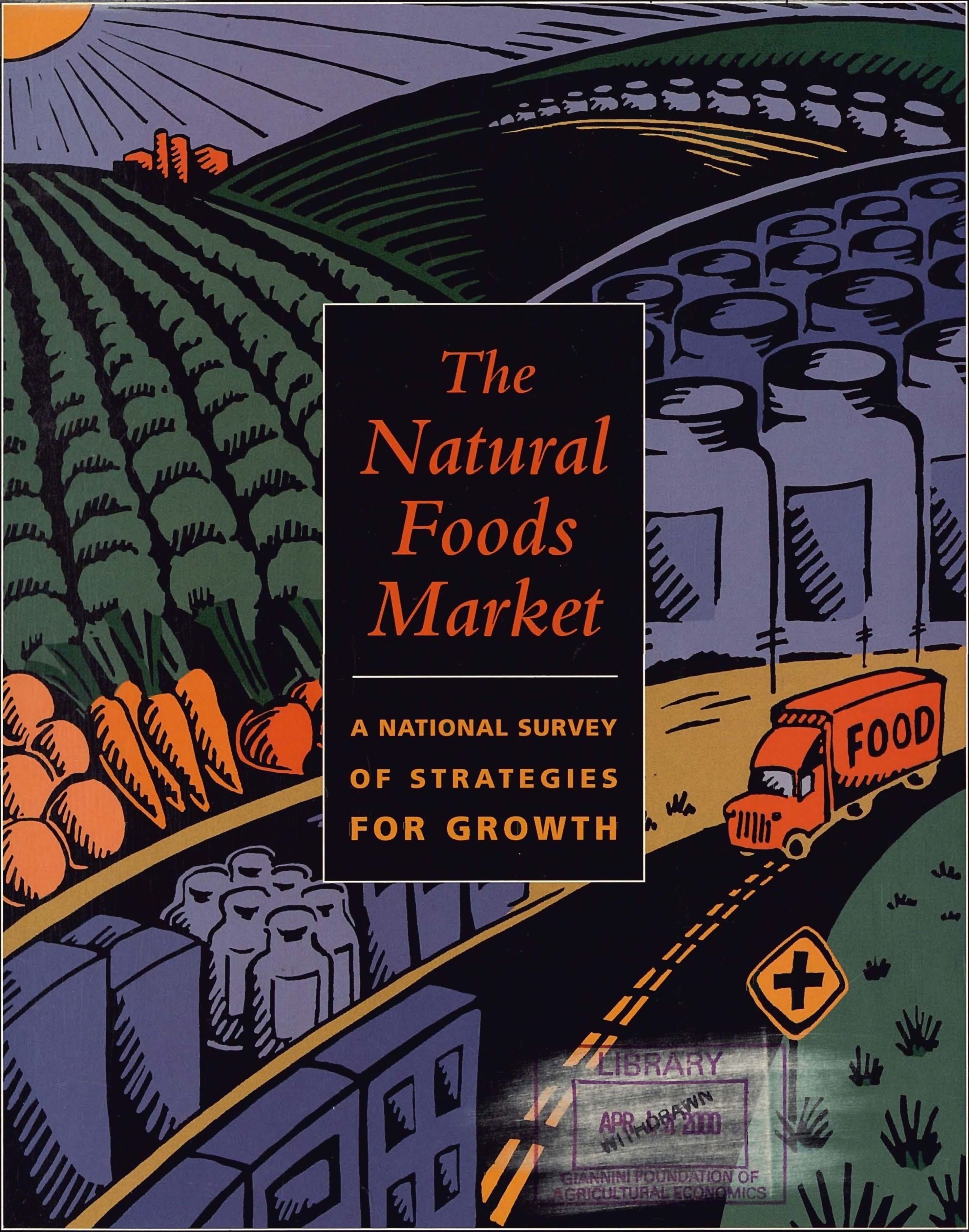
HAWIAA

Policy studies ~~program~~ report no. 12



The Natural Foods Market

A NATIONAL SURVEY OF STRATEGIES FOR GROWTH

NESSA J. RICHMAN

HENRY A. WALLACE INSTITUTE FOR ALTERNATIVE AGRICULTURE

The Natural Foods Market

A NATIONAL SURVEY OF STRATEGIES FOR GROWTH

POLICY STUDIES REPORT NUMBER 12

Nessa J. Richman

THE HENRY A. WALLACE INSTITUTE FOR ALTERNATIVE AGRICULTURE

Acknowledgments

This report would not have been possible without the inspiration of Professor Ray Goldberg, the encouragement of Michael Henry, and the support of the staff at the Henry A. Wallace Institute for Alternative Agriculture, including Garth Youngberg, David Ervin, Katherine Clancy, Rick Welsh, Elizabeth Higgins, Lydia Oberholtzer, Suzanne DeMuth, and Joanna Hildebrand. Special thanks to Kate Fitzgerald.

The author also wishes to thank the 27 state and regional agricultural producer organizations that helped us assemble part of our survey sample (see Appendix A), the 290 members of the food industry who answered our survey questions, and the six experts who took time out of their busy schedules for in-depth conversations: Bruce Bechtel, Steven Daugherty, Michael Dunn, Gene Kahn, Jean Kinsey, and Ann Woods.

Important contributions to the project were also made by Karla Chambers, Tanya Pavich, Barry Krissoff, Karen Klonsky, Janise Zygmont, Kenneth Clayton, Lewrene Glaser, Philip Kuehl at the Westat Survey Research Firm, Richard Kashmanian, Mary Gold, Joe Maddox, Bob Birkenfeld, Barbara Meister, Sarah Lynch, Terry O'Connor, Sam Rives, William Iwig, Kai Robertson, and Lori Ann Thrupp.

The author and the Institute also gratefully acknowledge the funding support of the Clarence E. Heller Charitable Foundation of San Francisco, California, and the Charles Stewart Mott Foundation of Flint, Michigan.

Special thanks to Timothy Thomas for his help with literature review and Deanne Kloepfer for her editorial assistance.

April 1999

Design/Illustration:
Sonya Cohen

Copies:
Copies of *The Natural Foods Market: A National Survey of Strategies for Growth* are available at a cost of $150.00 per copy (non-profit rate available upon request) from:

Henry A. Wallace Institute for Alternative Agriculture
9200 Edmonston Road Suite 117
Greenbelt, MD 20770-1551
301.441.8777
hawiaa@access.digex.net
http://www.hawiaa.org

ISBN 1-893182-19-3

Table of Contents

Preface

Sales of "natural" foods are rising much more rapidly than any other segment of the food market. Evidence of this leading edge of growth comes from a variety of indicators — the exponential rise in farmers' markets, the expansion in natural foods grocery stores, consistently strong stock market showings, and investment by venture capitalists.

Many mainstream supermarkets have joined the trend, offering an array of organic and other natural foods. Although natural products now comprise about two percent of total food sales, the rapid growth rate, if sustained, will quintuple its influence on the farming, processing, distributing, and retailing food stream over the next decade.

Despite impressive growth through the 1990s, achieving the full potential of the natural foods market is not assured. This immature market requires careful policy actions to fulfill its capacity to help satisfy private and public objectives. While the growth in natural food sales holds obvious rewards for the business sector, contributions to public policy objectives should not be overlooked. Scientists and practitioners of sustainable agriculture know that economic viability is key to farming and food systems that leave a lighter environmental footprint across the country. The spread of such systems could contribute to important national environmental objectives; for example, reduced water pollution. However, adoption of these alternative systems of food production has been slow. The strong growth in consumer demand for natural foods offers an economically viable opportunity for wider adoption.

In *The Natural Foods Market: A National Survey of Strategies for Growth*, Nessa Richman identifies the obstacles to achieving the full potential of this market development, and presents private and public strategies to reduce key barriers. Prominent on the list of obstacles is the uncertainty over standards for natural foods products, which would guide the actions of all market participants, from farmers to consumers. Both industry and government agencies have roles in alleviating that uncertainty.

The report's comprehensive analysis combines and interprets a diverse array of private and public information, to help experts and novices understand this developing market. It uses the latest information to chronicle the growth and diversity of the sector. The identification of obstacles draws upon the findings of a new national survey of farmers, food processors, distributors, and retailers. The responses of those already involved in natural foods are contrasted with those who are not already involved, in order to assess the obstacles perceived by each group. Private and public strategies to foster durable market growth are built from the survey findings and from the insights gained from interviews with food industry leaders.

The Henry A. Wallace Institute for Alternative Agriculture offers this report to encourage effective actions in the private and public sectors, which will lower obstacles to growth in the natural foods market. With the report, the Institute's Policy Studies Program undertakes a new initiative centered on analysis of the marketing of sustainable agriculture products. We hope that this report and following publications stimulate a dialogue within and among private and public circles, which moves society toward a sustainable food system.

David E. Ervin

Director, Policy Studies Program

The Natural Foods Market

A NATIONAL SURVEY OF STRATEGIES FOR GROWTH

Executive Summary

Natural foods are fast becoming big business in this country. Each year from 1990 to 1997, the retail market for natural foods grew 15% to 25%. In 1997, natural foods posted retail sales totaling $5.5 billion.

Industry analysts predict similar growth rates over the next five to ten years. If they are correct, natural foods will comprise nearly 10% of the total retail foods market by the year 2008, or more than $60 billion in retail sales.

In 1997, natural foods posted retail sales of $5.5 billion. If current trends continue, retail sales will exceed $60 billion by 2008.

This remarkable growth rate outpaced growth in mass market foods sales by a significant amount. Mass market foods sales increased an average of only 3% to 5% from 1990 to 1997.

The food industry is paying close attention. The steady upswing in natural foods sales over the past decade is most directly attributable to greater demand for natural foods products. More and more consumers are seeking healthful, safe food, often with the caveat that it is produced in an "environmentally friendly" way. Companies across the spectrum of the food system are working hard to respond quickly and accurately to these preferences.

This report by the Henry A. Wallace Institute for Alternative Agriculture documents the growth in the natural foods market and takes a critical look at the requirements for continued success. It presents findings of a new nationwide survey of food businesses, which indicate obstacles that may slow or otherwise impede future growth. The report also describes the results of in-depth interviews with food industry experts on the root causes of these obstacles, discusses the reasons why business strategies are or are not succeeding in getting natural foods into more retail outlets, and concludes with recommendations to assist the natural foods market in realizing its full potential.

Preparing this Report — Scope and Methodology

The data for this report were collected and analyzed in a year-long (September 1997 to August 1998) four-step process summarized below.

The first step consisted of a comprehensive literature search and interpretation. The publications we consulted included academic books, journals, and conference proceedings; industry trade magazines, studies, and reports; and the newsletters of myriad industry groups and natural foods-related non-governmental organizations. We researched Internet resources and conducted informal interviews with members of industry, academia, non-governmental organizations, and government agencies.

The second step was a national survey of 290 food industry businesses, which included approximately 70 randomly selected respondents from each of the following categories:

- ✦ agricultural producers,
- ✦ food manufacturers (includes processors),
- ✦ food distributors (includes wholesalers and brokers), and
- ✦ retail supermarkets.

Approximately one-half of the respondents in each category were self-described natural foods industry members (for more information, see Appendix A).

As with all surveys, the results of this one are subject to sampling error. The statistical significance of the numbers and percentages reported were calculated. Comparisons among surveyed groups are statistically significant at levels recorded in Appendix B.

The third step consisted of a series of in-depth interviews with food industry experts, including at least one agricultural producer, food manufacturer, food distributor, academician, representative of a food-related non-governmental organization, and U.S. Department of Agriculture official. This interview process was designed to uncover the root causes of perceived major market barriers that were reported during the survey and to begin developing recommendations to overcome these obstacles.

The final step focused on data and information analysis. Initially, we integrated the findings from the first three steps into a concise statement of the root problem underlying each major market obstacle. Then we developed potential solutions to address these root causes. From this process, we arrived at a set of recommendations for major groups interested and involved in the natural foods market. To complete this step, we followed guidelines devised by David Weimer and Aidan Vining in *Policy Analysis: Concepts and Practice* (Prentice Hall, 1992).

Key Findings — Obstacles to Success in the Natural Foods Market

Trends in the natural foods market are significant, enough so as to affect the entire U.S. food system — from agricultural production to food processing, distribution, and retailing. Natural foods are no longer seen as the exclusive purview of a small, marginal group of consumers. "Mainstream" shoppers are increasingly demanding such products, and businesses selling natural foods now include mass foods marketers.

Trends in the "natural" foods market are significant enough to affect the whole food system. Natural foods are no longer the purview of a small group of consumers.

The rewards for natural foods entrepreneurs are potentially great as growth in retail sales continues. However, the impact could be much more fundamental. Natural foods production has the potential to nurture new farming systems that meet consumer demand, with less environmental degradation than conventional farming methods.

Such change does not come easily. As we found in this study, serious difficulties face the natural foods market, particularly in relation to expansion. Three major themes emerged from our research:

- **There are no universally accepted standards for defining and producing natural foods.**
- **Natural foods and mass market foods companies view the natural foods market and conduct business in critically different ways.**
- **Many natural foods and mass market foods businesses do not understand how best to market and price natural foods.**

Note that no potential barrier was rated highly by all groups of respondents. This is not surprising, given that the natural foods market is growing quickly.

Meet Our Experts

BRUCE BECHTEL
Chief Financial Officer of Stahlbush Island Farms, a producer and processor of sustainably grown fruits and vegetables, based in Corvallis, Oregon.

STEVEN DAUGHERTY
Director of Government Affairs for Pioneer Hi-Bred International, a seed and feed company based in Iowa.

GENE KAHN
Corporate Executive Officer of Small Planet Foods in Sedro-Woolley, Washington, the largest organic foods manufacturer in the world. Their brands include Fantastic Foods, Cascadian Farms, and Muir Glen.

JEAN KINSEY
Professor at the University of Minnesota Department of Applied Economics, St. Paul, Minnesota, and Director of the Retail Food Industry Center in Minneapolis.

MICHAEL DUNN
Undersecretary for Marketing and Regulatory Programs, U.S. Department of Agriculture.

ANN WOODS
Director of the Organic Alliance, a non-profit organization based in St. Paul, Minnesota, which works to advance the introduction of organic foods into mass market supermarkets.

Lack of Standards

A key implication of our findings is that establishing standards for "natural" foods is important to many industry members.

The boundaries of the natural foods market are vague. The sectors involved in producing, marketing, and retailing natural foods adhere to various standards. Even where the overall standards seem to agree, the specifics may well be different. For example, many current definitions of natural foods state that the products should be "minimally processed," but differ in their meaning of "minimally."

This situation causes confusion and distrust. As a people, Americans have enacted volumes of product-regulation legislation, for everything from cars and toys to food, primarily to help ensure health and safety. In fact, the unhealthy practices of early mass market foods producers led to some of the first U.S. product regulations.

