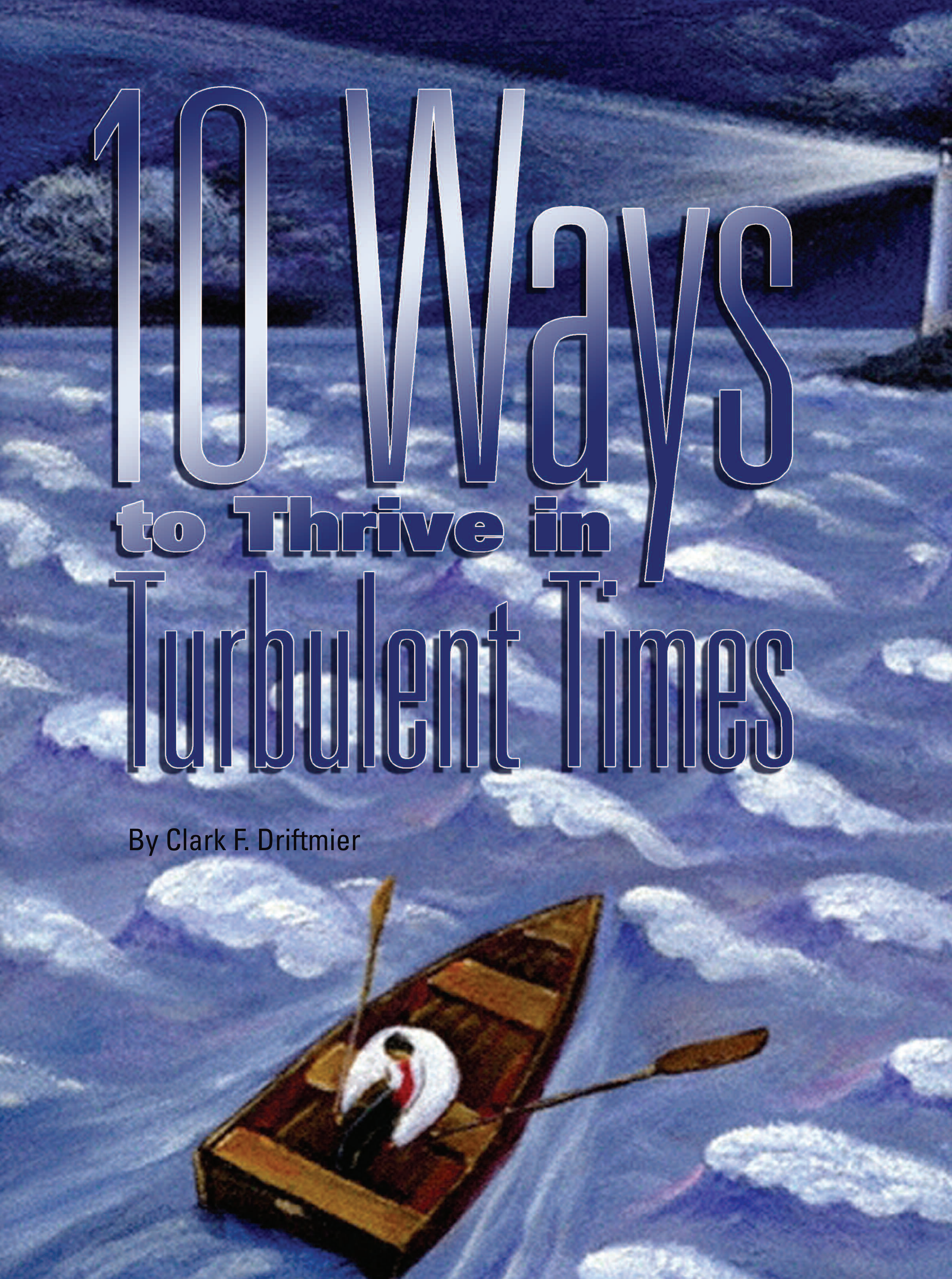

10 Ways to Thrive in Turbulent Times

By Clark F. Driftmier

The organic movement and its leaders have always risen to challenges and found ways to succeed. Through supply scarcities and distribution challenges and the efforts to build a consumer franchise, the members of the organic movement have persevered to create a vibrant and successful industry.

