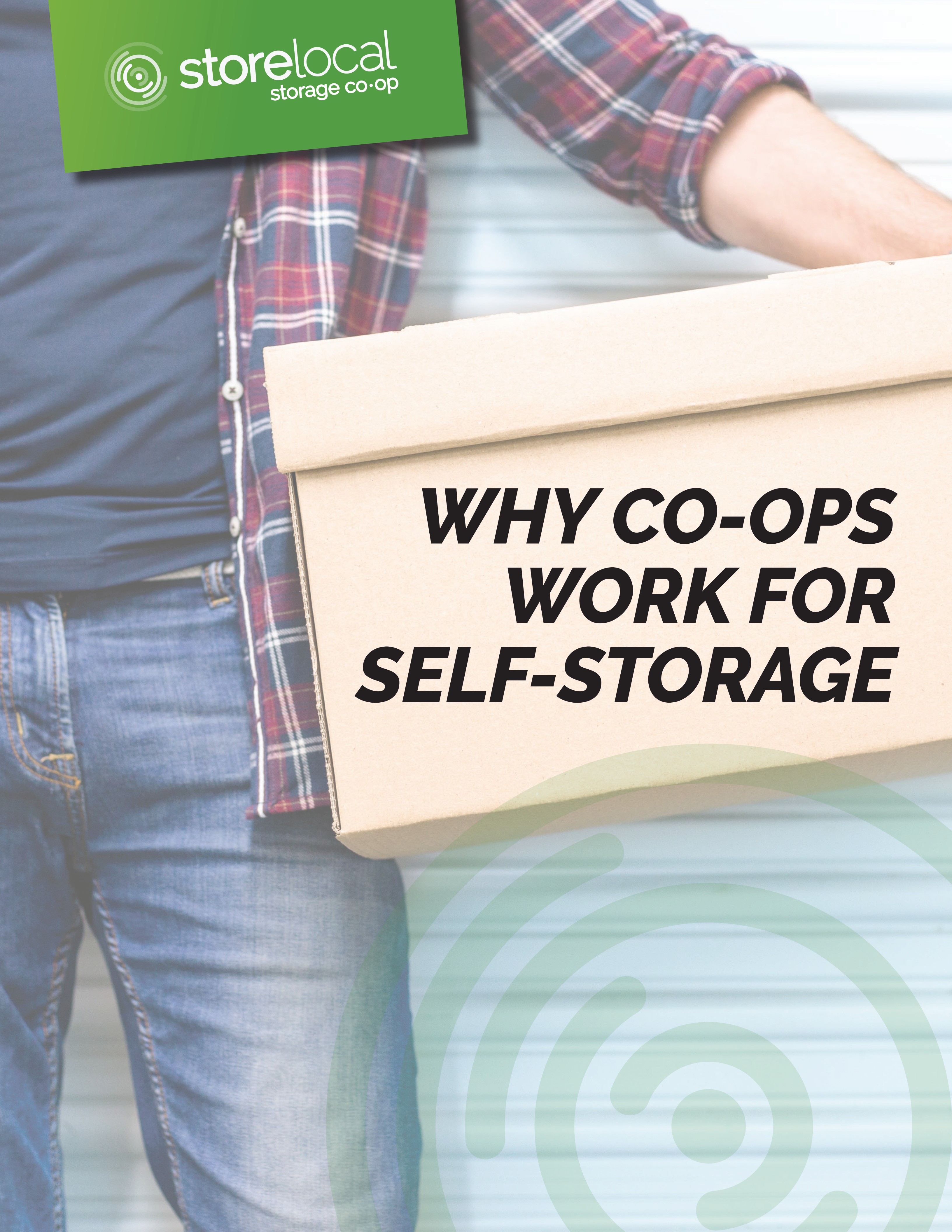
storelocal
storage co·op



WHY CO-OPS WORK FOR SELF-STORAGE

CONSOLIDATION AND THE SELF-STORAGE INDUSTRY: A CAUTIONARY TALE

Every business begins as a small thing — an idea scribbled on a napkin or a chance encounter with a former colleague. From there, its sole objective is to grow, gain market share, and with luck, turn a profit.