Private markets in this country succeed when they build consumer confidence. Such success stems in large part from the fact that consumers know that standards for products are in place and are being enforced. If they learn otherwise, their confidence in the products may greatly diminish.

It appears that the lack of standards for natural foods poses major problems in long-term expansion of the industry and possibly to the very success of the market. It also appears that in the natural foods market, setting standards is inextricably linked to labeling. Label claims can be useful indicators of food product quality, including food safety and nutritional value, and consumers have grown accustomed to such labels on their food products and now expect to find them.

In our survey, the potential obstacles relating to standards for natural foods were rated relatively highly by the entire survey sample. Specifically, "Uncertainty about future standards for natural foods" topped the list with a mean of 3.4 on a scale of 1 to 6 (1 being "not a barrier" and 6 being "a major barrier"); all segments except mass market foods manufacturers and retailers rated it over 3.0. "Lack of government standards for natural foods" (mean of 2.9) followed closely behind, with natural foods producers and manufacturers rating it as most significant.

Uncertainty About Future Standards for Natural Foods

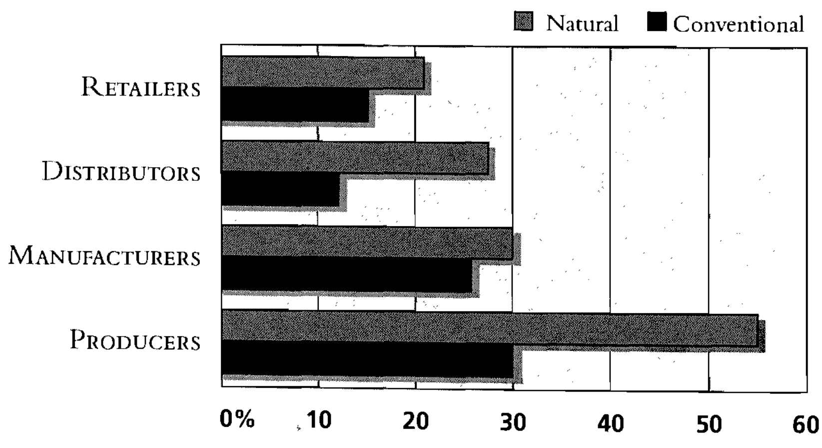


Figure 1a. Response to "Uncertainty About Future Standards for Natural Foods" (percentages indicate perceptions as a barrier or major barrier).

Lack of Government Standards for Natural Foods

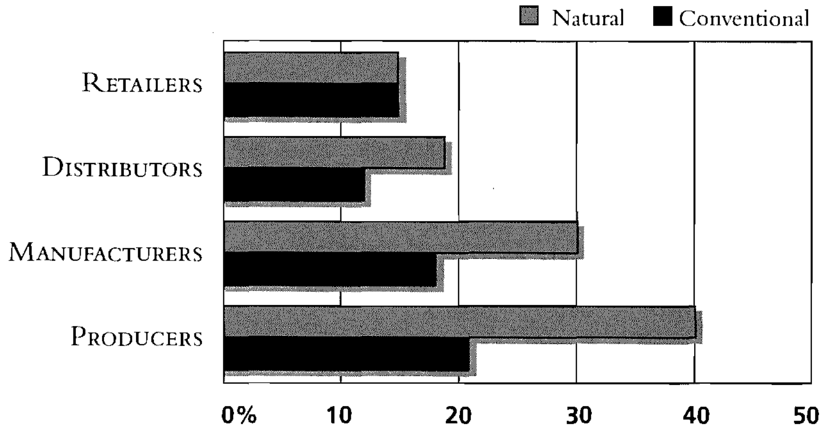


Figure 1b. Response to "Lack of Government Standards for Natural Foods" (percentages indicate perceptions as a barrier or major barrier).

These findings reveal statistically significant differences in the way that natural foods and mass market foods producers and retailers perceive "Uncertainty about future standards for natural foods." Natural foods producers rate this as a more serious obstacle than do mass market foods producers, while natural foods retailers view it as a barrier and mass market foods retailers do not.

Our experts agree that the issue of establishing standards for natural foods is important, although not all of them agree that such standards are necessary. Some believe that existing truth-in-labeling laws and similar legislation are sufficient to inform food producers, distributors, and retailers, as well as consumers.

In relation to the variety of responses, Jean Kinsey, Director of the Retail Food Industry Center, made an interesting observation. She divided the survey responses into two main groups: 1) those already succeeding in the market, who do not want new standards that might displace them, and 2) those trying to enter the market, who want standards set before they invest, thus improving their competitiveness with established industry members.

We conclude from the survey and interviews that the lack of standards will likely be a limiting factor to growth in the natural foods market over the long term. If nothing else, confusion about the meaning of "natural foods" could override consumer interest and confidence in natural foods products.

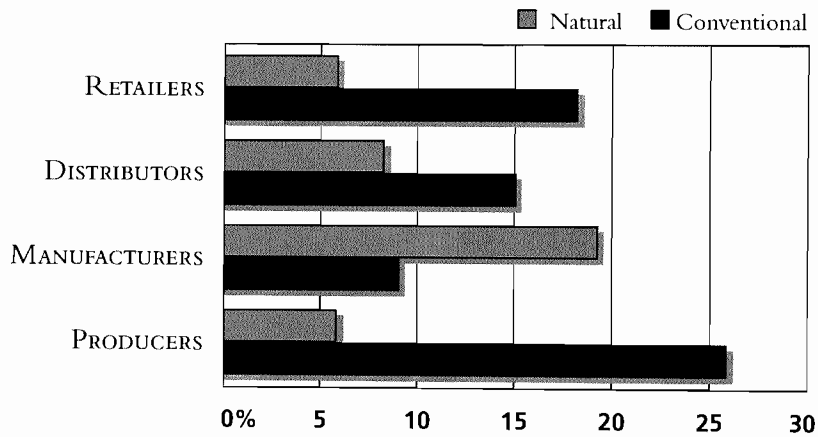
Different Views and Approaches

To varying degrees, all new markets experience growing pains. In part, this is because start-up companies are unfamiliar to consumers and with established businesses that could prove helpful. In addition, they often have little idea how to build the relationships and institutions that can help them succeed. Many are likely to approach their operations in ways that are very different from businesses that provide similar products, but are already well established.

Sometimes new and different approaches carve out a special niche and businesses flourish without strong connections to traditional institutions. But it is likely that growth in the natural foods market will eventually require greater integration with established food-related businesses and institutions.

This presents an obstacle. Our survey showed wide differences in the opinions of natural foods and mass market foods businesses about the natural foods market, and also differences in how these two segments operate. Mass market foods producers, distributors, and retailers, for example, rated "Insufficient market *demand*" as a major barrier (Fig. 2). Their natural foods counterparts did not. Rather, natural foods distributors cited "Insufficient market *supply*" as one of the most significant of all 20 potential barriers listed on the survey (Fig. 2).

Insufficient Market Demand for Natural Foods



Insufficient Market Supply for Natural Foods

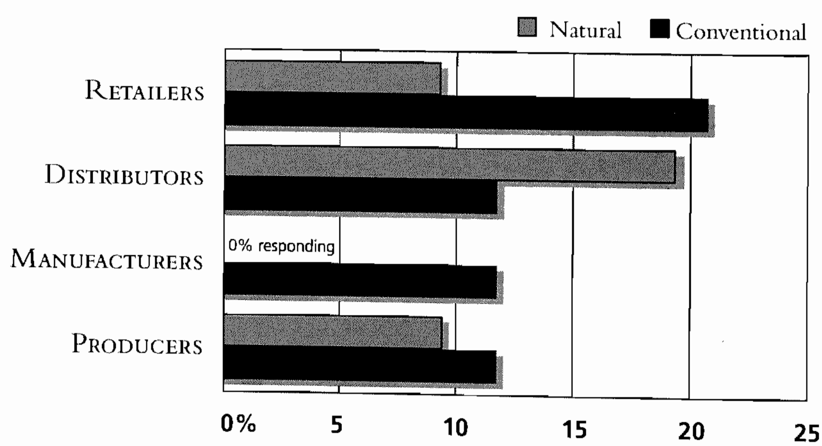


Figure 2. Response to "Insufficient market demand" and "Insufficient market supply" (percentages indicate perceptions as a barrier or major barrier).

These responses indicate that natural foods businesses are finding each other, but they have yet to make strong connections with those in the mass market foods industry who may well be key to continued growth. And the mass market foods industry has yet to discover the ways in which it can best integrate natural foods into existing operations.

Our experts postulated that this arises from major differences in standard operating procedures between the mass and natural foods industries. For the most part, the two markets do not have the day-to-day mechanisms in place that will allow them to find each other and establish profitable relationships. Mike Dunn, Undersecretary for Marketing and Regulatory Programs at the U.S. Department of Agriculture, pointed to obstacles that are built into the very center of the $80 billion infrastructure that supports food distribution in this country. As an example, the industry standard calls for 108-car trains to carry grain, but for organic grain products the need is for far fewer cars. The infrastructure is simply not built to accommodate this need.

Our survey and expert opinions strongly suggest that generic market channels and rules and regulations for their operation are as necessary for natural foods as they are for mass market foods. In the end, both markets may use the same trains, trucks, boats, market report Web pages, and newsletters. But there are currently no standard operating procedures in place to facilitate the movement of natural foods into the mainstream, despite the increasing demand for natural foods products.

The Marketing and Pricing Dilemma

Marketing is a complex task, and businesses that are not good at it risk their success, no matter how excellent their products might be. The experts say that a marketing plan requires formulation of a comprehensive strategy, which includes an assessment of the market climate, product development, marketplace positioning, pricing, advertising, and methods of measuring success.

Added to this formidable task is the fact that marketing natural foods is very different from marketing conventional foods. Few in the emerging natural foods market can afford to compete with Campbell Soup Company or ADM on the nation's air waves, or for desirable, affordable slots on a large food chain's shelves. So how do natural foods businesses reach consumers?

An important interpretation of our findings is that many industry members lack the information, expertise, or capital to price and market natural foods products.

Pioneer natural foods marketers developed a fairly sophisticated understanding of what their small group of consumers wanted. That understanding came over time, from decades of informal interaction with their buyers at farmers' markets, food cooperatives, and other forms of community-supported agriculture. Now the consumer base is broadening. Mainstream consumers say they want natural foods, but determining specifically what they want and at what price is a struggle for both natural foods and mass market foods businesses.

Our survey respondents perceived "Pricing and marketing natural foods" as one of the most serious problems facing the natural foods industry. Across all groups, one-fifth of the respondents rated this as a major barrier (Fig. 3), and the percentage was even higher for mass market foods producers and retailers.

Pricing and Marketing Natural Foods

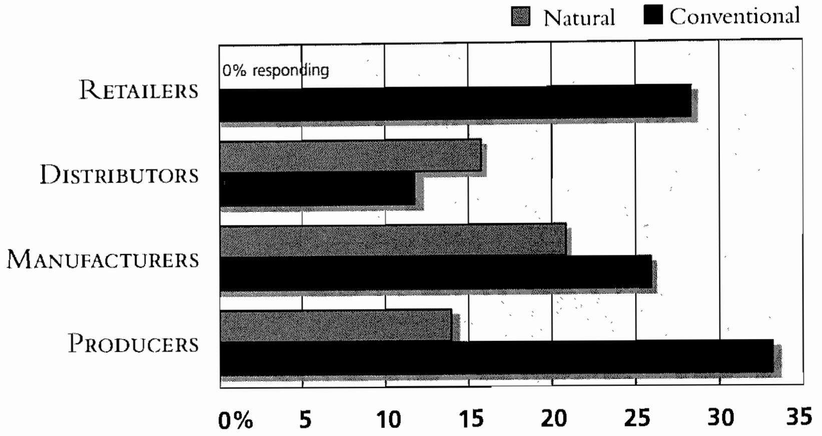


Figure 3. Response to "Pricing and marketing natural foods" (percentages indicate perceptions as a barrier or major barrier).

Ann Woods, Executive Director of the Organic Alliance in Minnesota, summed up her feelings in stating that conventional foods producers interested in growing food for the organic market do indeed face a major barrier. Whether selling raw inputs or value-added items, they know little about gathering the information they need to understand where, how, and at what price to sell their products. In many cases, that information is not even available.

The survey and interviews indicate that the marketing of natural foods, including pricing, is still a mystery to the food industry. Some, and possibly many, natural foods businesses lack the information, expertise, or capital — perhaps all three — to market their products to maximum advantage.

It also appears that mass market foods businesses often fail to understand the critical differences between marketing natural foods and conventional foods, or are choosing not to invest the time and capital necessary to do this job properly. Such decisions may suffer from lack of the information that, if available, might lead these businesses to invest in natural foods products.

Business Strategies: Finding Success, Avoiding Failure

Our survey and interviews included questions related to business strategies and whether or not they are working. We found that some strategies employed by natural and mass market foods companies are leading to success in the natural foods market, while other decisions have produced less than desirable results.

In relation to successful endeavors, our survey indicated the following:

- **Few natural foods retailers and mass market foods manufacturers and distributors have "developed a natural foods label," but many of those who have, have succeeded.**
- **While few mass market foods retailers "hired special staff for natural foods," most of those who did found that this strategy worked.**
- **Few mass market foods producers "increased the scale of their natural foods operations," but those who did were mostly pleased with the results.**

Decisions that were less successful include:

- **While quite a few natural foods producers and manufacturers use "newspaper/direct advertising" to promote their products, many feel this strategy is not productive.**
- **Almost half of mass market foods retailers surveyed have diversified and increased the scale of their natural foods products, but less than one-fifth of them feel they have been successful.**

We emphasize that a "successful" strategy will not always work, and that an "unsuccessful" strategy is not one that should never be used. The following discussion points out pitfalls to be avoided so that the strategies may prove more successful.

Creating Natural Foods Labels

We turn first to labels (e.g., third-party certified ecolabels and certified organic labels) that are essential to the credibility of natural foods products. They are most popular with natural foods manufacturers and to a lesser degree with natural foods distributors (Fig. 4). Note, too, that although only 29% of the conventional foods manufacturers who responded to our survey have tried labels, 70% of those who did rated it a successful or very successful business strategy.

Developing a Natural Foods Label

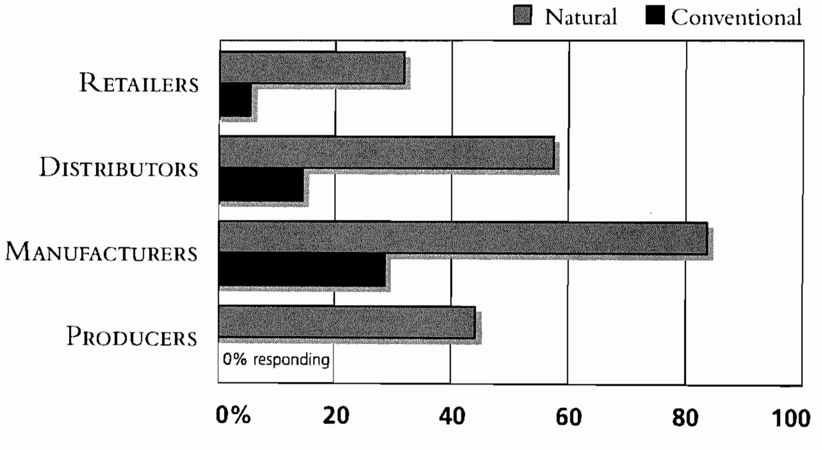


Figure 4. Percent of respondents who "developed a natural foods label."

