2018

Green Leaf Grocery - Executive Compensation Case Study

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ABSTRACT

The primary purpose of this teaching case is to aid students in understanding how executive compensation plans are utilized to achieve organizational goals and to then construct their own executive compensation plan for the CEO of Greenleaf Grocery, a fictional retail business based on an actual company.

Students have the opportunity to create a comprehensive executive compensation plan using salary, bonuses, stock options, benefits, and other compensation tools. Additionally, the case provides the opportunity to discuss the use of both short-term and long-term incentive compensation. The company in this case is poised to undertake an initial public offering of stock and retaining the current CEO is viewed as critical for this next phase.

The case affords the class the opportunity to explore ethical issues in executive compensation as well as other aspects of the organization's overall compensation structure.

Keywords: Executive Compensation; Teaching Case; Initial Public Offering; Ethical Issues in Compensation

Suggested Courses: Human Resource Management, Compensation and Benefits, Strategic Human Resource Management, or Management Principles

INTRODUCTION

Maria Sanchez, the Chair of Green Leaf's board of directors, hung up the phone. It had been a long week and she had just received frustrating news. Jack Lawrence, the CEO of Green Leaf had just called to inform her that he had been approached by the board chairman of one of Green Leaf's competitors in the grocery business asking if he would be interested in joining their company as CEO. Jack knew it was a small world and that this news might reach Maria or other board members and he wanted her to know that he had not initiated this contact. Jack was a talented, aggressive executive in the grocery industry and it was not surprising that he was getting attention from rivals. But Maria also suspected that there was some political gamesmanship involved here as Jack and the board of directors at Green Leaf had been working on the parameters of a new compensation plan for the CEO.

As Maria drove home that night she reflected on Jack's contribution to Green Leaf. He had been brought in as CEO following the then CEO's untimely death in 2005. Back then, as an ambitious, regional vice president for Target, he had sold the board on his vision for Green Leaf and his desire to grow the chain. Some had believed that he was too young and lacked the experience necessary, but he had proved them wrong. During his time as CEO Jack had grown the number of stores from 62 to 118 via natural growth and an acquisition of a competitor. Today Green Leaf was poised to go public with an IPO scheduled in the next year and a long-term goal of acquiring a chain of existing stores in the Southeast that would provide Green Leaf with market coverage from New Hampshire to Florida.

Maria knew the key to executing all of this rested on retaining Jack as CEO. She knew that the compensation committee of the board needed to develop an offer that was competitive with the external market, that was aligned with several strategic objectives of the firm, and that would keep Jack in place for at least the next 5 years. She also knew there would be pushback on the announcement of what she anticipated would be a rather large compensation package. When Jack was hired in 2005 there had been resentment by some employees because of the large differential of Jack's initial contract to the average worker's salary. There had even been a push by some workers to form a union but that never materialized. Additionally, some of the core customers of the company had balked at Jack's original salary saying that it was counter to the organization's culture. She feared this new pay package would attract even more criticism.

Maria picked up her phone and called her long-time mentor and former business professor, Dr. Ray Jones. "Hi Dr. Jones, it is Maria. I'm sorry to bother you, but I need your help. We are working on a new compensation package for our CEO and we need help. Earlier we brought in a high-profile consulting team from Boston but we were very disappointed in their recommendations. Would you be able to serve as an advisor?"

Dr. Jones always liked Maria and enjoyed hearing from her. "Maria, I would love to help, but I'm just too busy right now; however, I know just the perfect group of students who can assist you. Send me what information you can and I will get them working on this project."

Maria hung up the phone at the end of the conversation and a smile spread across her face. She relaxed for the first time in days. She knew the students would offer a creative solution to her problem.

