



CO-OPERATIVES UK

NEW INSIGHT 10

Sticky money

Evaluating the local impact of the co-operative pound

Justin Sacks

“The LM3 score gives your organisation a simple and meaningful barometer of its local economic impact.”

Overview

This document provides guidance for co-operatives on using the LM3 tool to evaluate their local economic impact using the Lincolnshire Co-operative Society as a case study to illustrate the process.

Over summer 2012, Lincolnshire Co-operative used the Local Multiplier 3 (LM3) methodology to measure the local economic impact of its operations on Lincolnshire. This process was sponsored by Co-operatives UK and externally assessed by K2A.

“Organisations around the world measure more than £1 billion of spending using the LM3 tool.”

Co-operatives UK is a trade association for co-operative businesses, with a mission to promote, develop and unite co-operative enterprises. As part of this mission, Co-operatives UK reviews best practice in financial and non-financial reporting to help members promote their unique value as co-operatives.

Lincolnshire Co-operative: operates convenience stores, pharmacies, funeral services, travel agencies, and post offices. Founded in 1861, the Lincolnshire Co-operative Society currently operates over 200 outlets and is owned by 205,000 members.

K2A is an international consultancy founded by Justin Sacks, principal inventor of the LM3 tool, who has worked with dozens of organisations around the world to measure more than £1 billion of spending using the LM3 tool.

LM3 methodology

LM3, which stands for Local Multiplier 3, is a tool that enables organisations to measure the impact they have on a local economy by tracking where the money they receive is spent and re-spent.

This methodology is publicly available as The Money Trail, a handbook published by nef in 2002 and authored by Justin Sacks of K2A.

There are three measurements to complete LM3:

- Round 1: Calculate your organisation's turnover less VAT
- Round 2: Calculate how your organisation spends its turnover in the local area
- Round 3: Survey suppliers and staff to calculate how much they spend in the local area

These figures are transformed into a ratio to show how the income your organisation receives generates income for local businesses and people thereafter.

This guidance and case study walks through these steps based on the direct experience of Lincolnshire Co-operative Society with some of their workings to illustrate the process.

Defining 'local' and timeframe of measurement

There are two variables to review before starting the LM3 process: defining what 'local' means for your organisation and what timeframe you want to use for measuring your impact.

Defining 'local': Lincolnshire Co-operative Society decided to use its trading area of Lincolnshire and Newark as its local area. This boundary is both well defined and well understood, which is important when asking suppliers and staff to respond to your organisation's survey. When calculating its Round 2 figure, Lincolnshire Co-operative Society counted any business or staff person as local if their main mailing address contained one of the 35 postcodes in Lincolnshire and Newark. These postcodes are: LN1-LN13, PE6, PE9-PE13, PE20-PE25, DN17, DN21, DN36-DN38, NG23, and NG31-NG34.

Timeframe of measurement: Many organisations use their financial year as the timeframe of measurement since they plan on undertaking LM3 annually. If gathering data is overwhelming, you can start with a much shorter timeframe, such as the last quarter. Using a shorter timeframe will make the process easier, and it is useful if you plan on measuring your organisation's performance on a quarterly basis.

Lincolnshire Co-operative Society's financial year starts in September, so it chose to use the first six months of this financial year (September 2011 through February 2012) as the timeframe of measurement. Lincolnshire Co-operative Society felt that six months was representative of the organisation's annual revenue and expenditure behaviour.

Round 1: Calculate your organisation's turnover

For most organisations, calculating Round 1 is straightforward and can be completed quickly by running a report in the organisation's financial accounting system.

Turnover: Lincolnshire Co-operative Society calculated that its turnover for the first six months was £123,039,000. This figure represents turnover from all aspects of its business, less VAT.

Round 2: Calculate your organisation's local re-spending

Round 2 requires a little more work than Round 1 but is straightforward for most organisations if they are consistent about entering addresses in their financial accounting system. Most financial accounting systems allow organisations to export data including addresses so that records can be sorted by postcode.

Suppliers: Lincolnshire Co-operative Society needed to perform a few cut and paste operations to connect postcodes to suppliers based on how the financial system exported information, so it focused on suppliers with whom the organisation spent at least £1,000. This totalled approximately 1,000 suppliers who accounted for 99 percent of Lincolnshire Co-operative Society's supplier expenditure. Lincolnshire Co-operative Society spent under £1,000 with about 700 suppliers. To be conservative, Lincolnshire Co-operative Society assumed these suppliers were based outside of Lincolnshire or Newark, though it is very likely that such suppliers were based locally.