The current economic downturn presents many challenges to the organic movement and to society at large. Everyone "From Wall Street to Main Street" (to use a current phrase) is looking at the stormy new reality of the economic downturn and seeking ways to move forward successfully.

The current uncertainty is especially acute for organic companies because relatively few of them have ever needed to manage through a truly difficult economic climate. The period of greatest development for most organic companies, 1990 until this year, has also been a period marked by robust industry growth, access to capital, optimism, consumer willingness to try new products, interest in self-actualization and a general sense of positive forward momentum. Organic growth has far outpaced the consumer economy at large, increasing at an annual rate of 20 percent or more for more than a decade. Many organic companies thrived with the rising tide of industry growth, and to quote the old proverb: "The rising tide lifts all boats."

Now, however, the tide has changed, growth has slowed (at least temporarily), and the organic industry has entered a turbulent period. In this uncertain world, the new proverb might be: "When the tide is not rising, make sure the boat is seaworthy."

It is also important to remember that the economy is cyclical. The current downturn is indeed severe, and its impact is not to be underestimated, but growth will return, in organic and in the economy at large. The trends underlying the growth of organic are deep and strong in nature, driven by macro changes in consumer concerns regarding health, safety, family, personal well-being and concern about the well-being of the earth. Trends based on consumer beliefs of this depth are not fads, nor will they dissipate when economic cycles swing from boom to bust. The key to success for organic companies is to understand the true nature of the current consumer economy, to build the company's reliance and strength to persevere amid the downturn and to thrive by providing true lasting value to consumers.

These days there are no "spare dollars" in the consumer's pocketbook. There is also less room on the retailer shelves for poorer-performing products. Consumers and retailers are separating "must-haves" from the "nice to haves" in their shopping carts and planograms.

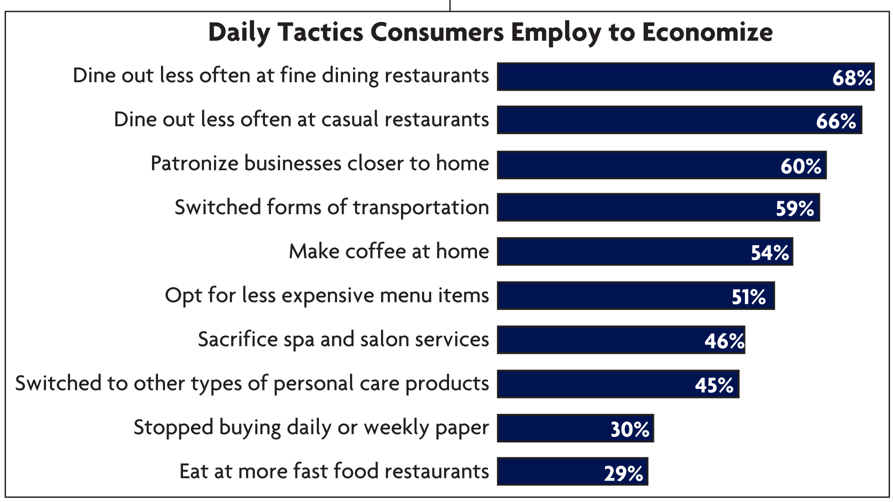

Figure 1. Source: Consumer Cutbacks in Today's Soft Economy *report. National Research Network, June 2008.*

More than ever, organic company leaders need to embrace and master a new reality, that of managing for careful control and nurturing of resources, of careful decision-making and choosing the right path.

The Current Marketplace

Looking at total U.S. organic sales data, the growth rate for organic products has slowed dramatically over the past year, decreasing from more than 25 percent in early 2006 to closer to 5 percent in the latest 4-week period ending October 2008. Although, this growth rate is still higher than conventional consumer goods, many of which are not growing at all, it still is a shock to the organic community.