Our experts believe that this is a critical aspect of marketing natural foods, and all agree that there must be safeguards to ensure the accuracy of natural foods labels. Steven Daugherty, Director of Government Affairs for Pioneer Hi-Bred International, sums it up in stating that well-recognized brand names, marketing research, and strong new product launching efforts are of primary importance, along with clearly defined labeling standards. He noted ConAgra, with its "Healthy Choice" brand, as an example of a company that entered the mass market health foods field early and put the necessary resources behind its product line. It is essential to have good quality as well, he points out, because products with fewer potential customers absolutely need to gain the support of repeat customers.

Although only 29% of mass market food manufacturers surveyed tried developing a natural foods label, 70% who did were successful.

In relation to organic foods, Dunn states that consumer understanding of the organic certification process and the national organic label will advance the organic foods market. He focused on USDA's recent experience with the public concerning the Proposed Rule for the National Organic Program. More than 280,000 responses were received, far more than the number of responses to any other USDA public comment period concerning agriculture. That, he said, shows organic foods are very significant in the public mind.

Hiring Special Staff for Natural Foods

Our survey showed that many natural foods industry members hire special staff for their products, while few in the mass market foods industry have done so (Fig. 5). However, of the mass foods market retailers who tried this strategy (13% of all who responded in this group), 60% said they had success.

Hiring Special Staff for Natural Foods

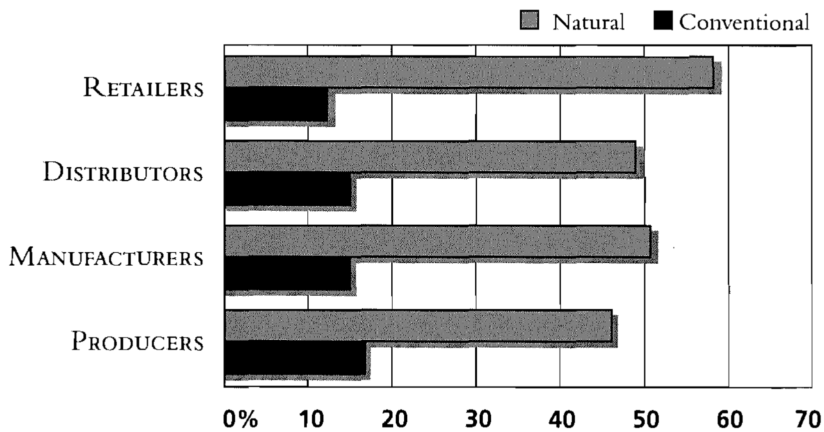


Figure 5. Percent of respondents who "hired special staff for natural foods."

Just 13% of mass market retailers surveyed hired special staff for natural foods, but 60% of them felt it was a good business decision.

Why don't more conventional foods retailers employ this strategy? Why do those who have done so feel it is successful? Our experts believe the answers may lie in a combination of attitude, commitment, and simple economics. Bruce Bechtel, Chief Financial Officer of Stahlbush Island Farms, views this issue from the standpoint of an agricultural economist as well as an organic agricultural producer. While understanding the economic issues involved in the supermarket decision-making process, he emphasized that many conventional foods retailers have little experience in selling organic and other natural foods. These foods, he says, have to be sold differently from other foods because some of the attributes that add to their worth for consumers require additional education. Limited backing from corporate headquarters, he guesses, may have something to do with store-level hesitance in making a substantial commitment to natural foods. He concludes that if conventional retailers do not follow up with consumer education, their initial commitments to natural foods may well fail despite great potential for consumer interest.

Gene Kahn, Corporate Executive Officer of Small Planet Foods, agrees in that he believes cost is the main barrier to the natural foods market, and it is crucial to communicate accurately what makes natural foods cost more. In addition, he argues that safety and health issues are very important to consumers, and facts about these issues must also be communicated to consumers if the natural foods market is to succeed.

Increasing and Diversifying Natural Foods Operations

We found that all four segments of the natural foods industry responding to our survey have increased the scale of their natural foods operations: 81% of manufacturers, 66% of producers, 65% of distributors, and 64% of retailers (Fig. 6). Only 23% of conventional foods producers followed suit, but 60% of those who did were satisfied with the results.

Increasing Scale of Natural Foods Operations

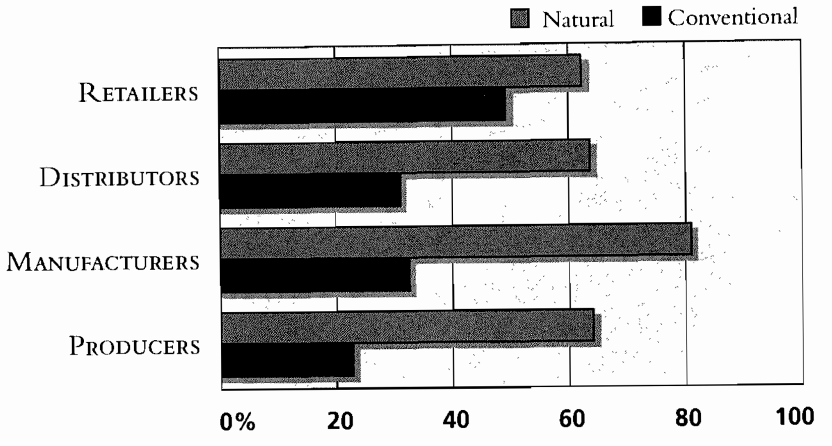


Figure 6. Percent of respondents who "increased scale of natural foods operations."

In addition, almost half of the mass market foods retailers participating in our survey diversified (49%) and increased (49%) their natural foods offerings, but fewer than 20% claimed success. To compare, the vast majority of natural foods retailers noted that their attempts to diversify and increase their natural foods offerings were successful (60% and 76%, respectively).

23% of conventional agricultural producers increased the scale of their operations — and 60% of those who tried believe the strategy was a success.

As Chief Financial Officer for a sustainable organic producer, Bechtel brought a first-hand perspective to this finding. He initially argued that it is very difficult to change producers' minds about anything. He pointed out that the average age of farmers today is over 50 years. They have worked the land for a long time, using the same methods, and are very comfortable in sticking with their standard operating procedures. They are also a risk-averse population — change does not come easily to them.

Upon second thought, Bechtel drew on his personal experience, noting that he has done a fair share of trying to convince older farmers that they should grow food using organic or sustainable production methods. In working with conventional foods producers to create more sustainable and organic production capacity, he says it is important to offer the right amount of money and the right amount of security. Conventional foods producers are generally interested in changing their production methods only if they can be guaranteed significantly higher prices and a long-term commitment in the form of a multi-year contract.

Using Newspaper and Direct Advertising

Distributing a newspaper advertisement or conducting direct advertising was attempted by one-half or more of natural foods producers (51%), manufacturers (51%), and retailers (73%) who responded to our survey (Fig. 7). Fifty percent of these retailers reported that they experienced success or total success, but few of these producers (33%) and manufacturers (14%) fared that well. It appears that for natural foods producers and manufacturers, this popular business strategy is currently a major trouble spot.

Using Newspapers/Direct Advertising

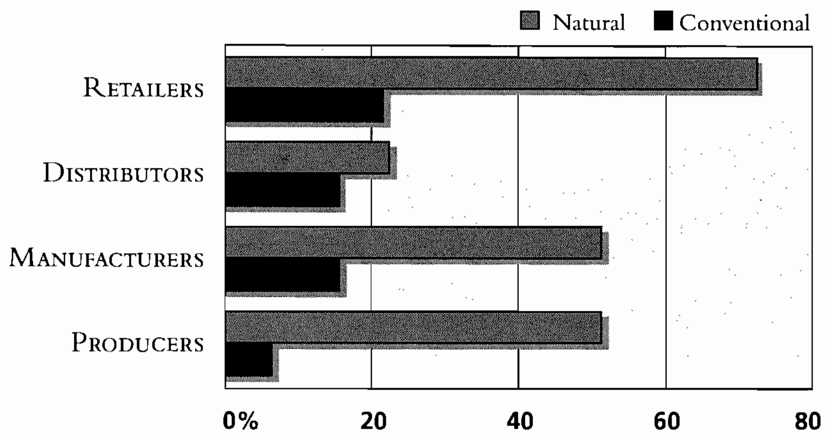


Figure 7. Percent of respondents who used "newspapers/direct advertising."

Our experts had several explanations for these findings. Bechtel believes that there is a lack of understanding about how to sell natural foods products and that businesses have to put more effort into understanding natural foods products and the consumers who buy them.

Daugherty postulates that the consuming public is confused by natural foods because there are simply too many products touting too many attributes. The public is not "linked into" the benefits of natural foods enough to care about buying these foods.

Woods believes that many mass market foods industry members simply are not putting the necessary resources into making newspaper and direct advertising succeed.

Dunn emphasizes that consumers do not know enough about natural foods. For organic foods, he believes, a national standard with a well-recognized shield and a public education campaign will be key to successful marketing.

Kahn contends that consumers must come to an understanding of the cost difference between natural and mass market foods. He states that many natural foods businesses do not know how to simplify their messages enough and that these businesses must capitalize more on the relative benefits of organic and natural foods, through consumer communication. For example, natural foods businesses need to "stop being the nice kids on the block" and come out strongly against pesticides. He emphasized that research is crucial to make this message known and understood.

Conclusions

Natural foods are still a very small part of the U.S. retail foods market, but sales are increasing rapidly. All indications are that this trend will continue, making this segment of the overall market an increasingly prominent part of the food system. Natural foods fit well with major market trends toward food safety, health and convenience, and increased interest in the environmental impacts of agriculture practices.

Based on the findings of our survey, expert interviews, and extensive research, the Wallace Institute concludes that as this market grows, it will also continue to expand out of traditional settings, such as small health food stores, and into mass market settings, such as chain supermarkets. In doing so, the natural foods market will spur some of the needed modifications to existing market information sources and institutions, carving a space for natural foods within these institutions. Other modifications will require public policy intervention. These latter modifications are crucial in creating a natural foods market that meets rising consumer demand.

Industry analysts predict that the natural foods market will continue to chart a path of strong growth.

We believe that there are no unconquerable obstacles affecting the natural foods market, but the means needed to help the natural foods market are not all in place. The appropriate government agencies and non-governmental organizations, in concert with members of the food industry and food trade associations, have the important task of assuring that the natural foods market reaches its full potential.

Credibility is Key

Credibility is key to long-term success in the natural foods market. Many of the attributes that are bundled into natural foods are not apparent in the end products that consumers pick up at the store. Thus, consumers must be made aware of these attributes — through standards, labels, advertising, etc. — if their confidence is to be gained.

To help build consumer trust and loyalty, health and safety standards for natural foods operations should meet or exceed those for conventional mass market foods operations. Ecolabeling and organic labeling must be held to a very high standard for certification. There is much work to be done to ensure the credibility of the natural foods market in consumers' minds.

Surveys tell us that consumers want safe, healthful, convenient food. They also care about the environment and the fate of U.S. farmers. To many, this translates into a desire to buy natural foods in supermarkets. While some people enjoy going to alternative retail outlets such as farmers' markets, many more want to buy natural foods without changing where they normally shop. Thus the success of natural foods in conventional supermarkets is critical.

Natural foods businesses and entities interested in the success of the natural foods market need to plan strategically. Today's natural foods market promises profits to those who act quickly and decisively, but their actions must be backed by careful research and planning prior to product introduction.

The survey and interviews conducted for this report illuminated several public policy themes that are important to success in the natural foods market. Among them are the following:

- The natural foods market must be afforded the same type of assistance that the mass foods market enjoys, in relation to implementation of standards and minimally necessary regulations aimed at serving consumers and the public good.

- Mass market channels need to be cleared of obstacles that limit access for natural foods businesses.

- There is a need to address the current lack of systematic processes for tracking the natural foods market — especially for conducting basic research on the production, manufacture, distribution, retailing, marketing, and pricing of natural foods — and to initiate the proper means of disseminating the resulting information to a wide range of users, including food industry businesses and the general public.

- Mechanisms must be put in place to assist in the organizing aspects of the natural foods market, in forming partnerships, coalitions, and working groups, and in building trade associations and other institutions that are dedicated to overcoming the difficulties and meeting the challenges posed by the growing natural foods market.

The following recommendations build upon these themes.

Recommendations

The Wallace Institute has developed the following recommendations for major sectors involved in the U.S. food system, with the goal of helping the natural foods market reach its full potential.

Government Agencies

1. National Agriculture Statistics Service: Include new questions directly related to the organic and sustainable agriculture market on existing surveys. Investigate the potential for a new organic and sustainable producer sample frame and marketing survey. Work with the USDA Economic Research Service, Organic Farming Research Foundation, Sustainable Agriculture Working Group network, USDA Sustainable Agriculture Research and Education Program, and others to develop these efforts.

2. Agricultural Marketing Service: Formulate a set of guidelines for companies developing natural foods labels. Work with food trade organizations including the Food Marketing Institute, Organic Trade Association, and National Natural Foods Association to complete this task. Educate food industry members about these guidelines and assist them in ensuring that their natural foods labels are credible and, consequently, have a greater chance at long-term success.

3. Agricultural Marketing Service and Extension: Work with the Organic Alliance, the Sustainable Agriculture Working Group network, and others, to create educational materials and teach extension professionals how to help producers learn about markets for organic and sustainable agricultural products.

Trade Organizations

1. Investigate and analyze the impacts that current trends, such as interest in functional foods and whole health marketing, have on the natural foods market and how these impacts may affect your members. Many of your members may not have the resources or experience to do this.

2. Develop standards and a system for self-regulating your members' natural foods products and explore developing third-party certification mechanisms to make sure consumer expectations for natural foods are met. The goal is to help your members build consumer satisfaction and ensure long-term success in the natural foods market.

3. Create recommended standard operating procedures for your members to make their interactions with members of the mass market as easy and successful as possible. Because business relationships are becoming more complex and technologically sophisticated, it is important that your members be "on the same page" with their new partners.

Research and Educational Institutions

1. Examine the attributes of natural foods that have led to greater consumer demand for these products. What product characteristics are most attractive to consumers (for example, environmental, food safety, nutrition)? Which types of labels have the most impact?

