

## GROCERY

Co-operative boss Richard Pennycook believes the group has “turned the corner” after returning to profit in 2014 following a torrid year. **George MacDonald** and **Luke Tugby** look at the journey

# HOW FAR IS THE CO-OP ALONG THE ROAD TO RECOVERY?

After being in the headlines for all the wrong reasons over the past 18 months, The Co-op finally had some good news last week. It reported a group net profit of £216m for 2014 after posting a £2.3bn loss the previous year. Chief executive Richard Pennycook said a “robust” performance in food led the recovery as underlying profits at the grocer increased 1.5% to £251m during the 52-week period. Overall like-for-likes were up 0.4%. As Co-op Food enters the next phase of its three-year strategy to restore it to its “rightful place at the heart of communities”, *Retail Week* takes a look at six key areas of focus.

## Property

The Co-op has nearly 2,800 stores, the majority of which cover between 3,000 sq ft and 20,000 sq ft. As part of its revival plans it is aiming to close larger stores and open more c-stores.

Bosses sold 37 larger stores last year and want to dispose of 50 to 75 more per year “if the market is right”, by offering “small packages to the market two or three times a year”.

Chief executive Richard Pennycook says the majority of its larger shops “work really well” because of their locations at the centre of communities and says the retailer would not dispose of all 717 of its larger properties.

Colliers International head of retail Mark Phillipson says the Co-op’s target of selling up to 75 larger stores a year is achievable in the current market. He says: “If they are in attractive locations, with attractive commercial lease terms and they are priced correctly, I’m sure there would be demand for these sort of properties.”

The Co-op opened 82 convenience stores last year to take its tally across the UK to 2,079. Bosses plan to open another 100 c-stores this year in a bid to meet changing shopping habits and achieve the aim of restoring the business to its “rightful place at the heart of communities”.

## Investment in price

Although it refused to divulge exactly how much it invested in price last year, it is fair to say the Co-op placed that at the heart of its food business strategy.

In what Pennycook calls a “highly competitive market”, Co-op Food delivered a “robust” performance as profits and overall like-for-likes increased.

Its positive results were delivered off the back of price drops in 40 different categories, while investment was also made in its own-brand range.

Pennycook believes that has set Co-op Food up to be “more competitive against the market this year than we were in the last”.

Planet Retail analyst David Gray says it was “essential” the Co-op invested in price and believed it would be a sustainable element of its strategy.

He says: “There has been quite a big disparity on price between the Co-op and the big four supermarkets. They had to address that because they were losing customers.

“There are a lot of ways they can afford it. The Co-op has been renowned for having quite an inefficient supply chain, so there is quite a bit of room for improvement to strip out cost.

“So do I think they can sustain it? Probably, but they may have to accept lower margins.”



Co-op chief executive Richard Pennycook and chairman Allan Leighton

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## Store revamps

Convenience is a big part of the Co-op's strategy, and as well as opening more c-stores it is refreshing its existing ones.

But just as important as the Co-op's investment in new stores has been the cash it has ploughed into refurbishing its existing estate.

More than 700 stores were refurbished last year and another 255 refits are planned by the end of 2015 as part of the group's True North strategy, focused on the convenience market.

Bosses say 336 of the refits, which involved stores being converted into the Co-op's new Gen2 format, had triggered "high single-digit uplifts in sales".

Planet Retail analyst David Gray is "not surprised" by those figures.

He says it was "critical" that the Co-op rejuvenated its "tired, drab" estate to regain shoppers.

He says: "When you are getting new Tesco Express stores and Sainsbury's Locals opening nearby, it's absolutely crucial. They should have done it years ago.

"The Co-op has a lot of convenience stores. They have obviously refreshed a lot of those and that's bearing fruit for them."

## Governance

After the Co-operative faced an existential crisis in 2013 and the early part of last year, brought about by a banking scandal and internecine warfare, the mutual launched a restructuring to adapt to commercial realities without losing its heritage.

The Co-op is to create a more professional, PLC-style board that will be held to account by a national members' council that will also promote co-operative values.

The changes will be voted on at the AGM next month under a new 'one member, one vote' system – a "historic" moment according to chairman Allan Leighton.

He perhaps typifies the new Co-op approach, combining extensive business leadership experience including a famously successful stint at Asda, with a commitment to the Co-op's unique heritage – his father ran three Co-op stores.

Leighton says the challenge at the Co-op is different from that faced by Asda, which he turned around alongside Archie Norman in the 1990s.

He says: "Our job is to hold on to everything that has served us well in the past and at the same time demonstrate relevance to the future."



## "They've got to work hard on tailoring the customer offer"

Phil Dorrell, Retail Remedy

## Other businesses

Food accounts for the lion's share of the Co-op's sales – just over £7bn of its £9.4bn total turnover. However, the group's operations include other divisions such as online electricals retail and funerals.

The electricals business is a tiddler in comparison with food. Last year its profits fell from £700,000 to £600,000 on sales down from £88m to £84m.

But Pennycook maintains it is worth hanging on to and is not up for disposal. He says it is "not dissimilar in profitability" to quoted electricals retailer Ao.com.

The Co-op's electricals business was hit in the first half of last year as a result of the bad publicity surrounding the group as it was engulfed in scandal and leadership turbulence, but recovered afterwards. "We love that business," says Pennycook.

Sales at the Co-op's funeralcare arm fell from £370m to £363m last year because of the "relatively low number of deaths in the UK".

However, underlying profit advanced from £62m to £66m, mainly as a result of cost-saving initiatives.

## The outlook

Pennycook says that the last financial year was "one in which we turned the corner" as it left turmoil behind it.

The new year has got off to an encouraging start. Group trading in the first 12 weeks was in line with or ahead of expectations in all parts of the business.

The retailer expects food trading conditions to remain "volatile" amid fierce price competition but is confident in its strategy designed to make it "the best community convenience retailer in the UK".

Consultancy Retail Remedy partner Phil Dorrell says the Co-op's store numbers and locations give it a great opportunity to carve out a powerful position for itself in convenience retail but it is still off the pace compared with competitors.

He says: "It's a viable business. What they've got to do is work hard on tailoring the customer offer, to localise it and to make sure they're not out of step on price.

"And they're going to have to inject more of the core Co-op – the heritage, the provenance, the links to communities. Do you really see that in stores?"

"They've got everything they need to do it, but there's a lot of work to do."

**"I've understood how the Co-operative can play a unique role in the fabric of British society"**

Allan Leighton