Company History

Green Leaf Grocery opened in 1956 and was a small, family-owned grocery store in Roanoke, Virginia. The founder, Thomas Campbell, ran a small, neighborhood store that offered general merchandise. His eldest son, Fredrick "Fred" Campbell reoriented the business during the mid-70s into more of a health food store and began selling more organic products. Fred opened new stores and by 1985 there were 16 stores. In 1989 Green Leaf acquired a chain of health food / grocery stores and the total number of stores grew to 45. Despite Fred's best effort to manage this growing business, the company struggled during this time. He quickly realized that he did not have the management structure in place to guide that large of an organization. Fred brought in more experienced mid-level managers and continued his growth strategy. By the year 2000, Green Leaf had 62 stores in the Mid-Atlantic region and a smattering of stores in the Mid-West.

In 2004, Fred died unexpectedly of a heart attack. Given that Green Leaf was still a privately held family business the board of advisors looked for a family member to assume the leadership position, but no one in the family thought they were prepared at their stage of life to take on those responsibilities. So the board conducted a search for an external candidate and selected Jack Lawrence. Jack saw that the company was struggling and quickly closed 9 of the worst performing stores and sold off 14 stores that were in the Mid-West and didn't seem to be a good fit with the company's core business in the mid-Atlantic region. Once the ship was righted, he began an expansion with new stores in nearby markets that allowed the company to better leverage their marketing dollars and focus on quality operations. Later, in 2009, he acquired 49 new stores with the acquisition of Sunbeam Groceries in the North East. Sunbeam was rebranded Green Leaf Groceries and along with new store openings the company's total stores rose to 118 by 2014.

Due to the company's recent growth and desire to acquire more competitors, the board of directors had decided to pursue an initial public offering (IPO). The IPO was scheduled to occur in the latter half of 2016. The company intended to use its stock as a means of acquiring additional stores in the future.

Last, with the company's meteoric rise, there have been some strains on the company's culture. Previously, Fred Campbell made a very low salary that was in line with the other employees. But as the CEO salary has increased and as profits have increased there has been some pushback from employees and long-term customers. "They see us as selling out to corporate greed and turning our back on culture we had under Fred's leadership", said John Fleming, vice president of human resources and a 30 year employee. "They see us as becoming just another large, cold, corporate entity that is only focused on profit maximization." In 2009 there had been a push by some employees to unionize, but Jack and the board had done a masterful job of communicating with all the employees why that would not be in Green Leaf's best interest and why it was not in their best interest. "Jack did a great job then, but he had a lot of credibility with the workforce because his salary was still relatively low. He could truly make the claim that we were all in this together. If we now raise his salary too high, there is a chance that workers might feel as though Jack and the board sold them out and will now want to consider another run at forming a union."

Grocery Industry

The supermarket and grocery store segment of the U.S. economy (NAICS code 44511) consists of roughly 41,076 businesses with revenues of approximately $611.9 billion. From the years 2012 to 2016 the industry enjoyed a very modest 1.0% growth in sales. This segment of the market is dominated by the Kroger Company with a 16% market share, Albertsons LLC with a 9.8% market share, and Publix Super Markets, Inc. with 5.5% market share (IBISWorld.com, 2017-a).

Another segment of the U.S. economy that is active in the grocery business is warehouse clubs and supercenters (NAICS code 45291). This sector of the economy generated revenues of $460.0 billion and enjoyed a four year annual growth rate of 2.1%. The industry consists of only 17 businesses and is dominated by Walmart Stores, Inc. with a market share of 69.8%, Costco Wholesale Corp. with 17.4% of the market, Meijer Inc. with 3.5%, Target Corporation with 2.9%, and BJ's Wholesale Club Inc. with 2.5% (IBISWorld.com, 2017-b). Most of these supercenter concept stores have added groceries as a component of the mix of goods and services offered.

As the Kroger company recently noted in their 10-K filing with the SEC, "The operating environment for the food retailing industry continues to be characterized by intense price competition, aggressive supercenter expansion, increasing fragmentation of retail formats, entry of non-traditional competitors and market consolidation."

Organic Grocery Segment

In March of 2017 the grocery industry received a bit of a shock when Whole Foods Market (NASDAQ: WFM) announced the worst financial performance in over a decade with six consecutive quarters of declining same store sales (Dewey, 2017). Whole Foods, the originator of the organic and fresh grocery segment 36 years earlier, also changed course on its earlier plans to triple the number of stores in the U.S. market from 470 to 1,200 and instead announced the closing of nine underperforming stores. CEO John Mackey said that the organization was losing customers to traditional big box grocers such as Kroger and would change from a growth model to a model of retaining existing customers (Craig, 2017).

