An analysis prepared as part of

THE Vivid Picture PROJECT

Summary Input from the Roots of Change Fund Sustainable Food Business Leaders Workgroup

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MEMO

To: Eileen Brady, Vivid Picture project director

From: Jill Kauffman Johnson, Coordinator

Re: Summary Input from the ROC Fund Sustainable Food Business Leaders

Date: September 14, 2005

This memo summarizes the input from three meetings of a subgroup of the ROC Fund Sustainable Food Business Leaders. Outlined below are key issues that emerged regarding challenges and opportunities for moving the sustainable food industry from niche to mainstream.

Summary of recurring issues and major themes throughout the discussions:

1. We are looking to create a food system that has a small footprint
2. An ongoing challenge of attracting and retaining high quality talent
3. The opportunity to target an emerging Hispanic population and greenfield development that is inevitable—develop it right.
4. Consideration of several retail models (corner store, coop)
5. The role of an efficient infrastructure or holding company
6. “Meaningful” ownership models
7. Encouraging a new system without incurring a lot of debt and with plenty of room for new players.
8. The need for culture shift and public education

Opening thoughts from the group

In considering the constellation of retail outlets, in the future there would be a spectrum of farmer’s markets to Costco where consumers would buy half of their food at farmer’s markets and half at Costco-like outlets. In France, there is the “hypermarket” which is a collection of small stalls. Safeway is struggling as they try this small stall approach.

Jim Cochran summarized his “New Architecture” written piece that was circulated prior to the meeting. Several basic points emerged:

1. We should create a system that would co-exist with the current model.
2. A system should create new economic opportunity
3. The system should have an economic infrastructure that includes housing, banking, insurance, and meaningful work.
4. We need to change the cultural model so consumers are attracted to the sustainable system.
5. The inherent flight of talent to urban areas is a challenge for producers. To get really good people to stay, there is a price tag.

However, if we think about setting up an intentional system, it can become a closed system. We should build on current successes, especially Coops where economic success, distributed ownership, and a food culture have thrived.

Retail models

Eileen Brady outlined some basic demographic trends that informed the discussion: Population in California in 2030 will be approximately 48 million people of which almost 50% will be Hispanic. A minimum of one million acres will be developed and we can expect at least 2,500 new markets. Thus, there are opportunities to create NEW centers because of such growth. The cultural value system of Hispanics is in line with a sustainable value system.

What kind of retail model would be ideal in a sustainable food system? Two key differences from the current model were identified:

1. Small store on every corner with good ambiance, convenient, fun (Starbucks model)
2. Producers would have ownership through the value chain, producers are stakeholders in the distribution and retail outlets.

The "store on every corner" model

The Starbucks "small store on every corner" retail model in greenfield opportunities may likely be appealing to the Hispanic community. However, Greg Steltenpohl has looked hard at the economics of the small store business model in San Francisco and there are several challenges. The trend over the past 10 years is for people to shop at larger markets (e.g., Trader Joe's, Whole Foods, Costco) and just occasionally buy items at their corner market. The successful small stores in San Francisco are the "mini-mafias"—where two or three owners own a couple of hundred stores. One limiting factor is the minimum drop size required by distributors—it hovers around $4,000 – 5,000. Thus, the distribution network is very traditional with a standard set of products. They own the property and can pass it down to relatives. The success lies in the combination of a real estate business model, with an efficient distribution network, and a social network (the extended family) for management.

Success lies in extracting costs

However, it should be noted that the grocery business is essentially a zero-sum game. The community will spend a certain amount of money on food. If another store enters the community, they are taking sales dollars away from an existing grocery store. The average supermarket costs are about $450 sq/ft. Thus, to be profitable in a smaller store format (or any store), it is necessary to lower the cost structure. A good example of a very successful community-based grocery store is Shopper's Grocery in Santa Cruz. However, the circumstances that make that store successful (e.g., land ownership, charismatic and savvy owners, loyal community customers) make it a hard model to replicate. Another interesting retail model is the New Leaf stores in Santa Cruz. There is one owner with 2 – 3 stores. The big stores subsidize the smaller stores—the range is 2,000 sq. ft. to 20,000 sq. ft. stores.

