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Case Study

Independent Liquor Group – Providing Choice and Flexibility

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CEMI Centre for Entrepreneurial Management and Innovation

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INTRODUCTION

The liquor retailing sector in Australia in 2017 was estimated to be worth around $11.7 billion and has enjoyed an annual growth rate of 2.4% over the past five years. It is made up of approximately 2,371 businesses, the majority of which are small, independent, family-owned and operated small to medium enterprises (SMEs) (Tomson, 2018b).

ilg
independent liquor group

Although the forecast is for continued growth of around 2.5% over the next five years, the industry is dominated by a small number of large, investor-owned firms. The largest of these is Woolworths Ltd, which owns a range of retail chains (e.g., *Dan Murphy's, BWS, Woolworths Liquor, Langton's, Cellarmasters, Winemart*). This ownership of major retail brands, including the largest "big-box" stores, has enabled Woolworths to capture 45.4% of the national market. Woolworth's buying power and retail network has seen its revenue growth at an annualised rate of around 3.8% over the past five years, which is significantly higher than the industry average (Tomson, 2018a).

In second place is Wesfarmers Ltd, which owns a further range of retail liquor stores (e.g., *Liquorland, Vintage Cellars, First Choice Liquor, Coles Online*). Like Woolworths, Wesfarmers has grown its market share through its ability to discount and provide a wide range of retail store distribution including the large "big-box" outlets. In 2018 Wesfarmers controlled 18.6% of the national market. Other major players are Independent Brands Australia (IBA), a subsidiary of the grocery wholesaler Metcash Ltd, and owner of the *IGA Liquor*, *Cellarbrations* and *Bottle-O* retail chains. IBA controls a further 9% of the market. Finally, there is ALDI Stores Supermarkets, a wholly owned subsidiary of the German company ALDI Einkauf GmbH & Compagnie oHG. In 2018 ALDI held a market share of around 3.5% (Tomson, 2018a).

BACKGROUND AND EARLY HISTORY

Operating within this intensely competitive market environment is Australia's largest liquor co-operative, the Independent Liquor Group (ILG). Established in 1975 by a group of independent hotel and bottle shop owners, the co-operative is now a major business comprising two separate but related co-operatives with a combined annual turnover of just over $773.5 million. ILG's dual co-operative structure was adopted in June 2000 with the objective of gaining the full taxation benefit of co-operative loans offered by the NSW Treasury Corporation. The change in structure allowed ILG to build its first distribution centre. More than 1,200 small, licensed liquor stores, hotels, clubs and restaurants across NSW, Queensland and the ACT are members of both co-operatives (ILG Suppliers Co-operative and ILG Distribution Co-operative). ILG Suppliers Co-operative also includes large liquor suppliers in membership.

ILG owns five banner groups: *Bottler*, *Super Cellars*, *Pubmart*, *Clubmart* and *The Liquor Co-op*, which provides the group with significant buying power because of the additional marketing and promotion opportunities that this provides. ILG also has a sophisticated supply system with the ILG Logistics Contract Warehousing and Distribution Solutions. This has wholesale distribution centres located in Western Sydney, Brisbane and Townsville. This offers a range of warehousing, handling and distribution services to members and can provide specific customised supply chain solutions to members (ILG, 2018).

Within the Australia liquor wholesaling industry, there are around 1,995 businesses, with a combined annual turnover of $5.3 billion. This sector has been growing at a rate of 1.6% annually over the past five years and is forecasted to grow at a modest 1% over the next five years (Thomson, 2018c). Competition in the liquor wholesaling industry is high with Metcash and the ILG Group together controlling around 70% of market share. Metcash Ltd, is a publicly listed company that is Australia's largest wholesaler of food, liquor, and general merchandise with 67% of the total market. ILG Group currently has around 6% of the national market. Other major players are Brown-Forman Australia Pty Ltd with 4% market share and Beam Suntory Australia Pty Ltd with 3.9% (Thomson, 2018b).