But the organic industry is not alone. Recent reports and articles have identified the current consumer attitude of frugality and conservation of resources. In November 2008, the Hartman Group and the National Research Network, leading market research companies, released new information about consumers and their purchase behaviors. In Figure 1, Hartman and NRN found that consumers are demonstrating a pronounced desire to economize by reducing certain types of purchases, from cutbacks in dining out to reductions in driving to a switch from coffee house latte's to home-brewed coffee.

As Hartman and NFN have shown, the current consumer mood is to prepare more food at home. There are two principle reasons for this trend. First, the desire to conserve resources has driven consumers to less-expensive meal solutions. Also, in times such as these, families tend to move closer to be together for support. The family dinner table is a positive, affirming place for family togetherness in times of stress.

"Having been in business since 1968, we've been through several economic downturns and I have actually found that times of recession have been good for business. Families go back to the basics. They prepare meals home, and when they do they become more aware of the food they are eating," said Michael Potter, president of Eden Foods, which manufactures organic staples such as beans, grains and pastas.

Food awareness and going back to the basics are two fundamentals of the organic movement. These trends may create long-term connections with food that will last long after the recession is over, encouraging overall growth in organic.

Another positive trend for organic companies is the tendency of Americans to give themselves small "rewards" when bigger sacrifices are being required. The family might need to cancel the trip to Disneyworld, so instead they spend the day at the local aquarium. A tough day searching for work might be ended with a dinner at home featuring organic food and a nice bottle of wine.

The Hartman Group, in its recent research into changes in consumer behavior, found clear evidence that consumers were giving themselves small, inexpensive "rewards" as compensation or a "pick me up" amid tough circumstances.

According to Hartman, "While consumers may be scaling down or cutting back on food consumption there are still some items that are necessary indulgences. In the face of economic uncertainty, consumers find some version of small and "doable" indulgence as a necessity.

Organic food may often qualify as this "doable" indulgence, plus the fact that is healthier for them and the planet also helps justify the indulgence.

Making Your Ship Seaworthy

While times are indeed turbulent, and the economic waters are choppy, there are several things businesses can do to successfully navigate through the difficult times. Below are 10 management priorities that company leaders can implement to help improve the company's strength.

1. Preserve Cash Flow. Cash is the company's most precious resource, and never more than during tough economic times. The leader must implement strong cash flow measures that might feel uncomfortable, even "Draconian" to employees and stakeholders.

"Preserving cash and access to cash is of vital importance—perhaps even "life-or-death" importance—for companies right now. The capital markets are severely constrained, and access to outside financing is scarce and at times complicated," said Gary Sebek, former CEO of Rudy's Organic Bakery, CFO of Aurora Organic Dairy and currently a managing partner at 2x Consumer Products Growth Partners. "Companies must institute strict controls over key financial measures to preserve cash, as well as keep very close management of spending such as travel, headcount, HR and all discretionary expenses."

The checklist of cash management measures includes the following:

- **Accounts Receivable.** Record diligently, every week at the minimum, and watch "Days A/R Outstanding" like a hawk. Be persistent (and diplomatic) in contacting non-paying customers. Many times "the squeaky wheel gets the grease" and the most persistent vendor receives payment first.
- **Accounts Payable.** Record as diligently as receivables, every week, and watch "Days A/P Outstanding." Use the judgment of the leader and the head of Finance to determine which payables to pay and which to hold. Communicate regularly with vendors to keep them apprised of the payment schedule.
- **Working Capital and Inventory.** For most companies, much of the company's working capital is invested in inventory. During a time of constrained capital, it is imperative that inventory be kept as small as possible to preserve cash liquidity, while remaining ample enough to adequately service orders. Maintaining both high product service levels and cash liquidity simultaneously is one of the toughest balancing acts for the leadership of the company.
- **Tight control on spending.** The company must institute an entire corporate culture of savings to help preserve valuable resources. One good way to help maintain greater cash control is for the CEO or CFO to personally sign all checks above a certain low level. The leader, along with the head of finance, should look carefully at each invoice. It's very important for the leader to have a visceral, "tactile" feeling about expenses and spending.

> "I have actually found that times of recession have been good for business. Families go back to the basics. They prepare meals home, and when they do they become more aware of the food they are eating."