Key strategies for lowering the cost structure include:

- Loyalty to suppliers
- Rationalize the number of SKU's
- Streamline interactions with suppliers through emails/fax, eliminate phone calls
- To reduce real estate costs, join a new development where the grocery market is the draw—on estimate is that a grocer needs to keep rent to 3 – 4 % of sales to remain profitable.
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This is much like the strategy Trader Joe's has taken.

The Coop model

Coops are having difficulty competing with the likes of Whole Foods on retaining management talent and product buying power. In response, Coops started to gather and approach distributors to get a discount on product. This association, the National Cooperative Grocers Association (NCGA), has pooled buying power, management talent, and marketing resources. The challenge for the Coops is they see the value of the national infrastructure and want the support, but they don't want to be told what to do.

Other models that are working currently

- The Trader Joe's model is interesting where they are paying their suppliers fairly and drive down internal costs through efficiency.
- Wal-Mart's electronic restocking infrastructure that could be copied as a system for farmers to have up-to-date information to sell product directly to retailers.
- With the success of Organic Valley Coop and Oregon Country Beef business models, it is curious why the model has not been replicated. The group agreed there was not a forum for sharing and discussing successful business models.

Options to combine these models into a new business model

Ideally a new business model would combine the local ownership model with an overarching infrastructure or holding company to realize efficiencies and attract top quality management. It would involve community investment and a franchise model. There would be professional management at some level, a holding company for equity, and investment at the local level. A key outstanding issue is the liquidity issue, which also speaks to attracting and retaining good managers. Employees want to be able to extract cash to pay for a house or kids' college. One suggestion was made that if housing for employees could be included in the model, it could help address some of the liquidity issues.

Possible Ownership Models:

1) An ESOP (employee stock ownership plan) can help address the liquidity issue.
2) Community ownership—either through a community development fund or the traditional Coop model. In the Coop model, a coop investor puts in $200, for example and then when the member leaves, they take their $200 with them. Their "return on investment" is the service they received over the life of their investment.

Distribution models

The Clover Stornetta model is interesting because they are a regional distributor as most milk producers are. However, they understand they are in the business of delivering perishable products. The Organic Valley model is also good as well as the other models for milk distribution. We should also consider the Harvard Case Study describing the bottler model (e.g. Coke). A key theme that emerged for distribution models, is the importance of creating economies of scale.

Other examples of distribution models to consider:

1. Horizon—meta-business/commodity business
2. Organic Valley—sustainable scale, labor, etc.
3. Veritable Vegetable
4. Local milk producers—e.g. Clover Stornetta, Strauss Dairy
5. Micro-distributors—Odwalla

Ownership models

The group looked at what are ownership structures that promote equality and business success. The question was posed, “what does it take to make ownership meaningful—at what point will you exercise your right to take a stand or make a decision”. For example, at Frontier Coop, there are 15,000 retailers who are owner-members. With so many owners, no one is in charge. Ideally, ownership would be spread across the whole system or value chain. We need to identify ownership models that can add efficiency to the system. Possible efficiency opportunities:

1. Real estate partner
2. Better distribution
3. Market research

Several examples of ownership models were put forward:

- ESOP model (Employee stock ownership plan)
- Emilia Romano
- Rudolph Steiner
- Weaver Street—Carboro, NC

Other examples:

1. Del Cabo has 400 small farmers that are part of the system that have agreed on standard packaging—supplier diversity is increased by standardizing packaging sizes to make it work for small and large retailers.
2. Adina (Greg’s new beverage company) has an example from their Hibiscus supply chain. Adina guaranteed prices for the growing and processing of the Hibiscus. When a buyer came along and offered more, they went with the other buyer. In the end, the buyer did not come through. It led Greg to the question of “what is

meaningful ownership" if the hibiscus growers were willing to shift in a heartbeat to a higher price bidder.

