Why Some Co-ops Fail:

Six red flags from the past ten years of startups

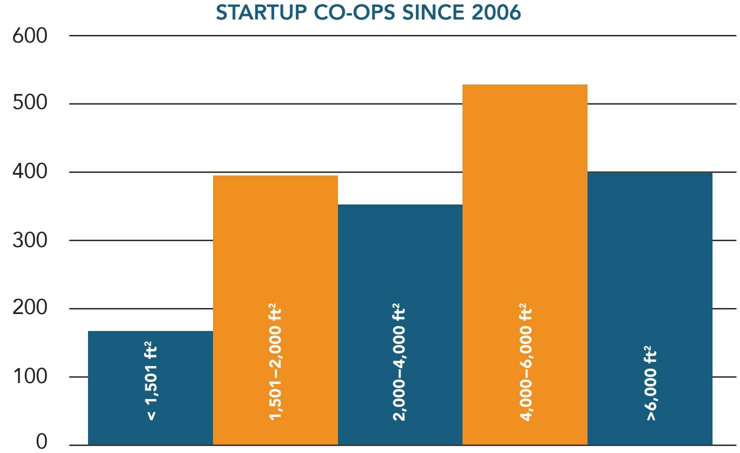
BY STUART REID

Four years ago I undertook an analysis of startup co-ops that had already closed. At the time, there were 63 startup co-op storefronts in my sample dating to 2006, and only 12 or 19 percent of them had failed. What has happened over the last four years? Are we opening more successful stores? Are co-ops failing for the same or different reasons?

In compiling the list of co-ops that have opened since 2006, I relied primarily on the records we keep at Food Co-op Initiative. However, I also solicited input from cooperative development centers across the U.S. and discovered a few more that we had never heard from and a handful that we knew of but did not know they had opened.

The final tally is 113 startup retail food co-ops opened during the last decade, and 27 of those have since closed. A 24 percent failure rate is disappointing—we don't want to see any co-ops fail—but significantly better than the results for most small businesses, where failure rates can exceed 50 percent. More importantly, the reasons why co-ops fail are becoming clearer and most are avoidable.

AVERAGE OWNER-MEMBER COUNT BY STORE SIZE: STARTUP CO-OPS SINCE 2006



Four continuing factors

In 2012, I identified four factors that were common among startup co-ops that did not succeed:

- very small retail spaces (500–1,500 square feet)
- startup budgets significantly below co-op averages
- unusually short or truncated development timelines
- over-reliance on member labor

These four factors remain the best indicators for potential lack of viability for a new co-op. Unusually low budgets and short timelines often imply cut corners and poor planning. Most new startups need three to five years (often more) to move from initial discussions through open doors.

Building membership, raising capital, and finding the right site and general manager are all essential and time-consuming tasks. Highly effective organizing teams with a supportive community can accomplish these things more quickly while achieving appropriate goals. It is also possible to move through organizing quickly if you set low targets for membership and capital. However, low membership means fewer committed shoppers and a smaller pool of owners to approach for capital.

Low capital forces compromises in store design, equipment, and fixtures, which lead in turn to a less attractive store that is inefficient to operate. Since even the most successful startups expect to lose money for two to three years, additional capital must be raised before opening and set aside to cover operating losses. Lack of working capital may force a new co-op to attempt a new capital campaign after they open. You can begin to see how various decisions intertwine to either strengthen or weaken a co-op.

Over-reliance on member labor can result from a lack of capital to hire and retain trained staff and managers. Food co-ops are sophisticated operations in a highly competitive market. Knowledgeable, trained staff are necessary for successful operations and customer service. Most co-ops have moved away from using member labor for store operations, but for those who do continue to use it in a planned and systematic way, member labor in itself is not a predictor for new store failure.

Two more red flags

There are two more red flags that I will add to the list for 2016:

- premature site selection
- converting or saving the local grocery store

Some co-ops have identified their preferred site almost as soon as they started discussing their ideas—which is a strong indicator of potential failure. Often these sites are inadequate for a modern grocery store, regardless of their availability, low cost, or past use. A co-op's site, like the rest of its business plan, must be determined by research, expert analysis, and financial projections. The research and planning will help determine how much retail space and parking you need, neighborhoods where the co-op can be most successful, etc. Jumping on an empty space or a hot bargain without a business plan is a recipe for disaster.