Whole Foods and similar organic grocers (e.g. Sprouts Farmers Market and Fresh Market) have witnessed eroding sales due to Kroger's Simple Truth organic brand goods which are on average 15% less than Whole Foods' prices (Peterson, 2017). Additionally, the grocery chain Aldi offers both gluten-free items via their liveGfree brand and organic items under the Simply Nature brand (Craig, 2017). Aldi, which currently operates in 35 states, plans to expand by opening 650 new stores in the U.S. by the end of 2018.

Then in June of 2017, the grocery industry was jolted when Amazon (NASDAQ: AMZN) agreed to purchase Whole Foods Market for $13.4 billion. The purchase of Whole Foods is seen as threat to Walmart's domination of grocery sales in the U.S. and is yet another sign that Amazon wishes to continue its dominance of online shopping (Wingfield & de la Merced, 2017).

CEO Profile

Jack Lawrence, 56, is the current CEO of Green Leaf Grocery. Jack began his career in the grocery business by working part-time at a local Kroger during high school and college. He earned a BBA in management from Stephen F. Austin State University in 1982 and accepted a job as a store manager with Safeway in Bakersfield, California. In 1994 Jack retired from Safeway as a district manager and moved to Illinois to pursue a MBA from Northwestern. While there he met his wife Lisa and they have two children.

Upon graduating from Northwestern in 1996, Jack was hired by Target to help grow their grocery business. He left Target in 2005 to take the CEO position with Green Leaf. At the time Jack was offered a salary of $175,000 with an opportunity to earn up to $120,000 in performance bonuses. Over time Jack has received merit increases and his base pay stands at $230,000.

Prior Consultant Product

Boston to design an executive compensation plan for the CEO of Green Leaf Grocery, Inc. Unfortunately, the board was very disappointed in the proposal that Peabody & Stankly submitted. "Basically all they did was look at the salaries of the CEOs of three of the largest players in the grocery industry, take an average of that and tell us that is what we should be paying. Are you kidding me?" Jeff Campbell, grandson of Green Leaf's founder and current board member, said in disgust. "First, they failed to grasp that we are nowhere near that size. Second, they failed to consider any of the strategic objectives we are attempting to accomplish with our compensation plan. Why, I bet if I grabbed three or four business students and threw them together in a team that they could come up with a better plan than that!"

Request for New Proposal

The board of directors would like you and your team to develop an executive compensation plan to address the following goals:

1. Develop a compensation proposal for the CEO that would be competitive with offers from rival firms attempting to lure the CEO away. The compensation proposal should be a "total compensation" package in that it addresses all facets of total compensation (e.g. salary, bonuses, benefits, and perks that are consistent with someone of this stature).
2. Ensure that the company has a successful IPO and that there is continuity in top leadership for the next five years.
3. Align the interest of the CEO with the stockholders of the firm.
4. Reward the CEO for reasonable risk-taking and growth of the firm.
5. Last, the board has come under criticism from employees and die-hard customers who see the company culture moving away from its early "family firm" roots and becoming more corporate. The board is worried that there will be negative reaction to what might be perceived as an "excessive compensation plan" by some. They would like to know if you have any creative solutions that might help alleviate that criticism.

To assist you in better understanding Green Leaf Grocery, the board of directors has provided you with the company's income statement and balance sheet for the past few years. The information can be found in Table 1 – Income Statement and Table 2 – Balance Sheet.