New Financial Infrastructures

Greg Steltenpohl provided an overview of the credit card company he is helping to create—Interra. It is focused on the consumer side and asked the question, "what if the card holder owns most of the system instead of the bank owning the system?" It also addresses the question, "what if we could create a credit card that could help retailers identify their best customers?" Wal-Mart, GAP, and most large retail stores issue their own credit cards and can track the buying tastes of their customers.

Interra is looking to create a membership organization that would administer the credit card which spans a broad section of small businesses so the small retailer could have the visibility into their customer preferences like the large companies do. There is also a feature that would create identity management so that the customer can control who gets his/her identity information.

A test pilot is being run in Boston with 1,500 towns participating that actively support small business. It costs the retailer $200 to set up the credit card system. The retailer pays approximately 1.85% for fees on the card (current they pay 2 – 3% to Visa for card privileges). If you pooled the funds, there are great possibilities for social investments to be made.

Attracting and Retaining the Best and Brightest

In the food industry, there is high turnover in personnel, the work is hard, and the pay is low. The profit margins are slim, hovering around 5%.

The key issues that were raised in the first round of discussions regarding recruiting and retaining the "best and brightest" for the sustainable food industry included:

1. Creating a sense of ownership for employees—the freedom to create, own the ides and the activity.
2. A clear opportunity for career growth
3. A sense of mission: contributing to something larger than themselves
4. Opportunity for profit sharing/equity/liquidity
5. Power of replication—learn a new way of business and take it to the next job
6. A visionary leader where the sense of ownership devolves to the employees

Two Examples

Marc Zammit described the philosophy of Bon Apetit, a food service company. With 10,000 employees nationwide, and nearly 200 sites they have a version of a franchise model. They have 17 basic standards they set and then the individual sites can take it from there. Some of the standards include things like buy seasonal, regional and organic when possible, fish should adhere to the Seafood Watch list, use real lemon juice, etc. The sustainable mission of the company was clearly and forcefully articulated by the charismatic CEO. This has set up a culture of real ownership and a sense of mission for the managers and hourlies that they are connected to something bigger than themselves. Bon Apetit has very little turnover.

Jesse Cool described her efforts to bring fair labor practices to her restaurants. First of all, she was not in a position to offer benefits to her employees until she opened three restaurants. She caps the work week to 50 hours/week and overtime after that. A few years ago she was in debt, but recently when she began to make a profit, she shared the profits with her management. Each quarter, she shares 5% of the profit with her managers. Almost immediately she saw they took more initiative to look for new opportunities to be frugal. Since she has started the profit-sharing, she has made more money than ever.

ROC Fund Sustainable Food Business Leaders (as of September 2005)

Dan Benedetti, President, Clover Stornetta Farm
Michael Besancon, President Southern Pacific Region, Whole Foods Market
Jim Cochran, Founder/owner, Swanton Berry Farm*
Jesse Cool, Founder/owner/chef, CoolEatz*
Paul Cultrera, General Manager, Sacramento Natural Food Coop*
Paul Dolan, former President, Fetzer Vineyards
Michael Funk, Founder, United Natural Foods
Larry Jacobs, CEO Jacob's Farm/Del Cabo Inc.*
Bu Nygrens, Purchasing Manager, Veritable Vegetable*
Greg Steltenpohl, Founder, Odwalla, Inc.*
Woody Tasch, Chairman, Investors Circle
Marc Zammit, Director of Culinary Support and Development, Bon Appetit*

*Indicates that they participated in one of the small group meetings.

Attachments

A copy of the illustrated facilitation from the first meeting of the business leaders
Jim Cochran's New Architecture piece
Larry Jacob's summary of a new sustainable food business
Greg's Interra Presentation
Jim Cochran's summary slides