2. Investigate industry responses to the natural foods market. How are natural foods businesses adapting to changing times? Why and how do mass market foods businesses enter the natural foods market? How have lack of government standards, third-party certification, and industry norms helped or hindered the development of the natural foods market?

3. Analyze the impacts that the growing natural foods market is having on rural communities, the environment, and food safety. Are they discernible impacts? What are the benefits to rural communities, the environment, and food safety of a fully developed natural foods market?

Industry Members

1. Inform the USDA that you are interested in learning more about natural foods. Ask them to develop guidelines for companies that want to enter the natural foods market and to collect more comprehensive market and price information on the natural foods market.

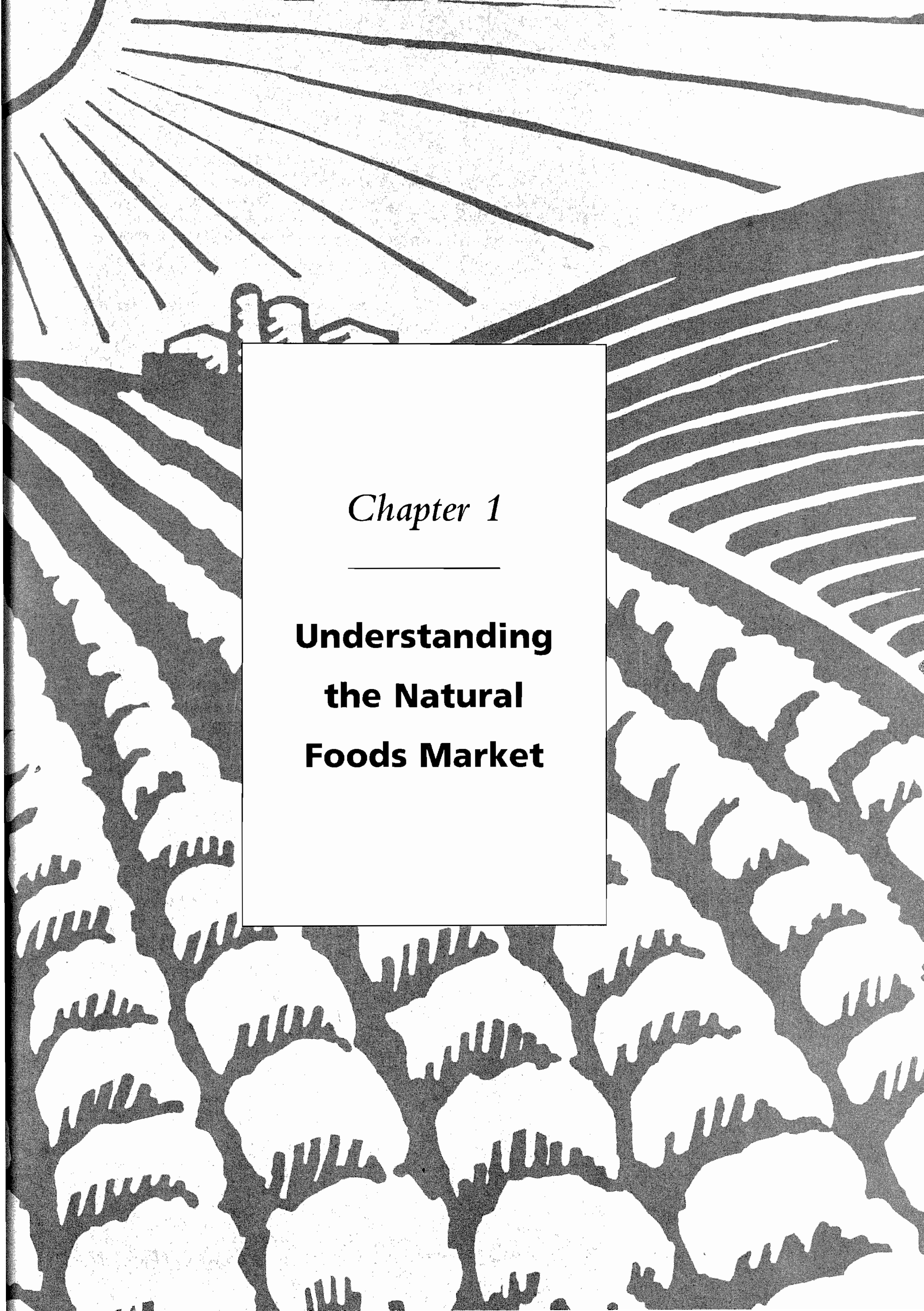
2. Tell your trade organization(s) that you want them to supply you with information about how the natural foods market works. Ask them to develop standards for developing third-party certification mechanisms, and for self-regulating production to ensure that they meet consumer expectations for natural foods. Ask them to create guidelines for interacting with other businesses involved in the natural foods market. Ask them to conduct more research and analysis on the issues in the natural foods market that are most pertinent to your success in the natural foods market.

3. Whether you are already involved in the natural foods market or are deciding to enter the natural foods market for the first time, develop a well-researched aggressive marketing plan for your product(s). This may include working with outside natural foods marketing professionals or developing your own in-house capacity related to natural foods marketing. Take advantage of all relevant expert public and private resources to maximize your chances of success.

Looking Forward

It is the hope of the Wallace Institute that this report will be useful to all those involved in the food industry in this country. We believe that it offers valuable information about what members of the food industry perceive in relation to the growing natural foods market, and excellent observations and advice from experts in the food industry. It also presents data about the natural foods market and recommendations that we trust will prove useful to businesses engaged in natural and mass market foods production, manufacturing, distribution, and retailing.

We see tremendous opportunities for the natural foods market. We intend to continue to work for policies and actions that will contribute to the future success of this market for the eventual benefit of the consumer and the broader public good.



Chapter 1

Understanding the Natural Foods Market

Chapter 1: Understanding the Natural Foods Market

Why This Report?

The Henry A. Wallace Institute for Alternative Agriculture has been working for most of the past two decades to promote a more sustainable food system in this country. In view of the upward trend in the natural foods market, it may appear that Adam Smith's "invisible hand" is indeed at work and that there is no need to analyze this success. However, as we conducted the survey and interviews that led to this report, it became obvious that the natural foods market faces significant difficulties that may hinder its future progress.

As natural foods have entered the mainstream over the past several years, many in the natural foods and mass market foods industries have voiced their concerns regarding obstacles to this market. They center around three themes:

- the prices are high,
- the quality is low, and
- the supply is inconsistent.

We contend that these are not true obstacles. Rather, they are symptoms of the obstacles that have arisen as the natural foods market has grown.

We are convinced that exposure of the root causes of these problems and discussion of workable solutions will assist all those involved in the natural foods market, in helping it reach its full potential. This is the goal of this report.

This chapter briefly addresses definitions of natural foods, trends in the natural foods market, and related issues of concern to various segments of the entire food industry. Chapter 2 discusses obstacles to continued growth in the natural foods market, stemming primarily from the findings of our nationwide survey of food industry businesses and in-depth interviews with experts in the natural foods industry, mass foods market, academia, and government. Chapter 3 describes survey responses to questions about business strategies related to natural foods, and opinions from our experts. The concluding chapter consists of recommended actions for government agencies, trade organizations, research and educational institutions, and industry members, to help ensure that the natural foods market has the opportunity to reach its full potential.

Defining Natural Foods

Central to any discussion of the natural foods market is a definition of what constitutes natural foods products. Currently there is no single, standardized, widely accepted definition. As noted later in this report, the lack of such a definition is one of the primary obstacles that could hinder the ultimate success of natural foods in the marketplace.

There is no single, standardized, widely accepted definition of "natural foods."

The Wallace Institute defines natural foods as foods that are produced with organic or sustainable farming methods, are minimally processed, and are free of artificial ingredients, preservatives, and chemicals. Others hold different views. For example:

- The *Natural Foods Merchandiser* (*NFM*), the Colorado-based trade publication of the natural foods industry, declares that natural foods should comply with the following key criteria: they must be health enhancing, eaten as close as possible to their original state in nature, minimal in their environmental impact, and produced and supplied in a socially just manner.[1]

- The Food Marketing Institute (FMI), the Washington, D.C.-based trade organization of primarily mass market foods wholesalers and retailers, defines natural foods as "those that are minimally processed and free of artificial ingredients, preservatives, and other chemicals that do not occur naturally in the food." FMI also states that, in general, "natural foods are as near to their original state in nature as possible, ...may not necessarily be beneficial to good health, ...and are considered environmentally friendly, [although] they are not always so."[2]

- The Federal Trade Commission (FTC) defined natural foods for advertising purposes in the 1970s, but that definition was never adopted as law or in regulations. Nonetheless, it is the definition used by many as a template for natural foods. The FTC decreed: "[T]o be advertised as natural, foods may not contain synthetic or artificial ingredients and may not be more than minimally processed. To call foods natural in cases where they contain ingredients that are more than minimally processed but otherwise meet the standards, advertisers must identify the processed ingredients or the type of processing as deviation from the standard." This definition also states, "Minimal processing does not include processing that, in general, can not be done in a home kitchen and that involves certain types of chemical or sophisticated technology, for example, irradiation."[3]

In addition to these definitions, individual firms and experts have expressed views that are sometimes contradictory. In one expert's opinion, unprocessed organic food that is grown by a large corporate agribusiness should not be considered natural.[4] Another expert interviewed for this report believes that highly processed food that is organically produced should be considered natural.[5]

Table 1. **Comparing definitions of natural foods**

	Processing Standards	Production Standards	Environmental Standards	Health Standards	Social Standards
NFM	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**
This report	**Yes**	**Yes**	**Yes**	**No**	**No**
FMI	**Yes**	**No**	**No**	**No**	**No**
FTC	**Yes**	**No**	**No**	**No**	**No**

In this report, we present data related to the natural foods market, which have been collected by various governmental agencies, food industry associations, relevant non-governmental organizations (including the Wallace Institute), and financial institutions. The data in the following section of this chapter concern trends in the natural foods market and the share that natural foods claim in the total retail foods market. This information stems primarily from research conducted by the *Natural Foods Merchandiser (NFM)*. It is collected on an annual basis from surveys of natural foods distributors and extrapolated to the total food market. It is the most reliable set of data we have found to describe these issues. It is possible that not all foods included in the *NFM* research meet the *NFM* definition of natural foods.

Note that standards for organic foods and organic agriculture are much more concrete than for natural foods as a whole. Early in 1998, the U.S. Department of Agriculture (USDA) proposed regulations setting those standards.[6] As the definitions presented above indicate, however, organic and natural foods are not synonymous. Most natural foods do not meet the organic standards.

No Longer a Fad

By any definition, natural foods are no longer considered a passing fancy. Growth in consumer demand for natural foods has made this apparent and changed the minds of many skeptics in the food industry. *Supermarket News* reports, "The strongest trend in 1998 was for an increase in natural, organic, 'better-for-you,' and vegetarian offerings in mainstream supermarkets."[7] Top-level industry executives in mass market (or conventional) foods businesses now routinely recognize and discuss *trends*, not fads, in the natural foods market.[8]

In 1997, natural foods posted retail sales of $5.5 billion. If current trends continue, retail sales will exceed $60 billion by 2008.

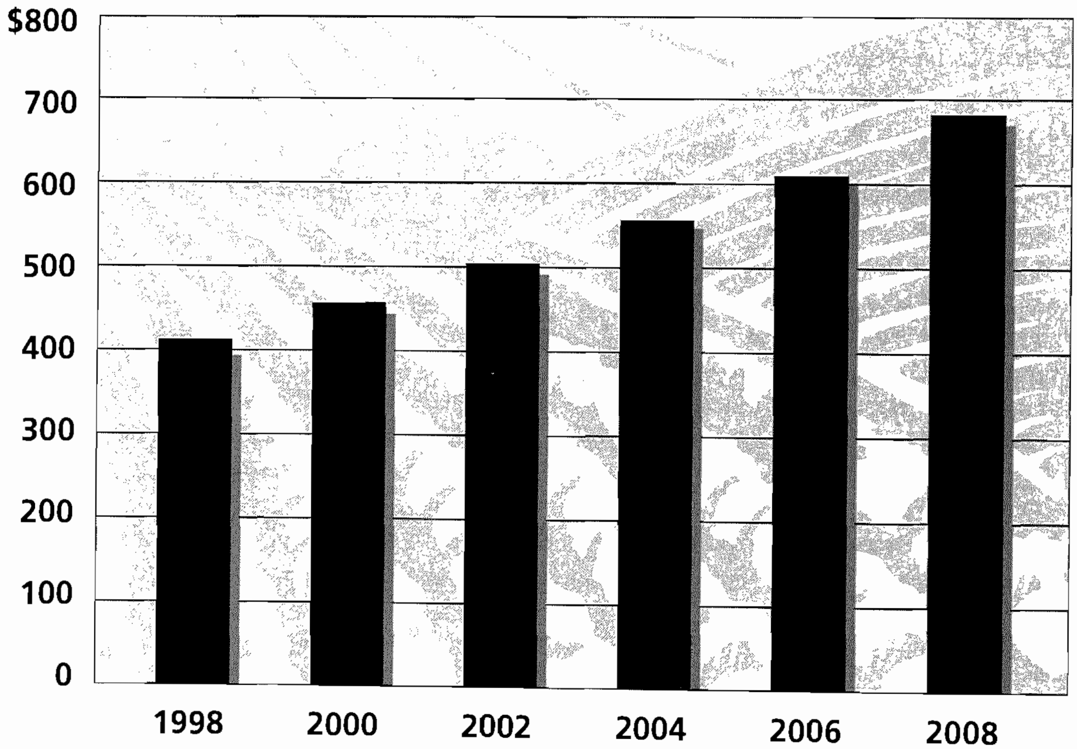
While natural foods currently comprise a very small part of the entire retail foods market, comparative average growth rates show that this segment is expanding at a fast pace. Over the past seven years, the natural foods retail market grew up to 25% each year,[9] while the mass foods retail market grew much more slowly, only 3% to 5% per year.[10] If the growth rates for the natural foods retail market are maintained or exceeded during the next 10 years, as many analysts predict,[11] natural foods will make up nearly 10% ($60 billion) of the total retail food market by the year 2008 (Figs. 8 and 9).

Natural foods retailers account for about $3.7 billion, or 68% of all natural foods sales,[12] and the number of these stores has grown significantly over the past few years. There has been an especially sharp upturn in the number of large natural foods stores such as Whole Foods and Fresh Fields. In 1990, according to the *Natural Food Merchandiser*, there were fewer than 90 natural food stores more than 5,000 square feet in capacity, but by May of 1997, there were more than 600 such stores. Industry experts predict that there will be about 1,000 of them by the year 2000.[13]

Still, the market for natural foods remains unusually diverse. For example, 48% of people who buy organic produce purchase it in natural foods supermarkets and small health foods stores, 41% at farmers' markets, and 59% in conventional grocery stores.[14] (These percentages add to more than 100 because some respondents indicated they shop at more than one category; the survey choice was "check all that apply.")