Blair Kellison, CEO of organic tea-maker Traditional Medicinals, views the careful management of resources and close communications with financial partners as two of his key priorities during the current downturn. "Traditional Medicinals has a strong balance sheet and a healthy cash position, but we have increased our level of attention nonetheless. We now have weekly versus monthly financial status meetings, during which we closely examine receivables, payables, inventory and cash on hand," he said. "We also keep in even closer contact and communication with our bank. I find that communication with lenders and investors is critical. They see the news reports and have a general sense of anxiety, so we stay in very close and frequent contact to let them know exactly what our financial condition is at all times."

2. Manage for Gross Margin. While conventional CPG companies generally operate with a gross margin well above 50 percent, organic companies saddle themselves with a far lower margin, frequently under 40 percent and sometimes much lower. It is literally impossible to operate effectively over the long term with an insufficient gross margin, especially during difficult times. The solution is for organic leaders to "attack" cost of goods relentlessly, mapping out all of the components that comprise cost. This cost control must extend to every ingredient, carton, case and component that adds to cost of goods. In the best organic companies, cost control is a deeply embedded cultural value, in which all employees are keen observers of cost and have a mandate to seek out and reduce cost whenever and wherever possible.

Sebek notes that gross margin is as important in most cases as EBITDA (earnings before interest, taxes, depreciation and amortization) as a key measure of company value. "Many investors and institutions that formerly used EBITDA as their sole principle measure to calculate the company's enterprise value have begun looking more at gross margin as the key indicator of long-term financial health and the ability to fund future growth," he said. "The feeling is that 'cash is king,' and a healthy cash flow builds the company's long-term enterprise value. I cannot over-estimate the importance of high gross margins and expense control to the health of the company and its potential value to investors."

One leading organic brand increased its gross margin by 6 points, from 36 percent to 42 percent over a three-year period. To do this, they broke down the cost profile of each major product group into its main components: ingredients, packaging, co-pack fees, distribution expenses, etc., then assigned specific targets for improvement over the three-year horizon. The resulting increase in gross profit dramatically improved the company's operating income, from a negative $2.4 million to a positive $1.7 million, a turnaround of over $4 million.

3. Plan Carefully to Avoid Costly Mistakes. Lack of planning leads to mistakes. In good times, these mistakes are sometimes compensated or "smoothed over" by the upward rush, but in tough times, there is no margin for error. "Planning has never been more critical than now in these uncertain times," Sebek said. "Not only must the operating plan be carefully thought out, but there also needs to be a very sober 'down-side' scenario that can be effectively implemented if the company's financial position deteriorates. This downside plan needs buy-in, externally and internally, to assure partners and management that the company has adequately prepared itself for a possible economically-driven shift in performance."

While speed is often a competitive advantage in organic, it's imperative to research all key decisions, even at the risk of slowing down the system. Leaders must discipline themselves and their team to do as good carpenters do: "measure twice—cut once."

For one organic company, the solution was to evolve from an improvisational, "shoot from the hip" leadership style to a more disciplined process based on strategic planning. Key to the company's success was to make both the process and the resulting plan a living, usable guide to management, rather than an abstract, "nice-but-not actionable" piece that would gather dust. To make the plan tangible, it was kept short in length; the time period included very immediate, action-oriented steps for the first 12 months of the plan, and managers were given specific tasks and timelines. The final key was the ongoing work of the CEO to keep the leadership team on task with the follow-ups and timetables.

4. Market to Consumers Using Value. In today's uncertain environment, consumers are conserving scarce cash for the items of greatest need and value. They are engaging in trade-offs and are "de-selecting" products that they see as non-essential. As noted recently in the *New York Times*, "Thomas J. Blischok, president of consulting and innovation for Information Resources, a market research firm, said shoppers were not moving entirely away from categories like organic products in the grocery store. But they are becoming more selective, buying four or five products instead of seven or eight, he said. Blischok conducted a survey of 1,000 consumers in the first half of the year and found that nearly two-thirds said they wee cutting back on nonessential groceries and nearly half said they were buying fewer organic products because they were too expensive."