Once that business gets to a certain point in its evolution, however, it may realize that it can no longer achieve its goals without adding resources, talent, or market share. One way to do that is by a merger or acquisition. When two or more businesses combine forces to form a single entity, it's called consolidation.

Consolidation has many effects on a market, but we're going to focus on the effects felt by smaller, independent competitors, using self-storage as an example.

Let's say two regional self-storage businesses, Ace Self Storage and Diamond Self Storage, merge to form Ace of Diamonds Self Storage. Ace has a 12 percent share of the market in their region and Diamond has an 8 percent share, so after the merger, they have a combined share of 20 percent.

At the time of the merger, another independent operator, Jack of Spades Mini Storage, has a 5 percent share.

The greater a business' market share, the greater their buying power, so the less they pay on a unit basis for many goods and services. These savings can be passed along to customers in the form of lower prices and enticing incentives, which makes it more difficult for Jack of Spades to compete.

Another effect of this merger will be increased visibility. More resources mean more (and often better) marketing, so people in the self-storage market are exposed more frequently to Ace of Diamonds than to independent operators. Jack of Spades will find it difficult or impossible to get their marketing efforts in front of potential buyers.

Finally, Ace of Diamonds' increased market share and more impressive financials will give them cheaper access to capital, meaning they will be able to afford new locations in desirable, high-growth places. Here again, Jack of Spades will find it very difficult to compete.

If Jack of Spades doesn't take action, it's likely they will see their market share and margins continue to shrink. However, since other small operators in this market are in the same boat, they may be able to join forces in order to stay in business. One way to do that is through forming (or joining) a co-op.

THE EFFECTS OF CONSOLIDATION

Consolidation is pretty much inevitable in today's world. Over time, the number of competitors in an emerging market will peak as the market matures, then begin to shrink as consolidation inevitably occurs.

In general, a more concentrated market has the following effects:

- Higher profits (and profit margins) for the biggest players without much additional investment;
- Slower job growth and innovation; and
- Less consumer choice.

A great example of how consolidation has had negative effects on a market is in the airline industry, which is largely dominated by the major players. The four major airlines — American, Delta, Southwest, and United — have a combined share of 67%.

When you have more planes, more routes, and are in more airports than anyone else, you pretty much get to dictate your own terms, which is why we now pay exorbitant fees for everything and are packed into planes like cordwood.

We're currently seeing this happen now in the telecom industry, which is dominated by a few major players who own much of the infrastructure and can charge pretty much whatever they like.

A BRIEF HISTORY OF CO-OPS

Even if you're not a student of history, you've probably at least heard of the Industrial Revolution. Most school textbooks focus on the one that took place shortly after the end of the U.S. Civil War, but that's technically the Second Industrial Revolution.

The First Industrial Revolution began in the mid 1700s and ran for roughly a century, tapering off around 1830 as the innovations of that age, such as steam power and mechanized textile production, became commonplace and markets matured.

Markets rise and fall, level off, and do it all over again. During times of growth, demand exceeds supply and prices increase. The opposite happens during a decline, when prices fall. Flat growth means relatively stable prices, during which competitors look to improve their profits by reducing costs.

These days, the signs of a mature market and increased competition are familiar to you. Labor is outsourced where possible. Cheaper materials are used or product lines are narrowed. Companies that figure out how to adapt to maturing markets survive; those who don't exit the market or go under. It's always been this way.

But there's a big difference between how businesses adapted in the past compared to how they do it now. These days we have regulatory bodies and labor laws. News travels around the world instantly. Unscrupulous practices are hard to hide. Publicly held companies are accountable to millions of stakeholders.

Feeding the Beast

Any company exists for one primary reason: to make a profit within the constraints allowed by societal norms or laws. But in the mid 1800s, as major industries began to take shape, such constraints were few or nonexistent. Companies could do just about anything they wanted to stay competitive, and they did. Child labor, deplorable working conditions, and a complete disregard for safety became commonplace[1].

Meanwhile, most of the world was in an economic depression. Workers, desperate to put food on the table, endured unspeakable conditions for very little pay, knowing that someone else was waiting in the wings to do it for less. That included immigrants and children.