Most natural foods sales in mass market foods retail stores are clustered around a few items, while sales in natural foods retail outlets are spread among many more products.[15]

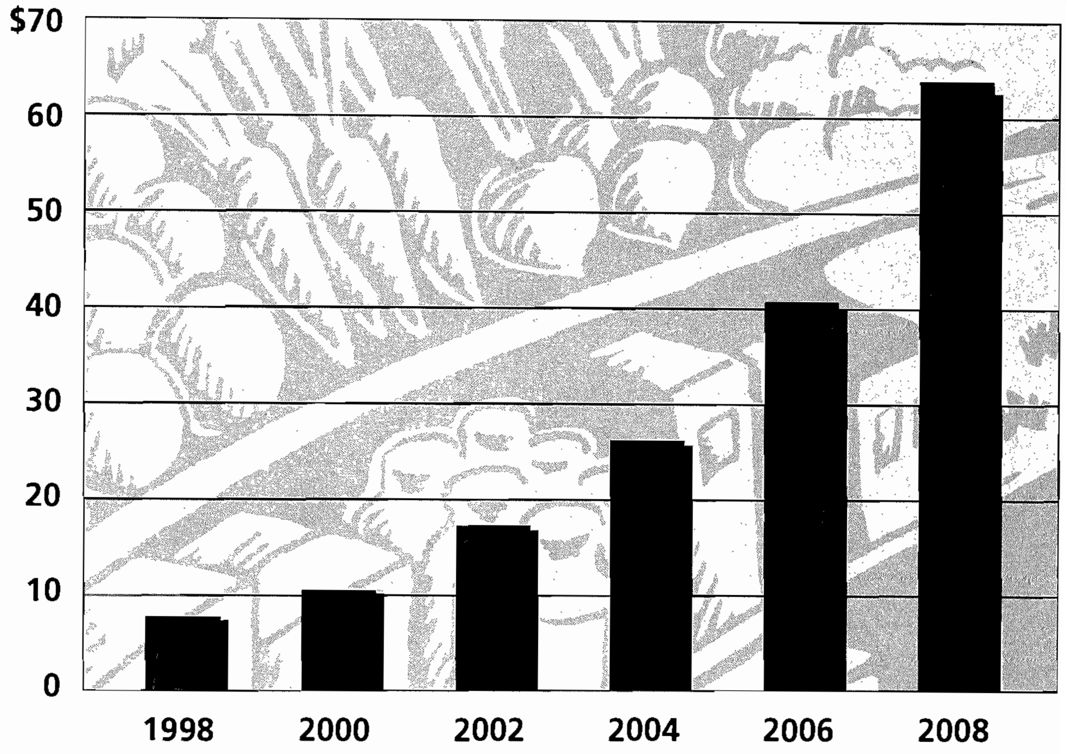
Projected Growth Rate of the Total Retail Foods Market (in billions of dollars), 1998–2008



Note: Total retail foods market sales have been estimated using a starting point of $377 billion in 1996 (Source: USDA ERS) and an annual growth rate of 5% (Source: USDA ERS).

Figure 8. Projected growth rates for mass market foods.

Projected Growth Rate of the Natural Retail Foods Market (in billions of dollars), 1998–2008



Note: Natural retail foods market sales have been estimated using a starting point of $5.49 billion in 1997 (Source: *Natural Foods Merchandiser*) and an annual growth rate of 25% (Source: *Natural Foods Merchandiser*).

Figure 9. Projected growth rates for natural foods.

What Do Consumers Think?

The findings of various studies and surveys strongly indicate that many consumers are interested in natural foods. The examples below make it clear that more and more consumers are serious about food health and safety and about the methods used to grow food. (See the beginning of the End Note section for references.)

Percent of consumers who...

a.	...say they have changed their eating habits to ensure that their diet is healthier:	**93**
b.	...say that nutrition is more important to them than price:	**77**
c.	...consider pesticide and herbicide residues to be a serious health risk:	**66**
d.	...believe that produce grown through integrated pest management (IPM) is safer than non-IPM produce:	**63**
e.	...consider long-term health effects to be a "very important" factor in deciding whether to buy non-organic produce (of those buying organic):	**76**
f.	...sought out and purchased food labeled as organic due to nutrition concerns:	**37**
g.	...consider themselves to be environmentally active or sympathetic:	**75**
h.	...consider the environmental impact of growing/producing foods when deciding whether to buy non-organic produce (of those who purchase and use organic produce):	**56**
i.	...believe that IPM production methods are safer for the environment than chemical production methods:	**78**
j.	...are somewhat or very interested in buying environmentally enhanced foods:	**71**
k.	...are somewhat or very interested in paying a 10% premium for environmentally enhanced foods:	**46**
l.	...say they would buy reduced-pesticide food if there were no premiums:	**75**
m.	...say they would buy reduced-pesticide food if the price were "slightly higher:"	**40**
n.	...look for official organic seals on processed food packages when deciding whether or not to buy them for the first time:	**43**
o.	...are willing to pay a 10% (or more) premium for organic produce:	**34**
p.	...buy natural or organic foods at least once a week from supermarkets:	**28**
q.	...are "core buyers" of natural foods:	**7**
r.	...are "receptive buyers" of natural foods:	**45**

But in an increasing number of cases, members of the natural foods and mass market foods industries are forming partnerships or merging to claim a larger piece of the natural foods pie.

Mainstream supermarket executives increasingly believe that the integration of natural foods into the strategic management of their operations is valuable. According to FMI, the percent of mainstream retailers who believe that offering natural foods is "very important" increased from 12% in 1992 to 26% in 1994, while 51% predicted it would be very important by 1996.[16]

The amount of certified organic acreage in the U.S. increased by over 50% from 1992–95.

Organic agriculture is also growing, which may be a portent for the entire natural foods market. The amount of certified organic crop land in the United States increased more than 50% during the period 1992 to 1995 — from 403,400 acres to 638,500 acres (Fig. 10).[17] While these numbers constitute a very small percentage of total farm acres in the country, the growth rate is impressive. In those same years, the number of certified organic farms rose from 2,753 to 4,856. And the Organic Farming Research Foundation estimates that there were 6,000 *un*certified organic farmers in 1994.[18]

The Upward Trend in Certified Organic Crop Land in the U.S.

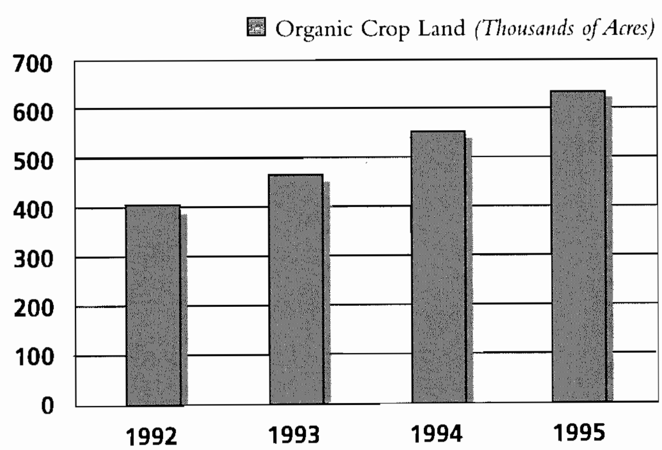


Figure 10. Certified organic crop land in the U.S., 1992–1995.

(Source: Julie Anton Dunn, 1997)

In step with producers, there have been steady, substantial increases in the number of food product handlers (including manufacturers, distributors, and retailers) that are certified for organic foods (Table 2).

Table 2. **The upward trend in certified organic U.S. product handlers, 1991–1994**

Year	No. of Certified Handlers	Pct. Change from Prior Year
1991	**277**	**n/a**
1992	**385**	**39%**
1993	**464**	**21%**
1994	**557**	**20%**
1995	**694**	**25%**

(Source: Julie Anton Dunn, 1997)

Issues of Concern

Growth in the natural foods market has had an impact across the entire food system. Below we briefly examine how major trends in the food system, including a steadily rising natural foods market, are creating challenges for agricultural producers, food manufacturers (in this report, manufacturers include processors), food distributors (in this report, distributors include wholesalers), and retail supermarkets.[19]

Producers

Most farmers and ranchers today produce for the mass market, but they are not marketing experts and rarely see where their products go after they leave the farm. A dairy farmer in Comanche County, Texas, sells milk to a processing plant that in turn sells to a distributor. The farmer knows little about the consumers drinking his milk, as little as they know about him.

Many such conventional farmers know even less about the opportunities afforded by the natural foods market than they do about the consumers of their products. They are not likely to rush into that market without significant assurances that they will be rewarded for the changes they will need to make.

Agricultural producers who currently grow food for the natural foods market understand very well that growth in that market is resulting in benefits. But often they are unsure of how best to take advantage of the market's potential. While many are aware that the natural foods market is expanding and new outlets for their products exist, they may not have access to the specific information they need to make the best decisions about where and how to sell those products. This lack of information may cause them to invest in the wrong crops, tools, and techniques, or to make inappropriate strategic planning and marketing decisions, as they strive to fulfill the growing demand for natural food products.

Manufacturers

Food manufacturers transform raw farm goods into a variety of packaged products for consumers.[20] All food products that "undergo some form of preservation, cooking, reconstitution or packaging before they are sold to consumers" are considered to be processed.[21] And that processing is big business in the United States. A 1993 study by McKinsey Global Institute showed that the processed food industry "is the largest single consumer goods industry, and, as such, plays an important role in the health of the economy."[22]

Within the overall food industry, manufacturers have a great deal of control over both production and marketing, including new product development. This power is evident in their ability to "push" products onto retail shelves through purchasing incentives and promotional programs and to "pull" products off those shelves by stimulating consumer demand through advertising and other promotional strategies.[23]

For mass market foods manufacturers, growth in natural foods poses several problems. Some natural foods must be purchased from myriad small producers who may be unfamiliar with conventional foods manufacturers' handling, quality, data, and other requirements. Mass market foods manufacturers are also hampered by insufficient information regarding consumer research and product formulation, pricing, distribution, and marketing because the companies they work with do not collect these data for natural foods.[24]

Natural foods manufacturers also face challenges, based largely on the rapid increase in demand for their products and the differences in characteristics of the companies that want to buy their products. Many of these manufacturers recognize the advantage in bringing new products onto the market quickly, but some have faltered, introducing products before the "kinks" have been worked out, and failing first to predict accurately which raw materials they will need and then securing those materials. This results in out-of-stocks and a perception on the part of conventional buyers that the natural foods manufacturers are unprofessional.

These manufacturers may also have trouble getting their natural foods products onto retail store shelves. Some do not have the necessary financial or management systems, nor do they provide product promotions that are acceptable to mass market foods distributors and retailers. Others refuse to pay the fees regularly charged by conventional supermarkets for preferred shelf placement.

Distributors

The vast majority of food on retail shelves is delivered by distributors that warehouse the food products and thus reduce transaction costs for manufacturers and supermarkets.

Who are these distributors? Many are owned by retailers. In 1996, almost all large U.S. supermarket chains (those with more than $1 billion in retail sales) owned and operated wholesale distribution centers for their stores.[25] Others are independently owned distributors that generally serve small chains.

Most mass market foods distributors spend little time on integrating natural foods into their businesses. To take advantage of growing opportunities and avoid common trouble spots, however, some of them have changed their organizational structure to include more slots for natural foods at the warehouse level. Some have also begun to provide more services specifically geared to the natural foods buyer, including techniques such as marketing through advertisements, "shelf talkers," different colored shelf stickers, and in-store demonstrations for natural foods. In short, they have incorporated natural foods into all levels of their strategic planning.

On the other hand, natural foods distributors are increasingly being asked to serve large, mass market foods clients, some of whom have never dealt with a natural foods distributor. That creates additional stress for natural foods distributors, which are generally smaller and less technologically sophisticated than mass market foods distributors.

Of the approximately 3,000 natural foods distributors in the United States, only two are national — Tree of Life, based in St. Augustine, Florida, and United Natural Foods, headquartered in Dayville, Connecticut.[26] Even some of the larger natural foods distributors fail to offer services commonly expected by mass market foods retailers. As the natural foods market continues to reach out to more mass market foods retailers and distributors, natural foods distributors are feeling pressure to reassess their products and services.

Supermarkets

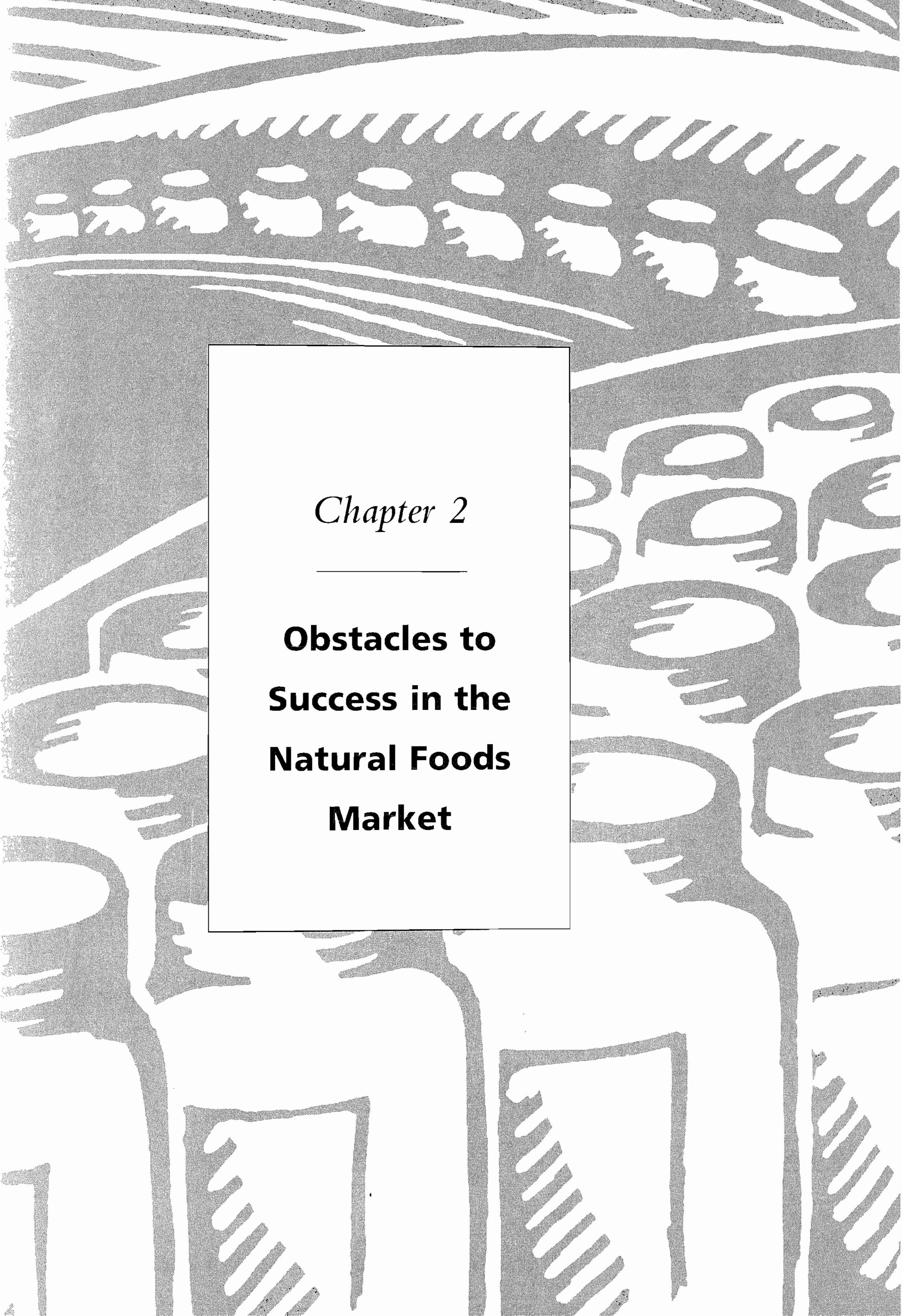
The advent of a growing natural foods market is especially evident at the supermarket level. Responding to consumer demands for environmentally friendly foods has been important to retailers for some time, but it is becoming even more vital. Over the course of just one year, the percent of consumers who said that retailers are "primarily responsible" for environmentally safe products doubled — from 10% in 1996 to 20% in 1997.[27]

Mass market foods retailers are responding. Since 1992 growth of natural foods products in mainstream outlets has ranged between 15% and 25% annually,[28] and natural foods retail sales in those outlets rose 12% from 1996 to 1997, when sales reached $1.8 billion.[29] There is evidence that mass market foods retailers are very much aware of the attraction that natural foods hold for consumers; many have initiated private label (store brand) natural foods programs, a strategy that is paying dividends. Private label foods sales reached $33.9 billion in 1996.[30]

Supermarket retailers understand that consumers are demanding more environmentally-friendly and safe foods.