Table 1. Income Statement

Green Leaf Grocery Income Statement (in millions)				
	2013	**2014**	**2015**	**2016**
Net Revenues	$516.8	$1,100.0	$1,800.0	$2,400.0
Cost of Goods Sold	353.7	772.5	1,200.0	1,700.0
Depreciation and Amortization	14.2	54.6	35.8	48.5
Gross Income	149.0	278.8	530.3	725.3
General Expenses	140.1	298.1	457.5	578.0
Total Operating Expenses	507.9	1,100.0	1,700.0	2,300.0
Operating Income	8.9	(19.3)	72.8	147.3
Extraordinary Change	(0.4)	(6.4)	(3.1)	(26.5)
Interest Expense on Debt	0.7	19.8	35.5	37.2
Other Expenses	0.3	0.4	0.6	0.5
Pre-Tax Income	8.2	(45.2)	34.8	84.1
Income Taxes	(3.3)	(17.7)	(15.3)	(32.7)
Net Income	4.9	(27.4)	19.5	51.3

Table 2. Balance Sheet

Green Leaf Grocery Balance Sheet (in millions)				
	2013	2014	2015	2016
Assets	N/A			
Cash and Short Term Investments		$14.5	$67.2	$77.7
Receivables		7.2	9.9	9.5
Inventories		63.6	98.4	118.3
Current Assets		103.5	203.1	231.6
Total Assets		761.6	1,100.0	1,200.0
Liabilities				
Accounts Payable		53.9	82.7	111.2
Short-Term Debt		2.8	5.2	9.2
Accrued Expenses		11.0	14.9	14.0
Other Current Liabilities		15.2	19.6	14.0
Other Liabilities		90.6	136.8	175.6
Long-Term Debt		367.4	529.0	421.6
Deferred Taxes		(43.2)	(22.6)	(15.3)
Other Liabilities		30.6	42.6	50.7
Total Liabilities		494.2	716.5	658.6
Total Owners Equity		267.5	386.8	513.8

ACKNOWLEDGEMENTS

Conducted under a grant from the Stephen F. Austin State University Research Enhancement Program.

AUTHOR BIOGRAPHIES

Dr. Marcus Cox serves as an assistant professor of management in the Management, Marketing, and International Business department in the Rusche College of Business. He earned his Ph.D. from the University of North Texas, his Certificate of Advanced Management from Babson College, and his masters and bachelor degrees from Stephen F. Austin State University. Dr. Cox teaches human resource management, compensation and benefits, and strategic management. His research interests include human resource management, organizational misconduct, executive compensation in the non-profit sector, and training effectiveness.

Dr. Mitch Crocker is a professor of management and has served as Chair for the Department of Management, Marketing, and International Business in the Rusche College of Business for the past six years. He earned his Ph.D. from Auburn University and his MBA and bachelor degrees from the University of South Alabama. He teaches employee and labor relations and sports analytics. His research interests include employee/student motivation, student learning styles, and motivation to participate in extreme sports. He is an avid scuba diver and underwater videographer.

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TEACHING NOTE

GREEN LEAF GROCERY – EXECUTIVE COMPENSATION CASE STUDY

The primary purpose of this teaching case is to aid students in understanding how executive compensation plans are utilized to achieve organizational goals and to then construct their own executive compensation plan for the CEO of Greenleaf Grocery, a fictional retail business.

Students will have the opportunity to create a comprehensive executive compensation plan using salary, bonuses, stock options, benefits, and other compensation tools. Additionally, the case provides the opportunity to discuss the use of both short-term and long-term incentive compensation.

Instructors can emphasize the need to research the industry and develop a compensation plan that is competitive with the external market for executives. Resources available to assist the student include the schedule DEFA14A filed with the Securities and Exchange Commission that breaks down executive compensation for publicly traded companies, investor databases such as Morningstar, and other publicly available data.

An additional issue that can be addressed in this case is the internal alignment of salaries and the broadening gap between the CEO salary and that of entry-level employees. Instructors can use this to discuss whether there are ethical issues associated with pay and whether high CEO compensation represents the best use of shareholders' money.

Last, the instructor has the opportunity to discuss how the new CEO compensation plan might impact labor relations within the organization. Students should be encouraged to consider creative means to alleviate tensions between workers and top management and whether management could take actions to curb the desire of employees to form a union. Suggestions could include items such as profit sharing plans, employee stock ownership plans, gainsharing plans, or team/store bonuses.