Unfortunately, cutting costs and moving more product, no matter how you did it, was the only way to win the game. The bigger you got, the more you could squeeze your suppliers, who had little choice but to go along. To be guided by principles, whether it was to offer suppliers a fair price or demand it from a large buyer, wasn't really a thing yet. This created a very real dilemma: How could smaller producers stay in the game while keeping their values and integrity?

This is how the cooperative was born.

WHAT IS A COOPERATIVE?

A cooperative is as much an ideology as it is a business structure. Broadly defined, it is simply **a group of people with similar interests, values, or goals who determine that they can accomplish more, and maintain more control over their destiny, by working together.**

In a mature market, where just a handful of major companies drive a category, smaller players must either get out of the game, carve a niche for themselves, or band together in some way.

Sometimes this happens through mergers or acquisitions. Other times, a key supplier will cut ties with one of the market leaders in order to support the efforts of one or more small companies in the category. You see this happen quite often in the food industry, such as when small suppliers with clearly defined values (e.g. fair-trade coffee) only sell to buyers who are committed to those same values.

The first cooperative was called the Rochdale Pioneers of England. Formed in 1844, they were a group of weavers and other skilled workers who banded together in order to compete against the large-scale producers of the age. Together, they developed the Seven Cooperative Principles[2] that still guide many co-ops today:

> **1. Voluntary and Open Membership**
> Cooperatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

2. Democratic Member Control
Cooperatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary cooperatives members have equal voting rights (one member, one vote) and cooperatives at other levels are also organized in a democratic manner.

3. Member Economic Participation
Members contribute equitably to, and democratically control, the capital of their cooperative. At least part of that capital is usually the common property of the cooperative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their cooperative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the cooperative; and supporting other activities approved by the membership.

4. Autonomy and Independence
Cooperatives are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.

5. Education, Training, and Information
Cooperatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the general public—particularly young people and opinion leaders—about the nature and benefits of co-operation.

6. Cooperation among Cooperatives
Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures.

7. Concern for Community
Cooperatives work for the sustainable development of their communities through policies approved by their members.

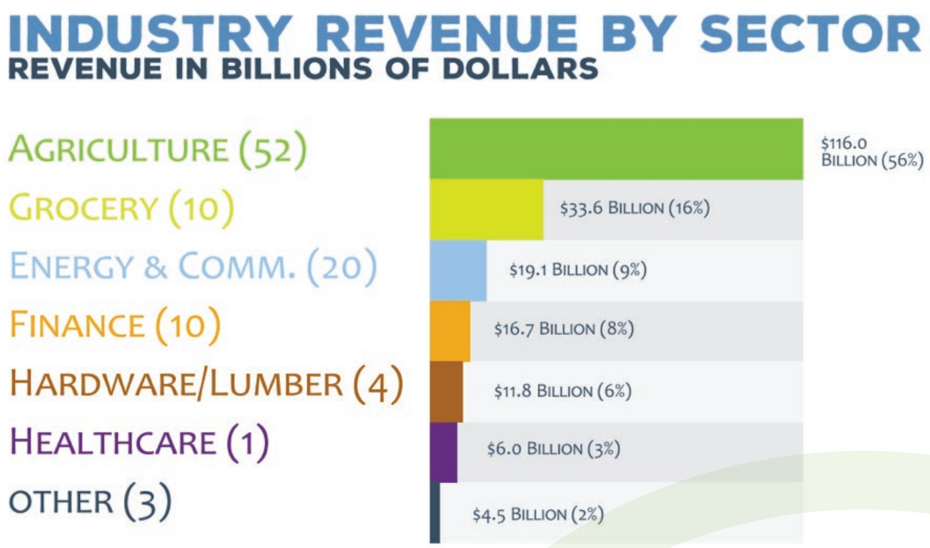
Since then, cooperatives of all sizes have been created to increase the market power of small companies across a broad spectrum of industries.

The Modern Cooperative

Many modern co-ops are already familiar to you. In fact, you probably didn't know many of them were co-ops. Do any of these names ring a bell?