Supermarkets are also facing competition in the natural foods market from high-end specialty stores and cost-cutting super centers. According to FMI, 17% of mainstream operators in 1995 had a separate natural foods buyer, meaning they devoted time and energy in an organized way to bring natural foods into their stores.[31] Yet conventional supermarkets normally carry only a small variety of natural foods; 31% of their natural foods products make up 96% of their natural foods sales.[32]

Natural foods supermarkets and health foods stores still hold the majority of the market share for natural foods. Whole Foods and Wild Oats, along with smaller chains and independent supermarket-sized natural foods outlets, have broken down many of the stereotypes about natural foods stores of years past. Together they anticipate sales of more than $10 billion in 1997.[33] Both chains have plans for rapid growth over the next few years. Whole Foods, with 12% of the natural foods market,[34] plans to own 100 stores by the year 2000[35] and 140 stores by 2003.[36] Wild Oats' Mike Gillian noted that the challenge for natural foods supermarkets lies in changing their formats to move into "real America," which he defined as places beyond natural foods strongholds, such as Boulder, Colorado, Santa Fe, New Mexico, and Austin, Texas.[37]



Chapter 2

Obstacles to Success in the Natural Foods Market

Chapter 2:
Obstacles to Success in the Natural Foods Market

The challenges to the food industry posed by growth in the natural foods market were the primary impetus for this report. At the Wallace Institute, we wanted to find out which challenges are considered the most critical by members of the food industry.

To do so, we first needed to understand market barriers as they are viewed in economics. Economists define market barriers as the results of market failure; that is, the inability to take into account all of the costs a market accrues, as well as all of the benefits it confers. Those costs and benefits are both private and social. Private costs (for example, the costs of farm machinery, seed, fertilizer, trucking, advertising, etc.) are borne by companies. Social costs, also called externalities, are borne by the public at large and include expenditures such as those needed to clean up groundwater supplies that have been degraded by agricultural runoff.

In relation to social costs, market failure occurs when the costs are imposed on people other than the producers and their customers. In relation to benefits, market failure is signaled when allocation of the benefits is less than optimal.

Generally, four issues underlie market failure:

- imperfect competition, where actions of certain buyers or sellers have an effect on market prices;
- imperfect information, where some segments of a market do not understand the true costs and benefits of the market;
- public goods, which are non-rival and non-excludable in nature; and
- externalities, or the "spill-over" costs or benefits that have unintended side effects associated with market transactions.[38]

In addition, government failures can affect markets. Active government failure takes place when government intervenes unnecessarily in an otherwise operational market. Passive government failure occurs if government does not act when necessary. Proper government intervention, on the other hand, has the potential to raise the welfare of society as a whole.[39]

Uncovering the Obstacles: The Wallace Institute 1998 Natural Foods Market Survey

We addressed each of the market failures noted above in asking 290 food businesses to rate 20 potential barriers, which were chosen after extensive research into problems in the natural foods industry. Participants in the survey included, on average, 73 respondents in each of the following categories:

- agricultural producers,
- food manufacturers (includes processors),

✦ food distributors (includes wholesalers), and

✦ retail supermarkets.

Approximately one-half of respondents in each category were self-described natural foods industry members ("natural," "organic," or "sustainable"). See Appendix A for sample origins.

As with all surveys, the results of this one were subject to sampling error. The statistical significance of the numbers and percentages reported has been calculated, and only statistically significant findings are given in this report. For more detail, see Appendix B.

The 20 potential obstacles included on the survey are listed below. Participants were asked to rate the obstacles on a scale of 1 (not a barrier) to 6 (major barrier), or to select "no opinion." Participants were also requested to identify any obstacles not listed on the survey. See Appendix C for the entire survey.

Potential Barriers to the Natural Foods Market

FIRM-LEVEL BARRIERS

Strategically Planning Natural Food Ventures

1. **Finding timely, complete market price and quantity information**
2. **Integrating new natural food ventures into existing operations**

Launching Natural Food Ventures

3. **Linking with natural food input suppliers**
4. **Gaining new skills, training, financing, equipment and/or processes**

Managing Natural Food Ventures

5. **Maintaining quality and safety standards**
6. **Allocating staff time**
7. **Implementing efficient production management methods**
8. **Packaging natural foods products**

Selling Natural Foods Products

9. **Linking with buyers' interest in environment, health, and safety**
10. **Pricing and marketing natural food products**

INDUSTRY-LEVEL BARRIERS

Market Issues

11. **Difficulty finding agricultural producers**
12. **Difficulty finding manufacturers**
13. **Difficulty finding distributors**
14. **Difficulty finding retailers**
15. **Market demand insufficient**
16. **Market supply insufficient**
17. **Unreliable market quality**

Policy Issues

18. **Lack of government standards for natural foods**
19. **Lack of industry standards for natural foods**
20. **Uncertainty about future standards for natural foods**

To analyze the survey results, we divided the food industry into two categories — natural foods market and mass market foods — and eight segments, as follows:

Natural Foods Market

- ✦ agricultural producers
- ✦ manufacturers (includes processors)
- ✦ distributors (includes wholesalers)
- ✦ retail supermarkets

Mass Market Foods

- ✦ agricultural producers
- ✦ manufacturers (includes processors)
- ✦ distributors (includes wholesalers)
- ✦ retail supermarkets

After analyzing the survey results to ascertain which obstacles industry members perceived as the most important, we interviewed six experts on the food industry to help us determine the root causes of the perceived obstacles. The interviews consisted of a series of open-ended questions, which were asked of each participant in the same order. Interviews generally lasted 60 minutes, but ranged in length from 50 to 90 minutes.

Survey Findings: General Results

The results of the survey were very diverse. As Figure 11 indicates (see also the box on the next page), some segments believed they faced many major obstacles, while some felt they faced few or none. Mass market foods retailers rated the most — 8 out of 20 — potential obstacles as major. Natural foods retailers, on the other hand, perceived only 2 potential obstacles as major.

Perception of Barriers of Food Industry Segments

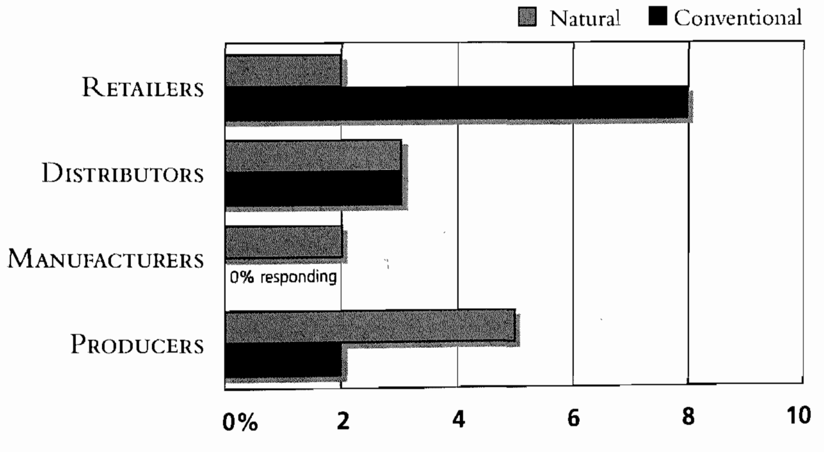


Figure 11. Number of barriers (out of 20) perceived by food industry segments as being major.

No single potential obstacle was rated a barrier by more than half of the respondents. This result is not surprising, given that the survey deals with a fast-growing market.

Meet Our Experts

BRUCE BECHTEL
Chief Financial Officer of Stahlbush Island Farms, a producer and processor of sustainably grown fruits and vegetables, based in Corvallis, Oregon.

STEVEN DAUGHERTY
Director of Government Affairs for Pioneer Hi-Bred International, a seed and feed company based in Iowa.

GENE KAHN
Corporate Executive Officer of Small Planet Foods in Sedro-Woolley, Washington, the largest organic foods manufacturer in the world. Their brands include Fantastic Foods, Cascadian Farms, and Muir Glen.

JEAN KINSEY
Professor at the University of Minnesota Department of Applied Economics, St. Paul, Minnesota, and Director of the Retail Food Industry Center in Minneapolis.

MICHAEL DUNN
Undersecretary for Marketing and Regulatory Programs, U.S. Department of Agriculture.

ANN WOODS
Director of the Organic Alliance, a non-profit organization based in St. Paul, Minnesota, which works to advance the introduction of organic foods into mass market supermarkets.

Expert Interviews: General Comments

In relation to the overall findings, our experts focused on those related to the retail side of the natural foods market, perhaps because conventional foods retailers perceived more barriers than any other group. The experts had the following to say:

- Ann Woods, Director of the Organic Alliance, believes that although the great majority of mass market foods retailers are dabbling in natural foods, they find that products in that category are not moving quickly. They know that natural foods supermarkets are succeeding, and they are frustrated that many of their efforts have not borne fruit thus far. She also surmised that mass market retailers, many of whom focus their natural foods category around fresh produce, still experience difficulty in certain regions with finding consistent supplies of high-quality organic and sustainably grown fresh fruits and vegetables.

- Professor Jean Kinsey, who directs The Retail Food Industry Center in Minneapolis, sees mass market foods retailers first and foremost as well-established, successful businesses. They work with or own distribution facilities that have not ordinarily dealt with natural foods and have long-standing relationships with distributors who do not carry natural foods. Finding new natural foods suppliers means extra work and added risk. Mass market foods retailers are in a high-volume, low-margin business, and they have to weigh alternatives in making the most cost-effective choice. This is even more difficult in franchised stores, where decisions are made at the store rather than the corporate level.

- Steven Daugherty of Pioneer Hi-Bred International believes that mass market foods supermarkets "have a big piece of their business that works," and therefore may feel that entering the natural foods market is "not worth the bother." He sees marketing as a key issue, saying that mass market foods stores may perceive a real problem marketing natural foods as more healthful and wholesome than the other foods they carry, without casting aspersions on their other (mass market) foods. In essence, they may feel that figuring out the correct marketing approach for natural foods is not worth the trouble. Daugherty also pointed out that retailers often have limited shelf and warehouse space and thus can not add more variety to their product mix without eliminating some items already on the shelves. In such a tight market, there is no room for products that may not provide the quality and consistency that mass market supermarkets have come to expect in the items that make up their optimal product mix.

Our experts focused on the retail side of the natural foods market — the market segment that perceived the most barriers.

✦ Bruce Bechtel, Chief Financial Officer for Stahlbush Island Farms, stated that the mass market foods retailers are bound to rate barriers as being more serious than do natural foods retailers because the natural foods market it is an unknown to most of them. The natural foods industry members are "living it" — they are already working with natural foods every day and incorporating these foods into strategic planning processes for their organizations. They are familiar with how to make natural foods work to improve their bottom line. In addition, most mass market foods retailers are simply not set up to communicate with natural foods suppliers. Finally, and perhaps most importantly, in Bechtel's perspective, mass market foods retailers are not familiar with the concept of educating their consumers about food products. He believes that while mass market foods retailers' corporate offices are in support of bringing in more natural foods, most store employees are primarily concerned with "moving 'X' amount of product," not with innovations to their standard product mix.

Survey Findings: Key Obstacles

The following sections analyze the three root problems that we believe to be the most critical to the natural foods market, based on the results of our survey and interviews, and on our research. The discussion covers the disparities revealed in the survey among the eight market segments and between the two market categories (natural foods and mass market foods).

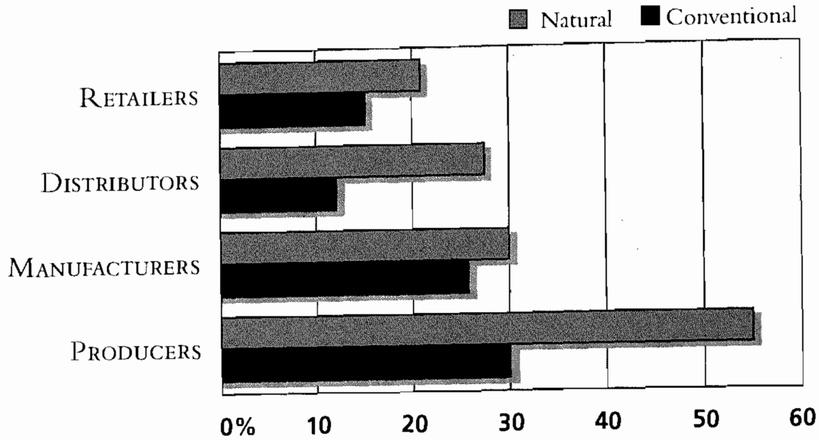
Obstacle One: Lack of Standards

It appears that the lack of standards for natural foods[40] poses major problems in long-term expansion of the industry and possibly to the very success of the market. It also appears that in the natural foods market, setting standards is inextricably linked to labeling. Label claims can be useful indicators of food product quality, including food safety and nutritional value,[41] and consumers have grown accustomed to such labels on their food products and now expect to find them.