In an era of such trade-offs, the challenge for organic leaders is to make sure that their product is one of the four or five that is purchased, versus one of the three or four that consumers leave on the shelf. In order to be preferred, the product must clearly demonstrate its strong benefit to the consumer and its superior set of attributes.

One example of value communication is the 2008 campaign by Whole Foods Market to emphasize the good value and low prices of many of its core items. This campaign helped to combat the retailer's image of high prices exemplified by the nickname "Whole Paycheck." Hundreds of basic items were lowered in price, with prominent yellow shelf tags highlighting and price reduction. In many stores there were also "end cap" displays of value products. There was also an extensive communication effort to support the campaign, and the value prices were mentioned in press releases, media interviews and quarterly earnings releases.

5. Manage the Shelf for In-store Velocity. Every supermarket and natural foods buyer maintains an updated product SKU ranking report for her/his category. On this report, products with an on-shelf velocity above a certain threshold are considered "stable" members of the shelf-set, while those below the threshold are risk of discontinuation. In difficult times, the buyers' management of this velocity will be even stricter, with less "forgiveness" of insufficient velocity.

Velocity can be increased with in-store "pull" programs such as sampling, coupon distribution at the shelf next to the product, participation in retailer flyers and coupon books, participation in retailer joint themed promotions linked to displays, and funding for special off-shelf displays and end-cap programs.

To increase velocity, one organic company, created a "SWOT" team task force to improve shelf facings and fill in distribution voids. Surprisingly (or maybe not) an audit found that there were significant distribution voids, even where the company's products had been authorized. Within a single retailer, certain stores had distribution while others did not, even though products were authorized chainwide. The company's team and the sales brokers worked in every major store with authorized distribution of the company's products. Voids were filled, out of stocks were eliminated and shelf facings were improved, This effort, along with a push for distribution in several new accounts, resulted in more than 100 percent sales increase over three years.

6. Make Trade Program Dollars Work Harder. Trade promotion is a critical component of any successful organic product plan, but too frequently companies approve trade programs that are not directly linked to product performance. In difficult times, every trade dollar has to work harder to "carry its weight." The company needs to be firm (but diplomatic) with distributors and retailers to analyze trade deals carefully and objectively, and must require that every trade deal approved is linked to a specific sales-building result. The company also needs to have the strength to say "No" to requests (or demands) for programs that don't directly impact sales. This discipline is difficult for organic companies, which typically are highly reliant on the "good graces" of distributors and retailers and are reluctant to decline requests for trade spending. However, to succeed in an economic downturn, such discipline is critical to preserving cash and optimizing the effectiveness of trade budgets.

> "Cancellation of marketing leads to a decrease in consumer awareness, lower product purchase rates and a decline in on-shelf velocity, leaving the company with a weakened brand exactly when greater strength and growth are needed."

7. Institute Better Controls on Trade Spending. Trade spending not only needs to be judiciously approved, but must also be actively managed and controlled. In particular, there must be a dedicated and extensive program in place to manage bill-backs, deductions and charge-backs. Distributors and retailers use these techniques aggressively to maximize their own cash flow, often with insufficient documentation as to the validity of the charge-back. Organic companies frequently compound the problem by not maintaining sufficient records and documentation to fully understand the nature of the deductions or to monitor or quantify their impact. Organic companies, if not careful, can easily amass a "deduction ledger" of staggering size that is thorny and difficult to manage or to reduce. This accumulated deduction is cash out of the company's pocket, an expense that represents a significant drain on company cash flow, leaving it unable to meet other critical needs. One leading organic company recently amassed a deduction ledger of nearly $1 million, which proved extremely difficult to eliminate.

An effective deduction-management plan is one that is accurate, documented, tough, determined, dogged, unyielding and uncompromising, while always maintaining utmost poise and professionalism. For example, the deductions manager can create a comprehensive Excel spreadsheet, with every outstanding or unidentified deduction listed separately along with the name and contact information of the customer, the name of the broker, the name of the company's regional sales manager, and a "notes" field to input any updates or new information. The ledger is reviewed weekly by the manager and the CSO, and monthly by the CEO. If necessary, the CFO and CEO step in to make appropriate calls to the customer and the broker. The person or department in charge of this messy but critical function should be chosen carefully to demonstrate considerable skill in protecting the company's cash flow from unwarranted deductions, while effectively documenting and clearing those deductions that are justified.

