

The Growth of the Organic Market: Producers' Perspectives
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It is a pleasure and honor to address this audience today, and to attempt to bring to you comments on the growth of the organic marketplace from the perspective of organic producers. As the speakers today and others in the industry can testify, there has been incredible growth in the organic sector over the past decade, and that growth is clearly anticipated to continue at rates that far exceed virtually every other category in the grocery business. In this, there is both good news and not-so-good news, and it will be my intent to share each of these with you.

So what are the implications of this tremendous growth for producers? I will address four aspects of this question:

- The short term good news of increasing demand
- The role for high standards in maintaining consumer confidence
- The mid and long-term bad news of increasing demand
- Potential USDA roles and policy choices to support producers

First, the obvious good news: growth means increasing sales opportunities for producers. Increasing sales allow independent farmers to expand production to achieve efficiencies of scale, and they certainly make bankers more willing to extend credit. Increasing sales holds open the possibilities that demand will stay ahead of supply, keeping prices higher than would otherwise be the case. So from a short term economic view, increasing sales are welcomed by producers. For some, especially the early organic adopters, it is also vindication that they were in fact not crazy for all these years, and that growing numbers of their consumer cousins are affirming the choices made all those years ago. Growing sales also is a partial fulfillment of the hope held by many organic producers that someday people of all strata of society will have access to a consistent, affordable supply of organic food. All of these are good things.

A second implication of this growth is the importance of high organic standards. The growth of the organic movement has been predicated on a belief in high standards, and every responsible grower and organic food manufacturer that I know insists that the national standards must maintain the historic integrity of high organic standards if consumers are to continue to have faith in the organic food that they are purchasing. There is a diversity of opinion among producers about whether the national standards consistently represent high standards. Some of that diversity, in my opinion, is simply a reflection of the fact that organic production is a complex value proposition about which people of good will can and should disagree. But there are some areas of the standards that draw more attention than others. Many livestock producers believe that the national standards are not high enough, particularly as they pertain to the potential or real abuse of consumer expectations about confinement production systems. Existing standards here must be intensely monitored to ensure conformance with consumer expectations as expressed in comments in 1997 that clearly did not want "factory farming" livestock production practices; if abuse is found, then the standards must be changed.

But while there is a diversity of opinion regarding current standards, there is strong agreement and concern among producers that, as organic market growth continues, powerful economic entities can and will exert pressure to lower the standards that already exist. Producers applaud Secretary Veneman and the Administration for not supporting the efforts of Congress to alter the national standards and provide feed exemptions for organic livestock, as was done a year ago. Producers fear this process will be repeated. If they are right, then this will have very negative impacts on organic market growth, for it will immediately call into question the integrity of the entire marketing chain, and shift consumer attention away from the fundamental positive value proposition represented by organic foods. Such a diversion of attention paralyzes the marketplace, and inevitably has negative repercussions all the way back to the producer. Producers want policy makers, regulators, and industry leaders to repeat the mantra: “High standards, high standards, high standards.”

I would be remiss in my duties if I did not raise an additional regulatory concern that affects organic consumer confidence and market growth. In 1997, consumers overwhelmingly stated that genetically modified organisms have no place in organic production. Their sentiments were heard, and GMO’s were taken out of the final rule. Since that time, however, it is clear that “promiscuous pollination” or “biological trespass” is occurring. The permitted practices of conventional farmers are having impacts on the quality and value of organic products, and these practices have the potential to undermine consumer confidence and interfere with the economic viability of organic farmers. A free market orientation to consumer markets acknowledges that consumers have the right to make important product choices, especially for something as intimate as the kind of food we choose to put in our bodies. Organic consumers have stated, and USDA has agreed, that GMO’s are incompatible with the organic production system. The title of this conference is “Ensuring a Healthy Food Supply”. The fundamental premise behind such an assurance lies in protecting the integrity of our food supply. It would seem that protecting the integrity of the organic food supply would be worthy of greater attention and action on the part of policy makers and regulators.