The problem with trying to convert or save a local grocery store is not that a co-op is inherently a bad option. In some cases, creating a co-op can be an excellent opportunity for the community—with enough planning. What leads many of these efforts astray is the pressure of a short timeline or presumed viability. Existing owners often are looking for a quick exit, and a grocery store that has already closed may have left the community with limited access to groceries. Keeping the store open or reopening it may require swift action.

It seems logical that a new co-op could open for business much more quickly by taking over an existing business or a fully equipped storefront. But if you look at the overall work plan for starting a co-op, most of the timeline is used to create the business structure, sign up owners, and >

raise capital. If a rushed development process leads to inadequate membership, capital, or business planning it will threaten the co-op's future viability.

There is also a tendency to assume that the new co-op will be successful, even if the previous store was struggling. A proper financial analysis must consider investment in upgrades, debt service, labor costs, changes in product mix and margin, etc. Past performance alone is a weak indicator of future results.

These six "red flags" are important considerations but relatively easy to identify and understand. The first, and most significant is store size. The impact of size is more complex because it is intertwined with many other factors. Since 63 percent of failed co-ops fall in this category, it deserves a closer look.

Small spaces and small thinking

It is becoming increasingly clear that small retail co-ops are at the most risk. This is not exclusive to co-ops opening recently. There are new wave co-ops from the 1970s and '80s that started very small and have never grown significantly or have failed. During the past 10 years, at least as many of those older co-ops closed as did startups. Many of the reasons are related to changes in the grocery industry that are impacting co-ops of all sizes. Competition in natural/organic foods is already ubiquitous and continues to grow.

Startup and overhead costs have risen dramatically, with disproportionate impact on small stores' operating budgets. Seventeen of the 27 failed startups (63 percent) operated in less than 1,500 square feet of retail space. Their average annual sales revenue was less than $195,000—yes, that is annual sales revenue. This group of co-oops also averaged fewer than 170 owners at the time they opened.

We know that most of these very small co-ops did not have a market study or financial projections that legitimized their business plan. Many of them had little contact with co-op development specialists who could have steered them toward a more viable path.

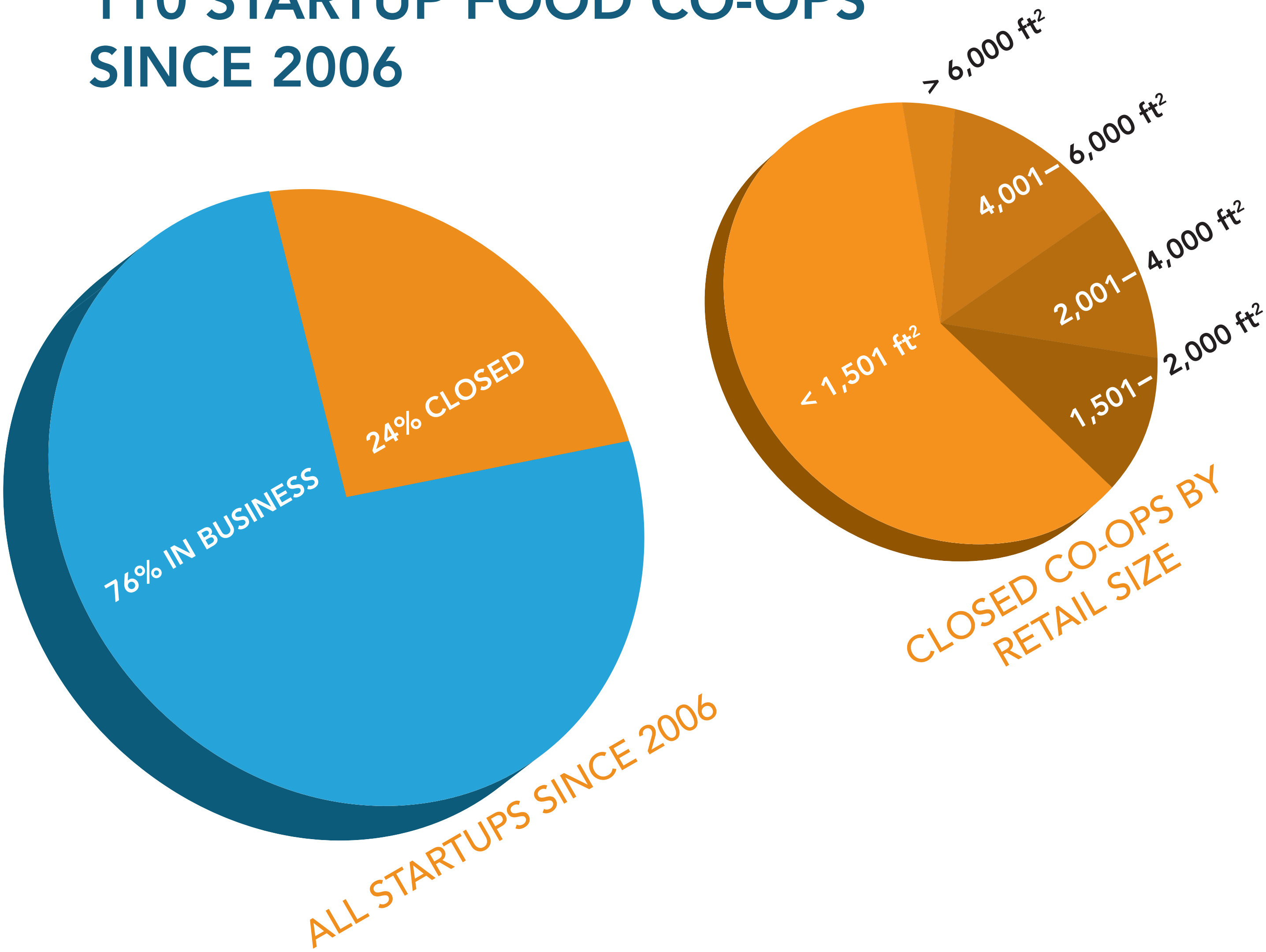
The reasons why organizing groups opt for a small store are varied, but there are common threads:

- small market area
- limited access to capital
- neglecting business realities of a retail and focusing on mission goals
- advice from someone who saw 1970s co-ops start small and grow
- member demand to make something happen
- well-intentioned but ineffective or misguided leadership
- conviction that they have found a new and better development model

Having a low population within your market area definitely makes it unlikely that a large retail store will draw the volume of business it needs to succeed. However, it does not follow that a store that is sized appropriately for the market will be large enough to be viable. Likewise, limited capital or limited willingness to invest capital in a co-op can make a small store the only affordable option. In either situation, it may be necessary to accept that the community will not be able to open a successful co-op, rather than push ahead. This is where it is tempting to trust the founders' idealism instead of the numbers. Yes, co-ops can and do survive where other businesses fail—but there are limits.

Just to make things interesting, there are some very small co-ops that have done alright and even grown. What did they do differently, and how can co-op organizers decide what will work for them? The answer is as simple—and complicated—as good business planning. There is a marked tendency to dismiss formal business planning when the goal is a small store. Since keeping costs down is generally one of the reasons for "going small," organizers would rather trust their instincts and the positive feedback they are getting than pay for professional market research and

110 STARTUP FOOD CO-OPS SINCE 2006



financial projections. Arguably, however, these professional projections are even more important for small stores since such operations are inherently riskier.

Larger co-ops

A larger retail space is not enough by itself to ensure that your new co-op will be successful. However, with strong business plans and objective assessments, your odds are excellent. Of the 10 stores that closed and had more than 1,500 square feet of retail space, five were under 2,500 and shared some of the same problems. The other five all had identifiable shortcomings that should have been corrected or the co-op's plans revised. In many cases, the problems were known but were discounted.

- **Co-op One:** Sales projections based on a deeply flawed market study (not done by a professional), poor site selection and no off-street parking, an extremely low percentage of capital came from owners.
- **Co-op Two:** No professional market study, not enough capital to equip and stock the full retail space, almost no parking.
- **Co-op Three:** Rushed conversion of a privately owned store, no market research to determine viability.
- **Co-op Four:** Grocery store conversion, no formal business planning.
- **Co-op Five:** Lack of community engagement, low membership, poor location.

New concepts and older advice

What about the great plans you have that nobody else has tried yet? Sure to become a model for other startups! My advice to you is the same: If you can show me a legitimate business plan, I'll listen to you. Unfortunately, almost all of the "better ideas," including some that looked promising, have been disappointing. Many of these have folded before opening.

There is no situation where a co-op should be started without due diligence. **A solid business plan with credible assumptions is the minimum any group should have before spending their own money and their neighbors' money on a new business.**

Let's end on a positive note. Even though organizing a new food cooperative takes a lot of time, commitment, and money, it can be one of the most rewarding things you ever do. By using good business practices and listening to the advice and support of the people who have already been down the same path, your odds of success are excellent! ☐