The reasons for founding the co-operative

The overarching member value proposition (MVP) for the ILG Group is the ability to work collectively to secure and maintain a competitive position in a marketplace dominated by a few very large investor-owned firms. This was the key motivating factor that led to the foundation of the co-operative in the mid-1970s. As explained by the ILG Chairman Chris Grigoriou:

> *"So, going back approximately 42 years ago a bunch of hoteliers and bottle shop owners got together and said, 'hey, look why don't we form a group where we can make a buying group so that they could get a better deal for their stores. They leased a little warehouse in Blacktown, then offered the products to other hoteliers and bottle shop owners the products, then as they grew, the co-operative model emerged with the members buying the shares. So, the basic idea was to return all the value back to the members."*

The first co-operative founded was the ILG Distributors Co-operative Ltd. This operated for several years before the foundation of the ILG Suppliers Co-operative Ltd, as a complementary business to link up the entire supply chain. A key factor motivating the foundation of the co-operative was the power of the major supermarket chains to control prices and undercut the smaller distributors. At that time the major liquor wholesaling business was Metcash Ltd., which was then known as Davids Ltd., a grocery business founded in NSW in 1928 by Joe David.

A key element in the ILG business model is the ability to establish sufficient scale economies through collective purchasing that it enables the distributors to secure the most competitive prices they can. This was the main factor driving the formation of the co-operative in 1975 and it has remained the case to the present. Further, this economy of scale through collective action has value not just on the wholesale prices of liquor, but across a wide-range of equally important areas such as marketing, advertising and logistics. As Paul Esposito, CEO of the ILG Group explained:

"You talk about the value proposition; it is essentially about scale. It gives us better buying power, and this is not just in terms of the alcohol, but when it comes to media, point of sale etc., it gives us that bit of extra power to create value that we pass back onto the membership."

MANAGING BOTH SUPPLIERS AND DISTRIBUTORS

While the management of two separate but interrelated co-operatives representing suppliers and distributors in membership may appear to pose potential managerial challenges, this is not the experience of the ILG Group. For the members of the supplier's co-operative, the value proposition is their ability to secure larger distribution for their product at lower transaction costs, but to also achieve better value across a range of measures. As noted by Paul Esposito:

"For the suppliers, their motivation to get involved is based on the objective of pushing their products, and making sure that their products are positioned well, priced well, and placed into out promotional calendar and buying cycle."

The membership of the ILG Suppliers Co-operative is relatively small and comprised of larger firms. By contrast the membership of the ILG Distributors Co-operative is large and consists of mostly small businesses, which requires more proactive management by the executives and directors of the co-operative. While suppliers are minority members (and only in the ILG Suppliers Co-operative), the value of this structure is that it allows suppliers and distributors to work together for the long-term sustainability of the industry. The diversity of the membership found in the ILG Distributors Co-operative requires the board and management of the ILG Group to be flexible and responsive to meeting the needs of different groups.

According to the ILG Group management this flexibility takes the form of offering special prices and supply arrangements within the co-operative than might be the case in other banner groups. In addition to attractive prices, promotion and supply arrangements, the distributor co-operative members receive a rebate that rewards them for their patronage.

The ILG Group is a "distributing co-operative", and its members must purchase shares upon entry. This varies across the two sides of the co-operative, with different amounts of share capital purchased at different prices. However, all share capital is returned at par value when the member leaves and does not appreciate, nor can it be transferred. This makes rebates the only financial distribution available to the co-operative's members, and rebates are only paid to the members of the IGL Distributors Co-operative. The ILG Group board has not yet considered making use of Co-operative Capital Units (CCUs) (see Mamouni-Limnios et al., 2016).