Now to my third point: the bad news. Unless organic farmers rapidly begin taking far more strategic market action, it is very likely that they will not benefit at all from future increases in consumer demand for organic products. The reason for this is that organic farmers to date, with a few notable exceptions, have not fundamentally changed the marketing paradigm which has afflicted their conventional cousins. Specifically, they have failed to invest in the development of consumer brands that give them “brand equity” in the marketplace, and they have failed to cooperatively aggregate their supply in a way that gives them effective bargaining power in the face of more economically powerful buyers. As organic production expands, and unless it is organized in a very different way than it is now, the organic marketplace will behave just like the conventional commodity market. In commodity production, the economic rule is that all profits erode to zero. It is not a question of if, only a question of when. Three things have allowed organic producers to maintain organic prices and price premiums to date. First, the biological and physical constraints of organic production have limited the rate at which organic production could expand. Second, the structure of the organic marketplace was diffused and fragmented. And third, the demand for organic foods has increased more rapidly than the supply. All of these are likely to change radically in the coming decade.

The growth in sale of organic foods is coming through sales in mainstream retail outlets, and select natural foods grocery chains. This single dynamic is changing who can exert economic power in the organic market. In the U.S., natural foods co-ops were the birthplace for the organic and natural foods market we see today. Consumers interested in organic and natural foods organized themselves into buying clubs or co-ops in order to aggregate their purchasing power, and make it feasible to cost-effectively purchase organic and natural food from producers on both a regional and national basis.

Stores focused intensively on consumer education about healthy eating practices and environmentally friendly food production practices, resulting in a loyal and growing consumer base for these foods. In the 1990's, the growth of savvy natural foods supermarkets such as Whole Foods and Wild Oats initiated a first wave of consolidation in organic retail. This was followed by the advent of mainstream grocery.

In 2000, mainstream retailers accounting for about 40% of all organic sales. The broadened appeal of organic foods in mainstream markets has grown to the point that Wal-Mart is today the largest single retail buyer of organics, and projections show that mainstream retail markets will account for 60% of total sales in this decade. With this will come retail pressure to reduce wholesale prices and force efficiencies back up the chain. With this also comes a dramatic change in who will educate consumers about organic products, for the Achilles heel of mainstream retail is that the front lines of customer service are staffed by 15, 16, and 17 year olds who typically have trouble telling oranges from tangerines, let alone organic practices from conventional practices. By hitching its wagon to the mainstream grocery star, the organic industry has ceded the battleground for effective consumer education.

The concentration in retail power is mirrored by concentration in distribution. After the purchase of the last two major co-op warehouses, Blooming Prairie and Northeast Cooperatives, United Natural Foods Inc. has become the undisputed single dominant distributor of natural and organic foods in the country. Access to distribution will become more of a challenge than ever for producers and manufacturers.

At the manufacturing level, we will to see substantial merger and acquisition in the next decade, as processors aggregate to combat economic concentration at the retail and distribution levels. In 2000, only about 20 companies had more than \$50 million in sales annually; these 20 firms accounted for 37% of all organic sales. Conversely, over 1200 manufacturers had less than \$10 million in sales annually; collectively these firms accounted for 28% of the market. A 2001 market research report by ProMar International has projected that the period from 2005-2010 will be marked by a "roll up" of small firms through merger and acquisition. A 2004 report by DataMonitor states, "The National Organic Program will change the U.S. organic market from a small business sector into one largely dominated by giant food and beverage processors. Smaller business will likely be folded into larger manufacturers' organizations, leaving only a handful of existing niche companies-currently the market leaders-operating independently."