- Land O'Lakes
- ACE Hardware
- TrueValue
- REI
- Do-It-Best
- Ocean Spray

Believe it or not, these are all examples of modern co-ops. Remember when we talked about mature markets? A quick glance at the National Cooperative Bank's (NCB) list of cooperative industry revenue by sector[3] underscores this point:



You'll notice that these are very mature industries critical to daily life. The market leaders in these categories are few but massive, with deep pockets and staggering buying power that would otherwise eliminate smaller players.

By forming cooperatives, small players are able to build a greater share of small markets, where the big boys have little incentive to compete. This is why the majority of co-ops are regional in nature. They can maintain quality and fair pricing while serving a market that would otherwise be ignored.

Though the “big box” players often dominate the share of larger markets, co-ops can often find a niche among consumers who prefer more choice or would rather support smaller players. REI is a great example of a co-op that has carved a lucrative niche for itself through quality products, conspicuous stewardship of causes that align with its brand, and returning value to its members.

But although many modern co-ops are formed around a shared ideology, their real advantage is economical. Market power is the ability of a player in a particular market to influence the various forces in that market rather than be subject to its whims. Cooperatives give minor players more market power together than they could achieve on their own.

PROS AND CONS OF COOPERATIVES

PROS	CONS
✔ economies of scale	✖ shared profits
✔ increasing buying and negotiating power	✖ less control, especially price
✔ democratic by design	✖ more risk averse
✔ shared ownership/ governance	✖ reduced organizational agility
✔ lower taxes (usually)	✖ shared ownership/ governance

Most of the upsides and downsides of a co-op are a natural outcome of being a collective. Entrepreneurs often get into business because they don’t like sharing control and really don’t like being told what to do. Personalities, egos, and motivations can all get in the way of thinking and acting in the collective best interest.

You may have noticed that shared ownership/governance is listed as both a pro and a con. This is because distributing decision-making and strategic direction among a diverse group with common interests can, and often does, result in better and more fully formed ideas. The internal vetting that comes from presenting and defending ideas can sometimes head off bad decisions, but the group will generally have a lower risk tolerance than the individuals within it.

But at the same time, it makes the process slower. If you're a my-way-or-the-highway kind of person, or relish the opportunity to make big bets on yourself, you might struggle being part of a co-op.

But any form of business has its compromises. In some industries, especially well-established ones controlled by a handful of big players, carving out enough market share for long-term viability can be borderline impossible. In such cases, pooling resources, knowledge, and leadership may be the only alternative to going out of business or making another major shift.

ECONOMIES OF SCALE

An **economy of scale** is an economics term that basically means that relative costs decrease as production increases. In other words, the greater your share of the supply in a market, the less expensive it becomes for you to participate in that market, relatively speaking.

Let's take the self-storage industry an example.

Self-storage is a maturing market, which means prices are relatively stable and predictable across markets. Supply and demand are pretty much in balance and the opportunity for innovation is fairly limited. When that happens, it becomes a bit of a numbers game. The goal of all players in the market is to maximize revenue and minimize expenses.

If you're an established self-storage company with many locations, you have greater leverage negotiating with suppliers, who will accept a lower price for goods and services because of the increased volume.

Let's say you own a large, regional self-storage company with 25 locations, and you decide to install new locks on all your units. A lock company ordinarily offers their best locks for $10 apiece but they cost $3. They have to cover their expenses out of the difference and hopefully make a profit. But if you come to them needing 1,000 locks, they will likely agree to a lower price, say $6, in order to earn your business (or keep you from giving it to a competitor).

Now imagine you're new to self-storage and have just one location with 200 units. The lock maker might come down to $9, but they have less incentive to work with you. Thus, your "big box" competitor pays $3 less than you do for each new lock, just by virtue of being bigger. And if they charge the same prices as you, they're making more profit as a result of higher margins.

But what if others are in the same boat? If you and other self-storage companies wanted to grow while preserving margins, you might consider banding together. One way to do that is by forming a co-op.

This is a simplistic example of how economies of scale work, and they're the main reason why joining a co-op could dramatically reduce the distance between you and the growth you want.

WHY CO-OPS MAKE SENSE FOR SELF-STORAGE

As noted earlier, self-storage as an industry is in what we would call early maturity. What does that mean?

All markets proceed through phases. Generally, those phases are introduction, growth, maturity, and decline.