Staff: All of Lincolnshire Co-operative Society's staff live in Lincolnshire or Newark so calculating Round 2 spending on staff was simple, but your organisation would calculate spending on local staff in the same way as suppliers if this were not the case; that is, counting payment only to staff who live in the local area.

Member dividends: One of the most important features of co-operatives is member ownership and dividend payment to members. When using LM3, your organisation may wish to highlight this component of your score. All of Lincolnshire Co-operative Society's members live in Lincolnshire, so calculating this figure was straightforward. If your organisation has members that live outside of the local area, you would exclude dividend payments to them from this figure.

Round 3: Calculate local supplier and staff spending

Round 3 is the most intense component of LM3. If you are overwhelmed by this step, you can at least report your figures from Round 2, which demonstrates how much your organisation spends in the local area. To complete Round 3, you need to survey local suppliers and staff, and sometimes members, about what percentage of their income they spend in the local area.

Suppliers: Of its 1,000 suppliers, Lincolnshire Co-operative Society found that approximately 350 of them were located in Lincolnshire or Newark based on their mailing address. Lincolnshire Co-operative Society decided that a mailing was the best way to secure a response. Suppliers were given six weeks to respond, longer than organisations usually allow suppliers to respond, given the summer holidays. Lincolnshire Co-operative Society also used the opportunity to ask suppliers three other questions: (1) did the supplier want a copy of the results, (2) was sales to Lincolnshire Co-operative Society a material part of their business, and (3) how could Lincolnshire Co-operative Society improve their business relationship.

Lincolnshire Co-operative Society received 49 responses, a response rate of 15 percent, from suppliers that represented 31 percent of Lincolnshire Co-operative Society's expenditure on local suppliers. This response rate is solid – a response rate of at least 10 percent representing at least 30 percent of local supplier expenditure is ideal. A single follow up with suppliers via telephone or email usually increases the response rate.

Staff: The approach to surveying staff can look different, depending on how your organisation feels about surveying staff. A survey can go out with payslips, or staff can complete surveys during a staff meeting. Lincolnshire Co-operative Society recently surveyed staff on other matters and did not wish to survey staff again. Instead, it calculated its estimate of local spending based on staff spending with Lincolnshire Co-operative Society. This is an overly conservative figure since staff will spend additional money in the local economy. To account for this additional spending, Lincolnshire Co-operative Society assumed staff spent an additional 10 percent of their wages in the local economy.

Member dividends: For Lincolnshire Co-operative Society, member dividends are generally redeemed in the retail stores at the point of purchase, so Lincolnshire Co-operative Society assumed that all member dividends were spent locally. Most co-operatives issue member dividends in this way, so your organisation may take a similar approach. If this is not the case, then LM3 provides an opportunity for your organisation to survey members and raise awareness of your commitment to local spending.

A copy of the covering letter and survey that Lincolnshire Co-operative Society sent to suppliers is included as an appendix.

LM3 score

LM3 is a ratio. The LM3 ratio shows the relationship between how much customers spend with your organisation (Round 1) versus how much additional money is generated for the local economy based on how your organisation spends its turnover (Round 2) and how those businesses and people then re-spend the money they receive from your organisation (Round 3).

The formula for calculating the LM3 score is as follows:

$$\frac{\text{Round 2} + \text{Round 3}}{\text{Round 1}}$$

The formula filled out using figures from Lincolnshire Co-operative Society looks like this:

$$\frac{\pounds 34,285,000 + \pounds 15,190,350}{\pounds 123,039,000}$$

“Every pound spent by a customer with Lincolnshire Co-operative Society generates an additional 40 pence for the Lincolnshire economy.”

In words, every pound spent by a customer with Lincolnshire Co-operative Society generates an additional 40 pence for the Lincolnshire economy.

In six months customer spending at Lincolnshire Co-operative Society generated close to £50 million for the local economy. This additional money is called the local multiplier effect.

Case study: Rounds 1 & 2

Below are some workings provided by Lincolnshire Co-operative Society. Some figures are confidential, but Lincolnshire Co-operative Society has graciously offered to make many of these figures publicly available.

Round 1: Lincolnshire Co-operative Society used the first six months of its financial year as its timeframe, September 2011 through February 2012. This figure represents Lincolnshire Co-operative Society's gross revenue less VAT.