ILG Group's distributor co-operative's membership is divided into two tiers. The Tier 1 or "Banner Group" are those members who operate under the *Super Cellars* and *Bottler* brands. These members contract with suppliers to distribute a specific volume and range of products, coordinated via dedicated marketing and promotion campaigns. For this, the Tier 1 members receive higher rebates as a reward.

The Tier 2 group operate under the *Pubmart*, *Clubmart* and *Liquor Co-op* brands. This second group, who are mostly smaller operators, receive slightly reduced rebate distributions than the larger "Banner Group" members. This reflects the capacity of the smaller distributors to commit to the volume and range of products that the larger members can accommodate. The difference in rebate returns for the two groups is therefore determined by the overall volume of sales and the range of products sold by the distributors.

MAKING THE MEMBER VALUE PROPOSITION

According to the ILG Group's Chairman and CEO, the main member value proposition (MVP) for the co-operative is to assist its members to compete in what is a highly competitive and oligopolistic market. The pricing and rebates offered by their competitors to suppliers and distributors must be closely matched or bettered by the co-operative. As explained by Chairman Chris Grigoriou:

> *"Whatever their offering by way of rebates we have to match, or better. That's how we're compared and that's what they're looking at. The average bottle shop owner or hotelier will be looking at the pricing of the products, the finance fee, and the freight. This what they will be comparing against each other, and we have to put the business case forward to attract new members."*

Despite the importance of financial issues in attracting and retaining members, the ILG Group is also aware of the need to build its value proposition to members on non-financial issues. This includes the sense of mutual ownership in the co-operative amongst members, and the resources, assets and systems that it is able to deploy to assist its members. This includes the ability of the co-operative to collectively market its members businesses to the wider community in the face of massive marketing and advertising by the major investor-owned-firms. As CEO Paul Esposito explained:

> *"So, we're under attack by the opposition and the price at the till matters, but we also need to come up with strategies to ensure that the members get footfall into their stores. So, it's a total mix and it is the marketing aspect that our members are really looking for at the moment."*

He noted that getting all the members onboard to support and comply with a marketing campaign was challenging. This particularly applied to smaller distributors in regional towns where the level of competition was much less than found in major cities. However, in those cases the members were allocated into the Tier 2 group. As such they did not face the same level of compliance required as would be expected from the larger Tier 1 group, and this accounted for their reduced rebates. Yet it was important for the co-operative to get its supplier and distributor members to cooperative so as to deliver value to both sides. As Esposito explained:

> *"You talk about the bigger challenges, we've got suppliers who basically pay for certain compliance, and getting our distributor members complying with it is our biggest challenge to me. So, its complex but I think all co-operatives have the same issues."*

A key part of this challenge is the relative diversity found within the membership base of the distributors. Some members were operating near a "big box" store such as a Dan Murphy's, while others were based in small country towns where they essentially had little or no competition. The focus of the ILG Group was on ensuring that the margins made by all members were sufficient to enable them to remain financially viable.

Balancing the interests of the supplier members with those of the distributor members was an ongoing activity undertaken by the ILG Group's management team. This often arose over product mix, when the major investor-owned distributors heavily promoted or discounted particular products sometimes selling at prices below what the ILG Group distributors could buy the same products from the ILG Group suppliers for. Despite these issues the general engagement across the two co-operatives was positive, and the ILG Group management invested a lot of time into researching the products that need to be distributed, and while they did not always get it right, they did communicate this research to the members who were able to use it to plan their purchasing.

MARKETING OUR CO-OPERATIVE ADVANTAGE

Co-operative and mutual enterprises have been encouraged to use the strengths inherent within their business models within their marketing communications by what has been described as "Marketing our Co-operative Advantage" (MOCA) (Webb, 1996). This is something that is well understood by the ILG Group's board and management team.