A key implication of our findings is that establishing standards for "natural" foods is important to many industry members.

In our survey, the potential obstacles relating to standards for natural foods were rated relatively highly by the survey sample (Fig. 12). Specifically, "Uncertainty about future standards for natural foods" topped the list with a mean of 3.4 on a scale of 1 to 6 (1 being not a barrier and 6 being a major barrier); all segments except mass market foods manufacturers and retailers rated it over 3.0. "Lack of government standards for natural foods" (mean of 2.9) followed closely behind, with natural foods producers and manufacturers rating it as most significant.

Uncertainty About Future Standards for Natural Foods



Lack of Government Standards for Natural Foods

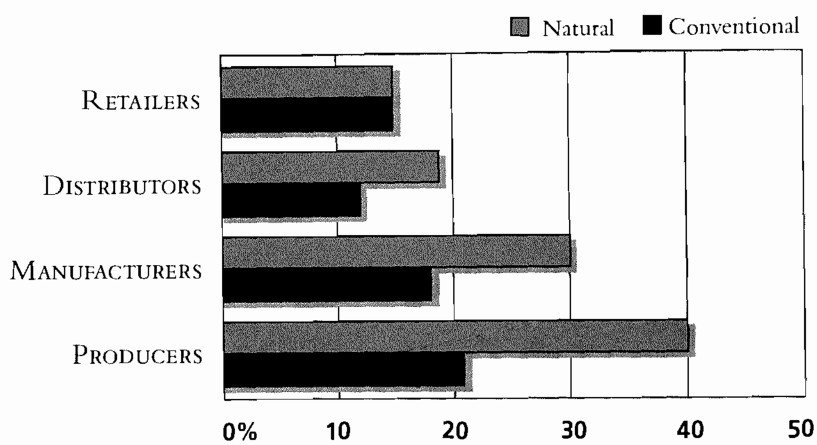


Figure 12. Response to "Uncertainty about future standards for natural foods" and "Lack of government standards for natural foods" (percentages indicate perceptions as a barrier or major barrier).

These findings reveal statistically significant differences in the way that natural and mass market foods producers and retailers perceive "Uncertainty about future standards for natural foods." Natural foods producers rate this as a more serious obstacle than do mass market foods producers, while natural foods retailers do view it as a barrier and mass market foods retailers do not.

In our interviews, Woods pointed out that some mass market industry members may not give much thought to what the standards should be or why they are important. Hence, the lower rating of these potential obstacles by some in the mass market.

Daugherty believes that the need for natural foods standards is obvious. He used organic foods as a case in point. There are 44 separate state and private organic certification organizations. Thus, consumers can not be blamed if they are confused or exhibit a lack of confidence in the consistency of the organic foods on their supermarket shelves. Daugherty argued that national organic standards can help eliminate fraud and work to build consumer confidence in the organic foods market, and

Key Differences Between Mass Market and Natural Foods Industry Members

1. Natural foods producers believe that "gaining new skills, training, financing, equipment and/or processes" is a barrier; mass market foods producers do not.

2. Both mass market and natural foods producers believe that "uncertainty about future standards for natural foods" is a barrier. Natural foods producers think it is more of an obstacle than do mass market foods producers.

3. Natural foods manufacturers think that "lack of government standards" is a barrier, but mass market foods manufacturers do not.

4. Mass market foods distributors believe that "market demand insufficient" poses a major obstacle, while natural foods distributors do not.

5. Natural foods retailers also state that "uncertainty about future standards for natural foods" is a barrier, while mass market foods retailers do not.

6. Mass market foods retailers believe that "linking with natural foods input suppliers" is a barrier; natural foods retailers do not.

7. Mass market foods retailers believe that "pricing and marketing natural foods products" is a barrier, while natural foods retailers do not.

8. Mass market foods retailers say that "difficulty finding natural agricultural producers" is a barrier, while natural foods retailers do not.

9. Mass market foods retailers believe that "difficulty finding natural foods manufacturers" is a barrier, while natural foods retailers do not.

10. Mass market foods retailers think that "market demand insufficient" is a barrier; natural foods retailers do not.

11. Mass market foods retailers believe that "unreliable market quality" is a barrier, while natural foods retailers do not.

NOTE: To be included here, all results had to be statistically significant (less than .100 in a 2-tailed significance test) and pertain to a potential obstacle that at least one of the groups surveyed rated as a barrier (above 3 on a scale of 1 to 6; 1 being "not a barrier" and 6 being "a major barrier").

that the lack of standards for natural non-organic as well as organic foods is as much a problem for the producer as it is for the consumer. Suppliers are wary about making investments in the market without a definition in place, and consumers are nervous about supporting a market when they are not sure of the products they are buying. However if the organic standard-setting process is an indication, it appears consumers and food industry members will be waiting an inordinately long time before seeing a governmental standard for natural foods.

Kinsey divided the survey responses to the question of standards into two main groups: 1) those already succeeding in the market, who do not want new standards that might displace them, and 2) those trying to enter the market, who want standards set before they invest, thus improving their competitiveness with established industry members. Kinsey also noted the importance of consumers who want standards because they wish to make informed decisions.

Gene Kahn, President and CEO of Small Planet Foods, disagreed somewhat with Kinsey's last point. He believes that government standards, although helpful, are not a deciding factor in consumers' decisions at the store level. Providing a high-quality product that is reasonably priced, safe, healthful, and convenient is most important to the consumer. He stated that neither standards nor the lack of standards will factor in consumers' decisions about buying natural foods, and that instead of worrying about this issue, natural foods industry members should be preparing for the challenge of fulfilling market demands. "To consumers," he points out, "it's just lunch."

Bechtel believes that the lack of standards is not a true market obstacle. Rather it is simply a complicating issue for industry members, who perceive the standards themselves as the real market barrier. He stated that large businesses considering entry into the natural foods market fear that the products they decide to carry will not fit under the standards for "natural." In Bechtel's view, truth-in-labeling laws will address these issues sufficiently.

Michael Dunn, USDA Undersecretary for Marketing and Regulatory Programs, said that setting the organic standards was the primary goal of USDA regarding the natural foods market. The Department has not yet started considering standards for any other category of natural foods. He said that the organic standards will provide a basis for differentiation and that a "critical mass" of interested people is needed before there will be any other standards. Dunn believes that producers will perceive the need for government standards more clearly than other market groups because they see the effects of government regulations every day as they compete with other producers. He views the role of USDA's Agriculture Marketing Service as one of assuring uniformity with national organic standards and thinks a public education campaign with a program and a shield (similar to the "Grade A" USDA shield for eggs) is necessary to make the organic effort successful.

CONCLUSIONS

We conclude from the survey and interview results that while standards do not seem to pose a threat to market growth now, in the long run the lack of a standard definition for "natural" foods, whether carrying an organic label, ecolabel, or "all natural" label, will be a limiting factor. Confusion about the meaning of "natural" foods may well override consumer interest in natural foods products.

If there are no regulations for labels that natural foods suppliers use to define, advertise, and promote their products, then natural foods labels could become worthless if consumers eventually lose faith in natural foods products. The market may well suffer if consumers do not understand what they are being asked to purchase or do not believe natural foods marketing claims. Lack of labeling regulation leaves the market vulnerable to fraud, the discovery of which lowers consumers' trust even more.

Our findings show, however, that at least some members of the natural foods industry are wary of the burden of additional standards. USDA, which would be primarily responsible for setting government standards for natural foods, is currently not interested in creating such standards.

The Wallace Institute believes that moving from the current state of inaction to ensuring a lasting, profitable market does not have to be a painful process. Instead, it has the potential to build ties among the public, private, and non-governmental organization sectors — all to the final benefit of consumers. Indeed, we contend that a cooperative effort on the part of all of these sectors is absolutely critical in ensuring that standards are established.

The needed expertise for establishing optimal standards exists in industry, government, and research institutions. Over the short term, a group of experts can identify key factors necessary to prepare industry members for a more standardized environment. Over the long term, the group may create a set of standards or separate sets of standards for various categories of natural foods, either via government or third party certification, and either voluntary or compulsory, to ensure that the natural foods market is growing for the good of industry, natural foods consumers, and the public at large.

Obstacle Two: Different Views and Approaches

In the preceding discussion, we noted that the primary differences of opinion about a lack of standards for natural foods were among the various segments of the food industry — natural and mass market foods producers and manufacturers and mass market foods retailers were more concerned than were natural and mass market foods distributors and natural foods retailers.

In contrast, responses to questions about linking the natural foods and mass foods markets at the firm level indicated a large disparity between the two categories. That is, members of the natural foods industry showed considerably less concern over this issue than did members of the mass market foods industry.

We believe that one important barrier to the natural foods market is based in different standard operating procedures used by natural foods companies and mass market companies.

We hypothesize that the schism over linking the two markets arises from very different perceptions about the natural foods market. Consider the responses by category to one of our two "perception" barriers — "Insufficient market *demand*." Mass market foods producers, distributors, and retailers told us this is a major barrier, while their natural foods counterparts did not see it as a significant barrier at all (Fig. 13). To the contrary, natural foods distributors cited "Insufficient market *supply*" as one of the 3 most significant of all 20 potential barriers listed (Fig. 14).

Insufficient Market Demand for Natural Foods

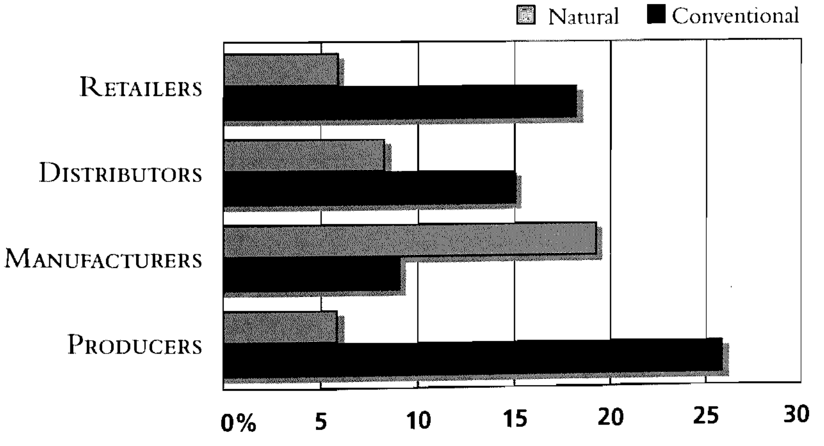


Figure 13. Response to "Insufficient market demand" (percentages indicate perceptions as a barrier or major barrier).

Insufficient Market Supply for Natural Foods

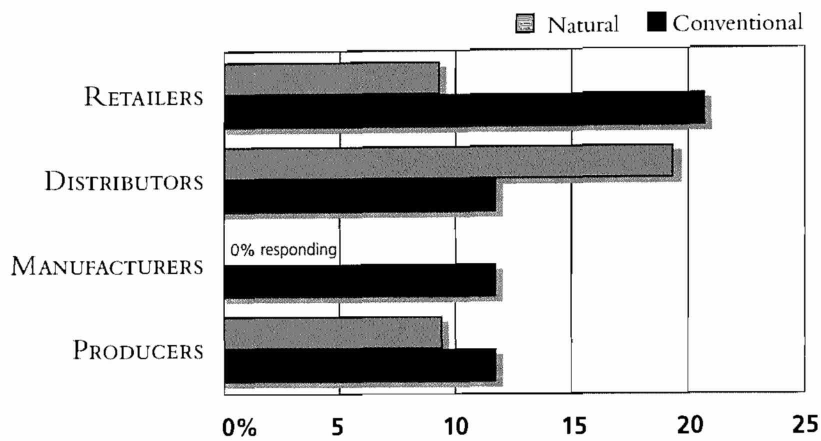


Figure 14. Response to "Insufficient market supply" (percentages indicate perceptions as a barrier or major barrier).

It may be that concrete barriers at the firm level grow from, or are at least exacerbated by, this fundamental gap in perceptions at the industry level. This translates into resistance to changing the day-to-day standard operating procedures that are known to all at the store level and that are viewed by store employees as normal and successful.

What does this mean? For one, it means that many in the mass market foods industry find it difficult even to know where to begin locating those in the natural foods industry who can help them enter the natural foods market. Finding natural foods producers was considered a serious obstacle by mass market foods retailers, while natural foods retailers said it was not a barrier at all (Fig. 15). The same held true for finding natural foods manufacturers as compared to finding mass market foods manufacturers (Fig. 16).

Difficulty Finding Natural Foods Producers

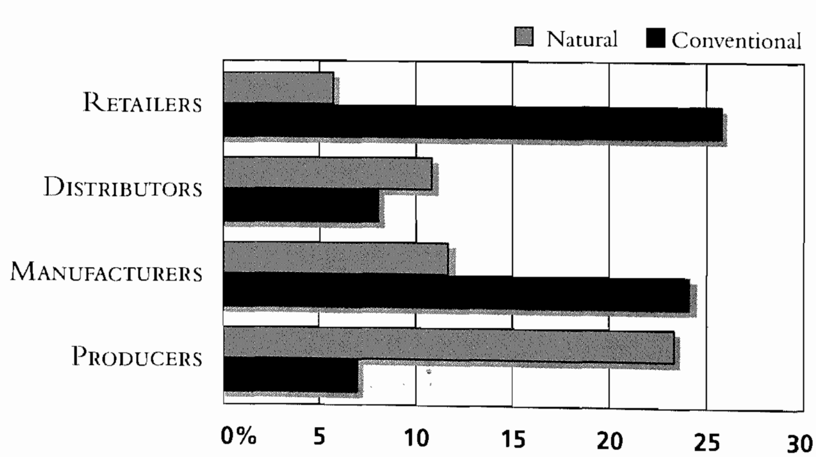


Figure 15. Response to "Difficulty finding natural foods producers" (percentages indicate perceptions as a barrier or major barrier).

Difficulty Finding Natural Foods Manufacturers

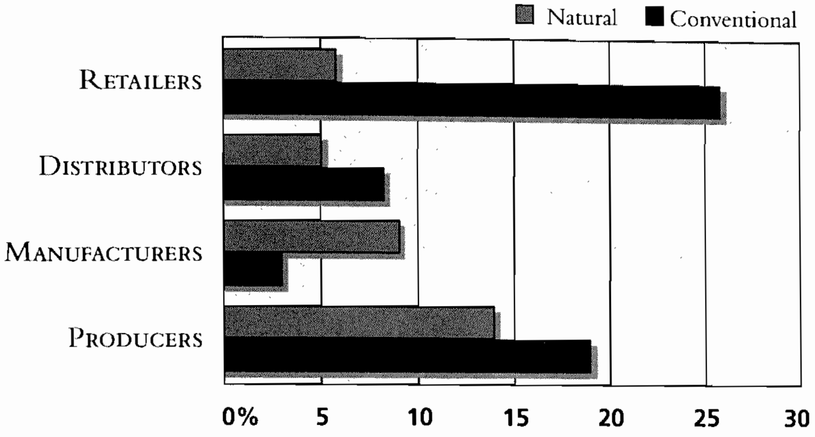


Figure 16. Response to "Difficulty finding natural foods manufacturers" (percentages indicate perceptions as a barrier or major barrier).