Round 2: Lincolnshire Co-operative Society broke down its expenditure into: payroll, cost of sales, member dividends, capital expenditure, and other items. Lincolnshire Co-operative Society determined that it spends its turnover locally as follows:

- Payroll (staff): £19,096,000
- Cost of sales (suppliers): £10,013,000
- Member dividends £2,317,000
- Capital expenditure £1,028,000
- Other items £1,831,000

Lincolnshire Co-operative Society also includes depreciation and amortisation costs valued at £2,788,000, all of which were assigned as not local.

Case study: Round 3

The main workings for Round 3 are the creation of an average local re-spending rate for suppliers, staff, and members. Lincolnshire Co-operative Society did not survey staff or members, so it carried out this process for suppliers only. The summary results are:

- Suppliers £7,509,750
- Staff (spent with stores) £3,454,000
- Staff (10% estimate) £1,909,600
- Members £2,317,000

Suppliers: Lincolnshire Co-operative Society identified about 350 local suppliers and mailed a survey to 320 them. Of these 320 suppliers, 49 responded. The average was calculated in a few steps.

First, Lincolnshire Co-operative Society calculated the amount spent locally by responding suppliers:

- Amount spent on Supplier A £4,097
- Supplier A's survey response 50%
- Amount spent locally by Supplier A £2,049

Second, Lincolnshire Co-operative Society repeated this process for all responding suppliers:

- Total spent on responding suppliers £2,477,134
- Amount spent locally by responding suppliers £1,851,372
- Percent spent locally by responding suppliers 75%

Third, Lincolnshire Co-operative Society applied this response rate to all local suppliers:

- Total spent on local suppliers £10,013,000
- Estimated local re-spending rate 75%
- Total spent locally by local suppliers £7,509,750

Staff and members: Staff are sometimes more willing to complete a survey if they feel their response will be anonymous. If this is the case, there is a simpler way to calculate the average. Take all responses and divide by the number of responses to calculate the average. For example:

- Response from staff person 1 50%
- Response from staff person 2 67%
- Response from staff person 3 45%
- Average (Add 1+2+3 and divide by 3) 54%

For staff spending, Lincolnshire Co-operative Society used the figures it already had on how much staff spent at their stores, £3,454,000, plus an estimate of an additional 10 percent to account for local spending on other goods and services. For membership dividends, Lincolnshire Co-operative Society assumed all dividends were spent at the stores, £2,317,000.

What the LM3 score means

What is a good LM3 score?

The lowest score is 0.00 and the highest possible score is 2.00, though a score of 2.00 is unrealistic for most organisations. LM3 scores vary considerably based on the type of sector your organisation operates in (e.g. food, construction) and the type of local area your organisation has selected (e.g. city, county, 30-km radius). For this reason, comparing LM3 scores is only useful if comparing two organisations in the same sector in the same local area.

“By measuring your organisation’s impact using LM3, you are setting a challenge for your competitors, as well as a challenge to your own organisation for improving its score.”

No matter what your LM3 score, your organisation has taken an important step towards understanding and improving its local economic impact, and this is a step that few organisations have taken. By measuring your organisation’s impact using LM3, you are setting a challenge for your competitors, as well as a challenge to your own organisation for improving its score in the future.

Other outcomes

The LM3 score gives your organisation a simple and meaningful barometer of its local economic impact, which can be communicated to external audiences for a variety of purposes. The LM3 process generates other outcomes, which are often more useful than the LM3 score.

Internal analysis: The LM3 process is the first time that many organisations have examined how they spend money or interact with suppliers. The process highlights where improvements are required, ranging from improving supplier relationships to collecting better information. Defining 'local' can also be important, providing organisations the opportunity to consider what local means for them. In the case of Lincolnshire Co-operative Society, the analysis allowed it to explain to members that one pound spent in a co-operative food store passes through five sets of hands, creating value each time, before the final penny leaves the local area.

Supplier engagement: The most powerful outcomes arise from supplier engagement. The LM3 process is often the first time that organisations have communicated their interest in how their suppliers interact with the local economy. Simply asking this question is sufficient to begin altering supplier behaviour. Nearly two-thirds of suppliers responding to Lincolnshire Co-operative Society's survey letter asked to see a copy of the LM3 results, indicating an interest in the issue. Lincolnshire Co-operative Society also used the LM3 survey letter as an opportunity to ask suppliers how their business relationship could be improved.

Staff engagement: The LM3 process can be a constructive staff engagement tool, boosting staff moral in the organisation by showing a commitment to their community as well as giving staff a chance to identify opportunities to improve the organisation's local economic impact.