Operating in a highly competitive market environment the members of ILG Group understand that they are better off working within the co-operative than they might be trying to operate alone. For the distributors, this is particularly the case as they are generally too small to maintain their sustainability in the face of the large competitors. This is a message that the co-operative communicates to its members all the time, as noted by Esposito:

> *"We communicate this regularly. We hold different forums throughout the year where we can present that. So, what Metcash do to combat that is what might be described as cheque book warfare. They say to our members, 'OK, we understand that you belong to co-op, but here's some money please sign up with us'."*

He noted that for many small distributors, particularly those who might have just taken over a new liquor store or hotel, the cash flow is tight, and the largest cost for them is the purchase of their stock. The distributor members were now comprised of an increasing number of migrants from a range of backgrounds who purchased a small bottle shop or hotel to make a living. Many find that the liquor licensing and compliance issues that regulate the industry imposed a burden on them in trying to establish their business. ILG Group supports these members not only with competitive pricing, but also with education and training to assist their members to deal with these regulatory and compliance issues. This ability to demonstrate their value to the members was a strategic focus of the co-operative. As Paul Esposito explained:

> *"We're trying to be more than just a box mover. Our plan going forward is to provide our members with HR support, assisting with store layouts, work health and safety management, the training of their staff. This is what a co-operative should be about."*

Delivering this message to the members is a key focus of the ILG Group and how it markets its co-operative advantage

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The co-operative works actively to retain its members' loyalty and seeks to add value to the MVP that goes beyond pricing.

FUTURE DIRECTIONS FOR ILG GROUP

Despite their success, the ILG Group is not complacent and recognises the need to adapt to changes in the market. One area is the need to move their business and that of their members more into the digital marketplace. As Paul Esposito explains:

> *"We're moving more towards a digital space. A lot of the decision making when it comes to the purchasing of alcohol is done when people are looking at their screens, and you may get a small percentage that get an impulse to purchase when they walk into stores. So, we're working to educate our members about how this process works."*

The co-operative has purchased a store in Victoria and leased another store in Sydney where the company can trial various retail strategies. These company stores will allow the co-operative to test and develop best practice and use the findings to educate and inform their members in the operation of their own retail outlets.

Currently the co-operative's distribution network is in the ACT, NSW and Queensland. However, it is planning to open a series of stores in Victoria that will be owned and operated by the co-operative, and to use these to boost volume at the national level, and address issues of tight or "lean" margins. By increasing the volume of sales through an expansion of the co-operative's national distribution network it will be possible to improve the co-operatives profit margins and pass the benefits back to all members.

As explained by Esposito:

> *"We can't do our Victorian strategy without the support of our co-operative's members in the ACT, NSW and Queensland. However, it gives us the ability to trial new initiatives, the members will then see what we are doing in our concept stores, and we're hoping that this will be enough to get everyone onboard."*

It was noted that this shift to new, and increasingly digital, approaches to retailing was not always understood or appreciated by all members, and that it might take a "generational change" with younger members coming into the co-operative to fully engage all members in these strategies. Chairman Chris Grigoriou agreed supported this view and further explained the underlying logic of the Victorian strategy:

> *"So, instead of investing in a large warehouse, we've decided to go with a retail outlet and start to build our own brand down there. If we can pop up a few stores with our own brand, we can say, 'look here's our new brand, we've been operating in Queensland and New South Wales for over 40 years, would you like to come along and join us?' This is a much better return for the members in Queensland and New South Wales."*

The board was still to finalise how it might distribute the profits from this Victorian retail network, but if it proves successful this could potentially involve issuing distributions to all members across the other states.

Establishing a network of company stores in Victoria rather than simply expanding the co-operative into that state along the lines of the existing business was justified by the ILG Group board on the need to achieve rapid market share and scale economies. As explained by Esposito:

> *"It gives us scale. The terms that you negotiate with suppliers are based on scale, compliance and data. Suppliers want to see data on product volume, price point etc., and having that information we can secure attractive prices, and this can generate additional income that we can give back to members."*

He agreed that the roll-out of a network of independent members across Victoria was feasible, what the company store model offered was potentially greater agility and coordinated marketing strategy. The ability to segment target demographic groups within the retail market and offer specialised products. The co-operative doesn't plan to rule out supporting small distributors in Victoria, but it needs to increase its scale economies rapidly and that will offer value to all members.

