members or regular members, the co-op has been able to draw on a dedicated group of supporters.

Iron River has an experienced board, with tenure varying from one – fifteen years. Root River also has a good degree on board continuity. The steering committee that started the co-op had a good balance of skills, and shared responsibilities well. Some of these founders are still on the board.

## **BUSINESS GROWTH PATTERNS**

Each of the co-ops opened in a different environment, and each of them proceeded slightly differently. Viroqua is a good example of a business that starts small and grows steadily. They started with a core membership of 40 members of a successful buying club, opened in a small storefront, remodeled it extensively, reached 1,000 members, and now are planning to relocate. The manager has invested in training and efficient systems, so they have been able to increase sales steadily and prepare for significant expansion.

Tower Foods Market opened in a new location for a grocery store, with a full-service 8,000 square foot store. There were discussions about changing the product mix to more profitable natural foods, but the offerings never changed before the store closed after two years. Sales were significantly under projections during that entire period.

Root River opened on the site of an existing grocery store, and used that store's figures to estimate their sales. This proved to be a reasonable estimate, and sales have held steady since the store opened in 2000. The manager cut operating costs in order to achieve profitability, which has been modest but consistent.

Iron River has operated for over 90 years, and the details of its business growth are beyond the scope of this report. The current store has done well enough to develop plans for relocating to a 15,000 square foot store, which is a \$2.5 million project. The cooperative also owns a hardware store at a separate location, and shares some administrative costs with that store.

## **MARKET NICHE**

Communities are very interested in having grocery stores, but don't always support these local businesses. A strong market niche can be very helpful in overcoming the inherent challenges of running a small, low-profit-margin grocery.

Three of the cooperatives were started as full service grocery stores, serving as small local competitors to large dominant grocery stores. They benefited from their location as the sole grocery store in a rural community, but they also faced strong competition from regional stores.

Root River is located on a highway near a state park, which creates heavy summer traffic. They are on the site of a previous grocery store, so can benefit from that site identity. They also offer a pharmacy service, by renting space to a local pharmacist. Iron River also provides an additional needed service in the community, through its ownership of a hardware store.

Tower Foods Market suffered from a poor location, and never drew enough customers through marketing. Sales figures were one-third below projections. Their stock was 100% conventional, and members commented that the store had no “Oneida” identity. Local products were not available at the store. Tower Foods was also challenged by the many collateral goals associated with its development: economic development, better health, tribal self-sufficiency. Keeping all of these goals in balance wasn’t easy for the organizers, managers or board members.

Viroqua’s natural foods focus gave it a unique identity in the marketplace. The founders knew that there was strong support for natural foods among some community members, and the competition was over an hour away.

### **KEYS TO SUCCESS and POTENTIAL PITFALLS**

Based on the preceding analysis, we can identify four key characteristics that contributed to the success of three of the cooperatives in this study: Root River, Iron River, and Viroqua.

#### **A. Strong operational management**

Each of the successful cooperatives employed managers that were willing to innovate, make necessary changes, invest and grow. The manager of Root River eliminated the meat department manager’s position to improve the bottom line. In Viroqua, the manager invested in technology that helped the co-op benchmark their performance, improve profitability, and gather the data necessary to plan an expansion. Iron River Cooperatives hired a new manager who had run a major business in another service industry, so he came with financial, personnel and marketing experience. He is leading their relocation effort.

#### **B. Member, Community and Industry Support**

Viroqua, Iron River and Root River all received substantial leadership and financial support from their members at start-up. They also benefited from strong cooperatives in their communities who provided financial support and/or shared expertise. Root River also got support from local public officials, who were very interested in attracting a grocery store to Houston. Local support was a major factor in convincing the local bank to make a start-up loan. Root River was the only cooperative in the group that received a commercial loan on start-up, but Iron River is currently negotiating for a major loan from a local lending institution.

A special mention should be made of the role of organized industry support. Historically, Iron River Co-op, along with dozens of other Finnish co-ops, received significant support from the Central Co-op Exchange. Part of their challenge today is their isolation as they work toward a major expansion without a CCE to provide advice, unbiased benchmark data and other support. Viroqua Food Co-op meanwhile has been able to tap into a national network of food co-ops that has clearly strengthened its management’s hand. While Root River, as a “conventional” grocery

did not enjoy similar industry support, the help they received from long-standing local co-ops and from their cooperative lender (NCDF) was critical. By comparison, Tower Foods was relatively isolated and independent.

### **C. “Reasonable” Competition**

Although travel for shopping is a fact of life in rural communities, the successful cooperatives all benefited from a location as the sole grocery store (or natural foods store) in their immediate area. In all three successful cases, the co-ops are approximately 20-30 miles from their competition.

### **D. Dedicated Organizers**

The three successful cooperatives all drew on substantial leadership skills from a dedicated group of volunteers. In Viroqua and Root River, the volunteers had track records to draw on from previous businesses experience. They also took advantage of advisors from local cooperatives, from the local community, and within the grocery industry. In Iron River, the cooperative was instrumental in forming a wholesale cooperative, which became an integral part of many successful retail co-ops across the northern tier of Wisconsin, Minnesota and Michigan.

## **POTENTIAL PITFALLS**

The case study of Tower Foods Market Cooperative provides a detailed examination of many potential pitfalls in a co-op grocery start-up. Although it might be viewed as a unique case because of its relationship with the Oneida Nation, it is probably safe to make the following generalizations

High turnover of leadership and management, significant “collateral” goals, lack of rigorous financial analysis, a poor location, and a failure to change direction quickly were all factors in the failure of this co-op. The story of Tower Foods Market also points out the importance of the “cooperative advantage”. A co-op that lacks member support, especially during the critical start-up phase, will lose out on the very tangible factors (financial, leadership and expertise) that have made Viroqua, Iron River and Root River successful rural grocery stores.