8. Make Marketing Program Dollars Work Harder. When cash is tight, marketing programs also need to "work harder" to make every dollar effective. The all-too-common response of leaders to budget problems is to eliminate consumer marketing programs altogether. However, the cancellation of marketing leads to a decrease in consumer awareness, lower product purchase rates and a decline in on-shelf velocity, leaving the company with a weakened brand exactly when greater strength and growth are needed. Rather than canceling marketing, a far better choice is to choose marketing programs that work "double-duty," that is, programs that achieve two or more goals simultaneously. For example, consumer promotions can be mandated to be in-store only, so that the marketing reinforces the trade program and the relationship with the retailer.

Another technique is to join forces with other compatible brands to reduce fixed costs. A good example of cooperation is to field joint in-store product sampling between two or three compatible brands. The high, one-time fixed cost of the demo station is shared, cutting each brand's expense by 50 to 75 percent. This savings extends to brochures and coupon books, the costs of which can also be shared among partners.

Recently three leading brands—Earthbound Farms, Santa Cruz Organic and Horizon Organic—jointly created a promotion called "The Organic Lunchbox." The goal of the program was to create media awareness and in-store consumer trial of the three products during the late August, early September back-to-school period. The program highlighted Earthbound Farms baby carrots, Santa Cruz juices and Horizon single-serve cheeses. A joint PR effort was launched, with extensive communications to parenting and family-oriented magazines as well as newspapers. For smaller regional papers, "mat releases" (complete articles with photos, ready for insertion in the paper) were distributed to make it easy for regional papers to insert the article in their weekly food sections. In-store sampling programs were fielded with brochures and coupon books for the three brands, along with in-store displays. By joining forces, the three brands shared the fixed costs and cut the cost per brand significantly. There was also greater media pickup because the story was more interesting to reporters than having a single brand promote its product.

9. Manage the Brand Effectively with the Growth of Private Label. Today, private label has become an integral part of most leading organic categories. Mintel's Global New Products Database tracked over 540 new private label organic foods in 2007, a massive increase from 35 new products seen in 2003. Furthermore, when Mintel asked survey respondents about the difference between name brand and private label organics, three in five (60 percent) said it didn't matter, that they reached for "whatever is available" when shopping. Organic companies have three basic choices regarding how they respond to private label: "beat 'em, join 'em or coexist with 'em."

In the "beat 'em" strategy, the organic brand maintains higher share versus private label by investing heavily in marketing and brand development to create a special emotional and personal bond with the consumer. If the brand "means" enough to the consumer, s/he will remain more loyal to the brand. In mainstream products, categories that invest heavily in marketing, such as cosmetics and major clothing brands, have far lower rates of private label switching than poorly-marketed categories with low brand equity development such as milk. In a recent study by Information Resources, only 22 percent of consumers would readily buy a private label cosmetic, compared to more than 80 percent who would readily buy private label milk.

A different strategy for organic companies is to "join 'em" by introducing private label products themselves. The key to this strategy is to build a company system based on cost leadership and vertical integration. Private label success is completely dependent on being the undisputed low-cost producer, as well as having vertically integrated operations so that the private label provider is in control of its own processes and resources. Additionally, systems need to be in place to meet the retailers' high private label expectations. The company needs to achieve 99 percent perfect performance in all areas of quality, service, accuracy and delivery. Anything less will leave the company subject to negative review by the retailer and possible switch-out to a different vendor.

The final option is to "co-exist with 'em" meaning that the branded company manages its share and shelf position to be a valued product alongside the retailer's private label offering. In this strategy, the goal is not to displace private label, but to be a valued partner with the retailer in managing the shelf set for optimal performance. This optimization often means creating a set that combines the retailer's private label with one or two strong brands, resulting in a diverse range of products that meet different consumer needs.