At time of writing the first of the ILG Group's corporate stores in Victoria was planned for launch in November 2018, with a plan for up to 6 or 7 stores to be established there over the following 3 to 4 years. The branding of the company store network was evolving, but the first store would operate under *The Liquor Co-op* brand. This would help to position the store as a co-operative, owned by the small businesses and family communities that comprise the co-operative's membership base. According to Chairman Grigoriou:

> *"If you look at the long-term plan for Victoria, once we get the stores up and we can create a brand, we can then start to get people to start joining up and joining into this new banner group. I think that the next step would be to establish a warehouse there. Then we can use the same model as we have in the other states. There are a lot of states and territories, such as the Northern Territory, who have no idea who ILG is or what we do."*

SOCIAL VALUE

The focus of the ILG Group is not entirely on the delivery of economic value to their members. They also work diligently on enhancing their members' connectivity with each other and across the suppliers and distributors to share information and best practice knowledge. In addition, they have given generously to community projects and are looking into the creation of an ILG Foundation, that will be funded by events and donations.

KEY LESSONS FROM THE CASE

The ILG Group case study provides a good example of the ability of the co-operative and mutual enterprise business model to provide small to medium enterprises (SMEs) with value through collective action that would otherwise be impossible for them to achieve alone. Research into the relationship between SMEs and co-operatives suggests that the underlying business model should be viewed as a strategic network, sometimes described as a "nexus of contracts" (Sexton, 1983; 1986), or a "coalition" (Staaz, 1983; 1987). This can apply to producer co-operatives as found in agribusiness or fishing, but also in consumer co-operatives where the members are small business owners.

Mazzarol, Mamouni Limnios and Reboud (2013) proposed a conceptual model for small firms' network engagement with co-operatives. This focuses on the interrelationships between antecedent factors, processes, and outcomes. The antecedents that motivate SMEs to join co-operatives include such things as the need to secure external resources and capabilities that they cannot acquire alone. Also important is the level of external environmental uncertainty within their industry or markets. As shown in the ILG Group case, the members of the co-operative were motivated to collaborate because of rising costs and increasing competition within their industry.

However, external pressures and lack of resources are insufficient by themselves. There must also be a willingness to cooperate, a common sense of purpose and member driven focus within the process of establishing the co-operative. Once formed, the co-operative's success will depend on its ability to deliver value to its members, and to run its operations in an efficient manner. There must also be a clear link between the member firm's success and the success of the co-operative. The directors and managers within the co-operative must also pay close attention to the retention of member loyalty through active patronage, and the fostering of social capital and trust between the members and the co-operative, and the members amongst themselves.

If these processes are successfully undertaken, the outcomes for the SME members will be enhanced access to resources, information and knowledge, stronger control within the supply chain (e.g., pricing and marketing), the strengthening of social capital, and the maintenance of a sense of common purpose and pride. The ILG Group case demonstrate these processes and outcomes. They show how, via cooperation, small business operators can compete against the largest investor-owned firms. As the ILG Group case illustrates, the co-operative business model can accommodate both buyers and suppliers who collaborate to create common value for the mutual community. While this may not be easily created, it reduces substantially the competitive tensions that typically create challenges for more conventional business models within supply chains.

However, the ability of the co-operative to play a valuable role for its small business members will be contingent on the willingness of the members to work together and maintain collective discipline. As the ILG Group case demonstrates, this relates to their willingness to adhere to group strategies in terms of following marketing and purchasing, information and data sharing, and even the display of co-operative branding. The idiosyncratic nature of many small business operators makes this level of discipline more challenging than is usually the case within franchise systems, or corporate groups. Such are the challenges that face directors and managers of co-operatives.

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