Stories behind the numbers: The LM3 process encouraged Lincolnshire Co-operative Society to reflect on how it supports the local economy that it has called home for over 150 years, putting stories behind the 'Love Local' campaign it currently manages. The stories that emerged ranged from the acquisition of the locally-owned pharmacy, Maltby's, which would otherwise have closed, to the growth of local businesses like Jenny's Jams, which found its foothold on Lincolnshire Co-operative Society's shelves and has since expanded.

Resources

The LM3 methodology remains creative commons (cc) and can be downloaded from the K2A website, k2a.cc, or from nef, neweconomics.org.

The LM3 methodology has evolved a little since its invention in 2002 to accommodate user experience, but the overall approach remains the same. Please contact K2A if you are interested in using LM3 to measure your organisation's impact, info@k2a.cc.

The appendix shows the covering letter and workings sheet issued by Lincolnshire Co-operative Society, which you are free to duplicate.

Appendix

«SUPPLIER»
«Address_1»
«Address_2»
«Address_3»
«Address_4»

17 August 2012

Dear Sirs



Local Purchasing

As many of you may be aware we are keen to promote the concept of buying locally whenever it is feasible to do so, you may have seen our 'Love Local' promotions.

With this in mind we have been working with Co-operatives UK on a new way to measure the importance of buying locally. So far we have reviewed our level of local spend but the next stage is to ask our suppliers to provide an estimate how much of their total expenditure is spent locally.

We would be grateful if you could provide an **estimate as a % only**. You may already calculate this, if not we provide some guidance attached to this letter which you may find useful. We are not asking for the amounts that support the number, we appreciate that information will be confidential.

If you could please complete the return slip below and either post it to the address shown or e mail it to kdoughy@lincolnshire.coop by the 30 September 2012.

Thank you in advance for helping us with this survey.

Kind regards

Yours faithfully

S Galjaard
Chief Financial Officer

% spent in Lincolnshire

Do you wish to receive a copy of the results of this survey?

Do you consider the sales to Lincolnshire Co-operative are material to your business as a whole?

Are there any changes we can make to improve our relationship with you?

	%
	YES/NO
	YES/NO

Supplier Ref «SuppRef»

Lincolnshire Co-operative Society – Supplier spending survey

The purpose of the table below is to help you, our supplier, arrive at an educated estimate of the percentage of your expenditure that goes to people and organisations based in Lincolnshire. For this survey, Lincolnshire refers to the county of Lincolnshire, which includes the following postcodes:



DN17	NG23	LN1	PE6
DN21	NG31	LN2	PE9
DN36	NG32	LN3	PE10
DN37	NG33	LN4	PE11
DN38	NG34	LN5	PE12
		LN6	PE13
		LN7	PE20
		LN8	PE21
		LN9	PE22
		LN10	PE23
		LN11	PE24
		LN12	PE25
		LN13	

You do not need to send this survey back to Lincolnshire Co-operative Society. The only data expected is the number in the '% spent in Lincolnshire' box.

Item	Total £ spent	£ spent in Lincs.	£ spent elsewhere
Staff salaries			
Staff NI & Pensions			
Supplies			
Contractors			
Rent/Mortgage			
Utilities			
Repairs & Maintenance			
Insurance & Fees			
Loan repayments			
Taxes & Fees – Lincs.			
Taxes & Fees – Other			
Other			
Total			
% spent in Lincolnshire			

Co-operatives UK

Co-operatives UK works to promote, develop and unite co-operative enterprises. It has a unique role as a trade association for co-operatives and its campaigns for co-operation, such as Co-operatives Fortnight, bring together all those with a passion and interest in co-operative action.

Any organisation supportive of co-operation and mutuality can join and there are many opportunities online for individuals to connect to the latest co-operative news, innovations and campaigns. All members benefit from specialist services and the chance to network with other co-operatives.

www.uk.coop

ABOUT THE AUTHOR

Justin Sacks founded K2A in 2005 with the goal of making supply chain impact measurement accessible and useful. Since then, Justin has helped organizations measure the collective impact of over two billion dollars. From community halls in Wales to small farms in Haiti, Justin continues to work with organisations as large as the US government and as small as a local cooperative to maximize the impact of every penny spent. Justin holds degrees from Yale University and the London School of Economics, is a dual citizen of the US and UK, and was named one of the Future 100 ethical entrepreneurs under 35 in the UK in 2008.

Local Loved Trusted

Co-operatives Fortnight 2013
is the UK co-operative
sector's annual campaign.
It's the perfect opportunity
for co-operative businesses
and members to help people
choose co-operative.

Local
Loved
Trusted



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22 JUNE – 6 JULY 2013

22 June to 6 July

www.uk.coop/choosecoop

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