Self-storage is roughly a $40 billion market, with steady annual growth exceeding 7 percent.[4] And while customer needs continue to evolve, the basic offering is the same as it's always been: a safe and secure place to keep your stuff.

How else do we know the market is maturing?

One way is by the increased attention of real estate investment trusts, or REITs. These are companies that invest in or operate income-producing real estate across a variety of sectors. REITs have fueled consolidation in self-storage and other industries by scaling quickly and accelerating innovation.

That we are seeing greater interests from REITs in self-storage is a good sign for the industry as a whole. It implies there's still plenty of opportunity for growth and innovation. But **if you're a small operator, you should watch this trend very carefully.**

When the size of a market remains relatively constant but the number of competitors shrinks, it's often a result of consolidation, usually through mergers or acquisitions. Increased consolidation is one of several signs of a maturing market.

Since it's virtually inevitable, it's not useful to say that consolidation is good or bad. Obviously, REITs think it's good and consumers may as well. But what about the perspective of a small operator?

The effect of consolidation on small operators

The cost to open a new self-storage facility is typically north of $1.5 million, depending of course on the size and location. The point is, it's a lot of money and there are many hurdles you must clear before opening.

But to a REIT, that's pocket change (relatively speaking). No matter how quickly you can get that kind of money together and check all the boxes, a REIT can probably do it faster (and cheaper, since they're a lower lending risk and have more collateral). We've already established they have greater buying power than a small operation, so they can do everything at a lower unit cost. Moreover, they generally prefer buying over building, so if you happen to want the same location, your chances of outbidding them are slim.

If you're already established, the situation doesn't get much better. You may offer lower rates than a big-box operator, but they can afford all the bells and whistles that draw high-value business. Next thing you know, you're on the value end of the market even though a year ago, yours was the nicest and newest place in town.

This trend leaves small operators with a difficult choice—keep focusing on low-value business, reinvest heavily to try and compete, get out (or sell out), or …

… wait for it …

… join a co-op.

Why join a self-storage co-op?

Consolidation follows a pattern: One player in the market gets large enough that businesses with low market share can no longer compete, meaning they have to either be taken over or go out of business. It's like the adage, "If you can't beat 'em, join 'em."

But many businesses want to stay in the market. They believe there's plenty of upside and demand, and that the "pie," if you will, is big enough for everyone to have a piece. Sometimes there's a third option, which is to form or join a co-op.

That's how Storelocal began. We saw which way the winds were blowing in our industry and believed there was a way to bring small operators in under one banner, and provide them with the technology, marketing, and group benefits that give an added boost. Put simply, **we believe that small operators are better poised to succeed in the self-storage business when they work together toward a common goal:** building market share and making more money.

We support our members in several key ways:

BRAND SERVICES: No matter how much brand awareness you think you have, the reality is probably less. The reach of a national brand like Storelocal is greater than what you could generate on your own[5] (think Best Western and Ace Hardware).

BUYING POWER: We have the clout to negotiate vendor discounts and drive down operating costs for our independent operators.

EDUCATION: We bring a wealth of industry knowledge to our members via events, podcasts, webcasts, one on one collaboration, white papers, and more. The Storelocal community is here to help.

PROBLEM SOLVING/PREVENTION: We all face similar problems, so we facilitate the networks and relationships to help us solve them together and avoid them in the future.

TECHNOLOGY: Built by the independent operators for the independent operator, our Tenant™ technology suite gives you all the modern tools for success, from a tenant interface to digital signage.

If you've already seen the effects of consolidation in your particular market and are concerned about your ability to compete, but don't want to get out, let's talk.

ENDNOTES

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ABOUT STORELOCAL

Storelocal offers convenient, affordable self-storage with the modern customer in mind. We believe that self-storage is more than just a place to keep your belongings. A great self-storage experience offers user-friendly technology, exceptional customer service and storage unit options designed to fit your needs. Whether you're a college student looking for climate-controlled storage that will keep your stuff cool during summer or you're an RV owner in need of the most secure indoor storage in your area, we've got you covered. From online reservations to the moment you're rolling up the door on your storage unit, we've here to make your self-storage experience the best it can be.

Visit www.selfstorage.coop for details.