There are three reasons why this will happen. First, the advent of national organic standards has reduced risk for multi-national food companies to make substantial investments and enter the marketplace. This is being observed in the mergers/acquisitions and new product development activities of companies such as General Mills, Heinz, and others. Second, given the increasing role of mainstream retailers in the purchasing and retailing of product, there will be increased investment required for national manufacturing capacity and brand development. This investment is far more likely to favor larger firms who can leverage existing marketing and brand management expertise. Third, the advent of official U.S. standards will also spur the increased international export of U.S. produced organic products, again favoring larger manufacturers and processors. These standards will also facilitate the import of foreign-produced organic raw products, further increasing supply and competition for U.S. producers.

And so it is: for farmers, it's déjà vu all over again. I can see only four pathways that lead to a different result for producers, and not all of these are accessible to all producers.

- For commodity producers, especially for grains, the use of Capper-Volstad protection in the formation of organic “marketing-in-common” organizations that allow the aggregation of supply and ability to bargain more effectively for prices. The existing organization OFARM is an example of what this might look like, and I applaud this group for moving forward in this pathway.
- For dairy, livestock, and specialty crop producers, the formation of new generation processing and marketing cooperatives to add value to raw products and the creation of brand equity in the trade or at the consumer level. The dramatic success of Organic Valley Cooperative, and the advent of groups such as Wholesome Harvest, are examples to watch.
- For groups with consumer ready products, a return to organic market roots through strategic alliances with consumer food co-ops, or with independent retailer chains that are seeking to differentiate themselves from their big box retail competitors. The Sixth Cooperative Principle, “Cooperation among cooperatives” holds potential for producer-owned businesses to secure market access in retail locations that still believe, and have an economic interest, in customer education.
- For those who have suitable products, the continued emphasis on direct markets, such as farmers’ markets, roadside stands, and pick-you-own farms.

For my fourth and final point, I’d like to touch on the implications of these developments for USDA. Substantial positive change has occurred inside USDA over the past 10 years, and many USDA agencies have begun to embrace the interests of organic producers and consumers. In light of my comments above, I would argue for a prioritization of producer-owned business development over production improvement. Having said that, I would make the following observations:

Within AMS, the National Organic Program must uphold the principles of high organic standards in order to keep faith with producers and consumers alike. Other programs within AMS, such as the Farmer Direct Marketing program and FSMIP, have supported market development, and this should be continued.

The Rural Business Cooperative Service has supported business development assistance through the Rural Business Enterprise Grant program, the Rural Cooperative Development Grant program, and perhaps most notably the Value Added Producer Grant Program. In light of the changing economic structure of the organic marketplace identified above, this is where the action is, and I believe this is where additional support will pay the highest long term dividends. In a similar vein, the SARE program should be a greater source of assistance in business development than has been the case, at least in the regions I’m familiar with. From a marketing standpoint, I don’t see SARE resources being used strategically to address the market structure questions that will drive this industry, and that is a lost opportunity.

The Foreign Ag Service has expanded its support for trade missions, and development of market information for American exporters. Thank you! This needs to continue.

The Risk Management Agency should be applauded for its efforts to begin development of risk management education and risk management programs for producers, and for their support for limited resource farmers.

CSREES needs to fully implement organic research initiatives as authorized in the farm bill. Progress has been made, but more is warranted.

NRCS has entered an agreement with the Organic Trade Assn. to make the services of its agency available to organic producers. This is a good start. On a state level, the NRCS in Minnesota, along with FSA, Extension, the University of Minnesota College of Agriculture, Food and Environmental Science, and the Minnesota Dept. of Agriculture have all signed a memorandum of understanding that they recognize the legitimate role of organic agriculture, and that they will work collaboratively to bring the services of their agencies to organic producers. This framework deserves greater attention in other parts of the country. And as a very specific example for NRCS, Minnesota should not be the only state where EQIP funding is used to support organic farmers in the implementation of on-the-ground practices that conserve natural resources.

There are other programs that could be mentioned, but this provides an overview of how USDA programs can act in concert to help producers actually benefit from the continued growth in the organic marketplace.

Thank you all for your kind attention.