10. Communicate with Stakeholder Network. Good communications by the company's leaders to its stakeholder network is essential during times of difficulty. Many stakeholders will be very confused, anxious or ill-informed about the nature of the downturn, its effect on the company and whether the company is in trouble. In the absence of good, accurate information, misinformation and damaging rumors frequently fill the vacuum.

"I see one of my most important jobs is to communicate – with employees, suppliers, customers, key vendors, bankers and investors," said Kellison, CEO of Traditional Medicinals. "It's important to be honest about current conditions, to give the facts, not over-sell and keep expectations in line. Even if our company is doing OK, I can't assume that my stakeholders know that it's OK. I need to continually reach out and provide fact-based information regarding the company, its health and the key priorities and opportunities."

Communication with employees is also important. "The knee-jerk response in an economic downturn is to wring greater productivity out of your workforce by making employees work harder. But this can hurt more than help, by fueling resentment and burnout," said Stewart Friedman, professor of management at the Wharton School, University of Pennsylvania. "A smarter approach: Be open with your employees about the business problems you face, and invite them to be part of the solution while encouraging them to meet critical needs in other parts of their lives."

The Big Picture

The 10 steps above certainly require an extensive volume of work and a dedication on the part of the organic company and its leaders. The good news is that these steps are also fundamental "best practices" for the long-term success of the company, not merely its survival over the short term. If properly and successfully implemented, these steps can help ensure that the company doesn't just survive, but actually thrives as it navigates the "choppy waters" of the current downturn and steers towards a bigger and better future.

Looking out at the longer view, it is important to remember that the U.S. consumer economy is cyclical and will change eventually back to a period of growth. Additionally, while consumers may trim their organic purchases, almost none of them will cease to be organic consumers. As organic advertising veteran Sharon Krinsky explained, "Once the organic 'bell' has been rung, you can't 'un-ring' the bell. The entryway to the organic opportunity is generally a one-way door, and very few consumers ever leave that opportunity completely."

Katherine DiMatteo, president of the International Federation of Organic Agriculture Movements and former executive director of the Organic Trade Association, brings nearly 30 years of senior experience and perspective to the current situation. She notes that worldwide organic trends and current conditions mirror that of the United States, with some important differences.

"In my travels in Europe, the Middle East and Asia, it has become apparent to me that everyone in the organic sector has been affected by this downturn. Processors, traders, and retailers worldwide are trying different pricing strategies to find the right price/value mix. At the same time, European companies are more efficient in general with fuel, transportation, commodity purchases and the cost of production. As such, organic companies in Europe have been less affected by the wild swings in commodity and fuel prices than their U.S. counterparts

DiMatteo also noted that the economic downturn as having an effect on the global market for organic exports and imports. "In general, there's less emphasis on export in Europe and a trend toward more local production and the creation of food systems that keep organic goods and commerce more dedicated to the local economy."

Finally, DiMatteo commented on some of the broader opportunities for the organic movement. "As organic grows worldwide, I see more focus on developing balanced market opportunities, with stronger domestic demand and consumption. Organic isn't just about premium markets, products and exports, but is also a way to build good prospects for local economies. Organic also plays a vital role in helping to preserve security in the food supply as well as food sovereignty. Finally, the old notion of organic food as an indulgence for the affluent needs to change in these changing times. Organic is for everyone and is beneficial to people, their communities and the future of agriculture worldwide.

Kellison notes that the Chinese word for "crisis" is comprised of two separate characters—one representing "danger" and the other representing "opportunity."

"In a time of crisis, there is a tendency to focus exclusively on the danger. This tendency is understandable, but in so doing one misses the opportunity. I see this as a time of opportunity for our company. We can use this time to learn more about ourselves and the market and to improve our systems. We also plan to start new marketing programs to build our business. In my experience, strong companies get stronger during difficult times."

Organic company leaders have several important considerations to make as they seek to navigate through the difficult current period. Efficient operations, smart decisions, careful management and good communications will have the long-term benefit of strengthening the company at its core. Growth will return and there will be new opportunities. Over time, consumers will continue to embrace organic products for their personal health, for their families and for the health of the planet and future generations. Remembering this long-term positive trend, and focusing on key priorities to keep the company "seaworthy," will help organic companies thrive in turbulent times.

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