A closely related obstacle is linking with natural foods input suppliers. Mass market foods industry members, particularly retailers, believe this is a major barrier, while natural foods retailers feel it is not a barrier at all (Fig. 17).

Linking With Natural Foods Input Suppliers

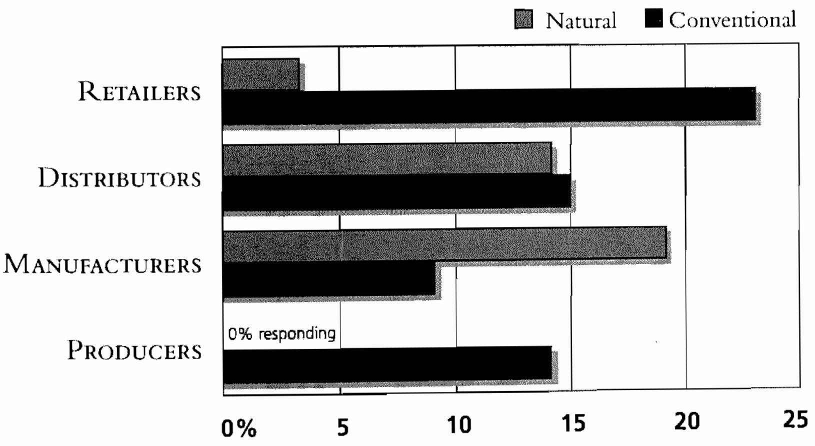


Figure 17. Response to "Linking with natural foods input suppliers" (percentages indicate perceptions as a barrier or major barrier).

It also means that the mass market foods industry has trouble knowing how to integrate new natural foods ventures into existing operations (Fig. 18). In particular, mass market foods distributors see this as a major problem because they have tightly controlled ordering, warehousing, and delivery systems. Integrating natural foods would necessitate changes in these systems. Natural foods distributors do not face this dilemma.

Integrating New Natural Foods Ventures Into Existing Operations

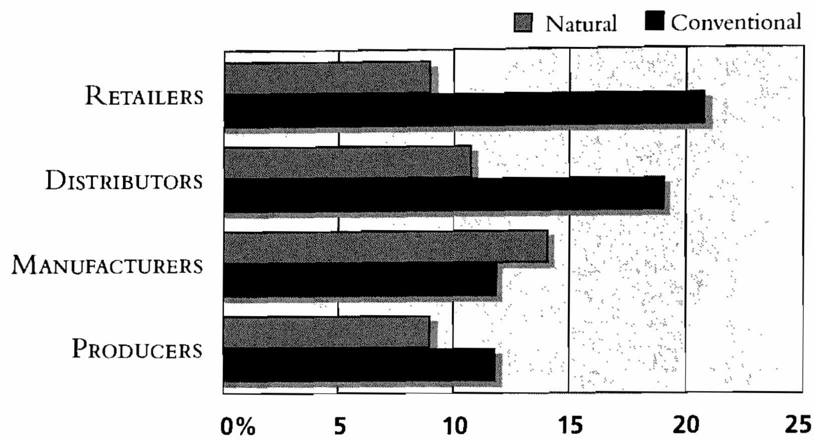


Figure 18. Response to "Integrating new natural foods ventures into existing operations" (percentages indicate perceptions as a barrier or major barrier).

These responses indicate clear differences in the "organizational cultures" of natural and mass market foods businesses; that is, in the way these businesses define themselves and the manner in which they respond to the market through their standard operating procedures.[42] The rules and regulations that establish their stability and routines are not the same. Note, for example, the responses from natural and mass market foods distributors to questions on our survey about daily business operations (Table 3).

Table 3. **Percent of natural foods and mass market foods distribution companies using Efficient Consumer Response (ECR) techniques**

	Category Management	Electronic Data Interchange	Activity-Based Costing	Continuous Replenishment
Natural foods distributors	16%	5%	16%	5%
Mass market foods distributors	27%	23%	23%	15%

NOTE: ECR is an umbrella term used by the food industry for a variety of business strategies.

Thus, mass market and natural foods businesses appear to be separated by more than just the percentage of food they sell with an organic label, ecolabel, or "all natural" label. They have developed and continue to exist in different business environments. For example, consumers want natural foods at reasonable prices. Our survey indicates that many retailers have attempted to meet this demand, but they are having problems locating the natural foods suppliers (raw and processed) who can get them the products they need in the amounts they need.

It seems that growth in demand for natural foods at the retail level has not led to development of a mechanism that allows mass market foods retailers to inform natural foods suppliers further down the market channel of their needs.

While no generic market mechanism exists, several of the experts we interviewed pointed out that some natural foods businesses (for example, Horizon Dairy and Cascadian Farms) have been successful in forming such links independently. Both Kahn and Bechtel said they are working to establish ties with mass market agricultural producers. They believe that a steady income from contracts for organic and natural food products will be the incentive producers need to change the way they grow food, and both pointed to the success they have had in this arena.

Dunn, however, believes widespread success will come only when standard operating procedures for communication, food distribution, and similar activities are changed. He pointed to obstacles that are built into the heart of the approximately $80 billion infrastructure that supports food distribution in this country, as an example. The industry standard calls for 108-car trains to carry grain to U.S. terminal markets, but for organic products the need is for trains with far fewer cars. The infrastructure is simply not built to accommodate this need. Similar obstacles are built into processing plant contracts and other aspects of infrastructure systems.

Dunn argued that market infrastructure for organic and natural foods needs to be generic, not company specific, and also that these infrastructure issues must be closely examined to expose communication- and distribution-level voids. Filling those voids will help natural foods industry members create strong, accessible, generic market channels.

CONCLUSIONS

The survey and interview results suggest that generic market channels, and rules and regulations for their operation, are as necessary for natural foods as they are for mass market foods. In the end, both markets may use the same trains, trucks, boats, market report Web pages, and newsletters. But there are currently no standard operating procedures in place to facilitate the movement of natural foods into the mainstream channels, despite the increasing demand for natural foods products.

For example, supermarkets' responses to our survey questions about integrating new natural foods ventures into their existing operations and linking with natural foods suppliers show that they can not find a sufficient supply of natural foods products. Producers' answers show that they can not locate enough supermarket outlets to sell their natural foods products. This disjoint between the two ends of the market channel indicates that there may be prohibitively high "transaction" costs keeping the two segments of the market from communicating their needs to one another.

Generic market channels that natural foods industry members can use with the same ease as do mass market foods industry members should lower the costs for businesses already in the natural foods market and start-up costs for those wishing to enter the market. Reduced costs should result from standardization of communication and transportation procedures and through common solutions to common problems, such as waste disposal and overstock distribution.

There are also indications that some standard operating procedures cause problems for segments of both the natural foods and mass foods markets. Conventional and natural foods retailers say that "Gaining new skills, training, financing, equipment, and processes" is a major obstacle (Fig. 19). So do natural foods producers, but not mass market foods producers. We speculate that the difference in responses from natural and mass market foods producers stems in part from the built-in bias against natural foods producers in many USDA programs. The Organic Farming Research Foundation reports that in 1995, only $1.5 million — less than one-tenth of one percent of USDA's annual research and education budget — was spent on projects linked to organic agriculture.[43]

Gaining New Skills, Training, Financing, Equipment, and Processes for Natural Foods

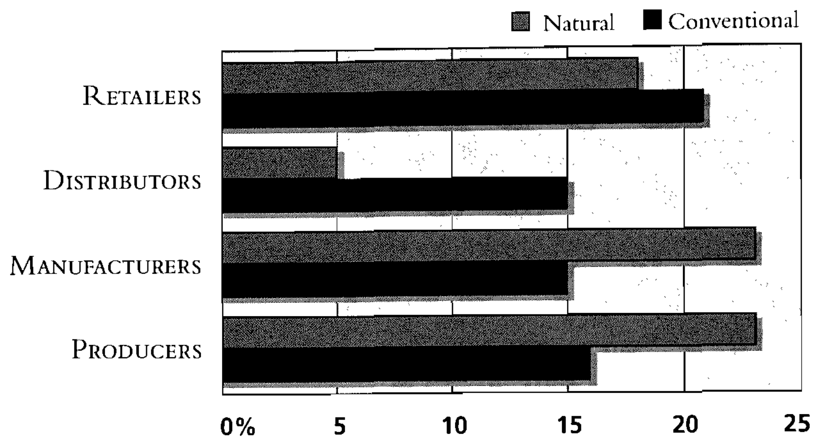


Figure 19. Response to "Gaining new skills, training, financing, equipment, and processes" (percentages indicate perceptions as a barrier or major barrier).

In addition, our survey shows that allocating staff time to natural foods rated as an obstacle for both natural foods and mass market foods retailers (Fig. 20). This may stem from the practice of carrying mass market and natural versions of so many consumer items in stores. As noted in the 1997 FMI report *The Food Marketing Industry Speaks*,[44] 63% of supermarket retailers stated that recruiting staff had become either "somewhat more difficult" or "much more difficult" over the preceding year. Supermarket employee turnover is high, as are training costs. The addition of natural foods in a conventional retail supermarket adds complexity in most areas of employee training, including customer service, sales techniques, product knowledge, technical skills, and check stand procedures.

Allocating Staff Time for Natural Foods

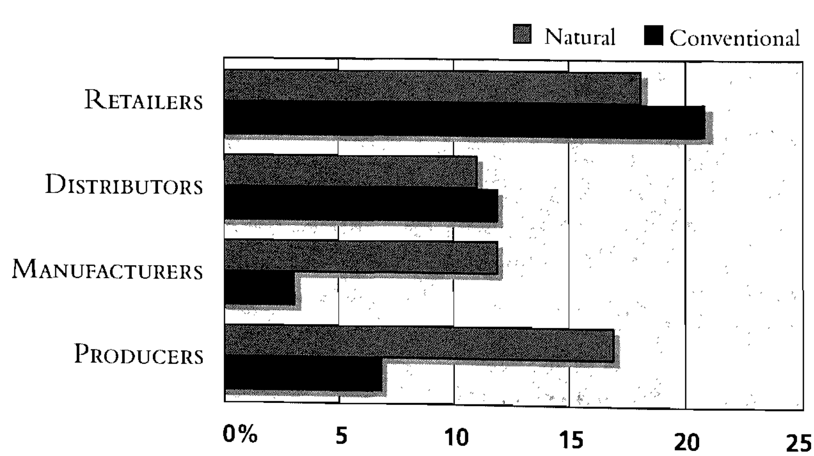


Figure 20. Response to "Allocating staff time" (percentages indicate perceptions as a barrier or major barrier).

Obstacle Three: The Marketing and Pricing Dilemma

In our survey, "Pricing and marketing natural foods" was rated as one of the most serious obstacles facing the natural foods market. On average, 20% of the respondents rated this issue as a "major barrier" (Fig. 21). The percentage was even higher for mass market foods producers and retailers.

Pricing and Marketing Natural Foods

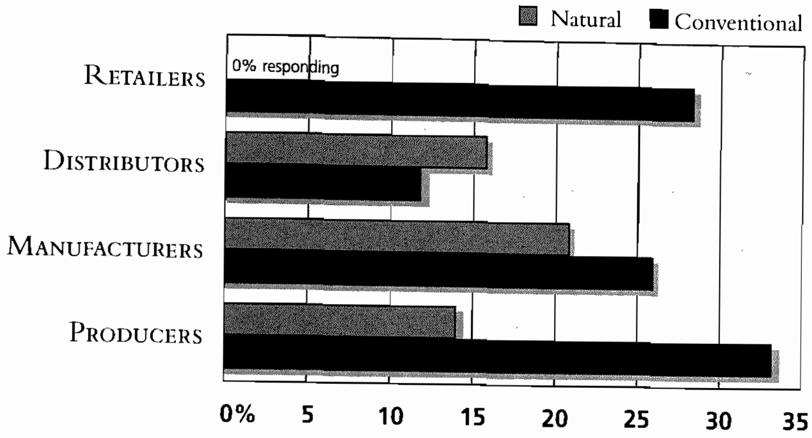


Figure 21. Responses to "Pricing and marketing natural foods" (percentages indicate perceptions as barriers or major barriers).

Responses to this issue indicate another significant difference between natural and mass market foods retailers. Specifically, mass market foods retailers believe it is a barrier, while natural foods retailers do not.

In our interviews, Woods said that mass market foods producers interested in growing organic food face a major obstacle. Whether selling raw inputs or value-added items, they have few ways to gather information about where their products fit in the range of prices for like products. Organic and sustainably grown foods are not tracked by USDA in the same manner as mass market foods. Thus market participants who are producing and selling organic or sustainably grown foods do not have a consistent, affordable source of pricing information. Dunn noted that USDA is interested in what the organic and natural foods markets are doing, but that those markets are not large enough to warrant USDA measurement.

Kinsey and Daugherty both indicated that pricing is related to two main issues. First, organic and sustainably grown foods are generally more expensive to grow. Producers of these foods do not use synthetic chemical fertilizers, pesticides, or herbicides, and crop damage rates may therefore exceed damage rates on mass market foods farms and increase per-unit output costs.[45] Damage rates can be particularly high in appearance-sensitive crops such as fruits and vegetables. Second, because of these higher production costs and sometimes because of a "pricing opportunity," natural foods are often sold at higher retail prices than mass market foods. It appears, then, that even if producers control production costs, consumers may still pay more. While many consumers say they are willing to do that, significantly fewer decide to pay a premium when they are actually at the retail outlet. This translates into decisions by mass market foods retailers to carry a very limited selection of natural food products.

Bechtel, as the head of a sustainable produce operation, explained how Stahlbush Island Farms decided upon prices for its value-added products (fresh-frozen fruits and vegetables). First, they figured out their costs. Second, they visited several grocery stores over time and compared the costs of different frozen produce brands. Finally, they priced their product within the price range of similar products.

Bechtel sees pricing as a problem for retailers as well as producers. As a producer, he needs to keep his costs and prices low, but they can not be as low as mass market foods products because of production costs and the need to obtain a competitive return on investment. He believes it is difficult for mass market foods retailers to explain to their customers why organic and sustainable products often cost more than their mass market foods counterparts.

Promotion and advertising for natural foods was viewed by all of our experts as an obstacle for industry members. Retailers are used to manufacturer incentives to stock and promote products. But there are few natural foods manufacturers that provide marketing assistance as an incentive for retailers. Kinsey sees this as the major marketing-related barrier for natural foods businesses.

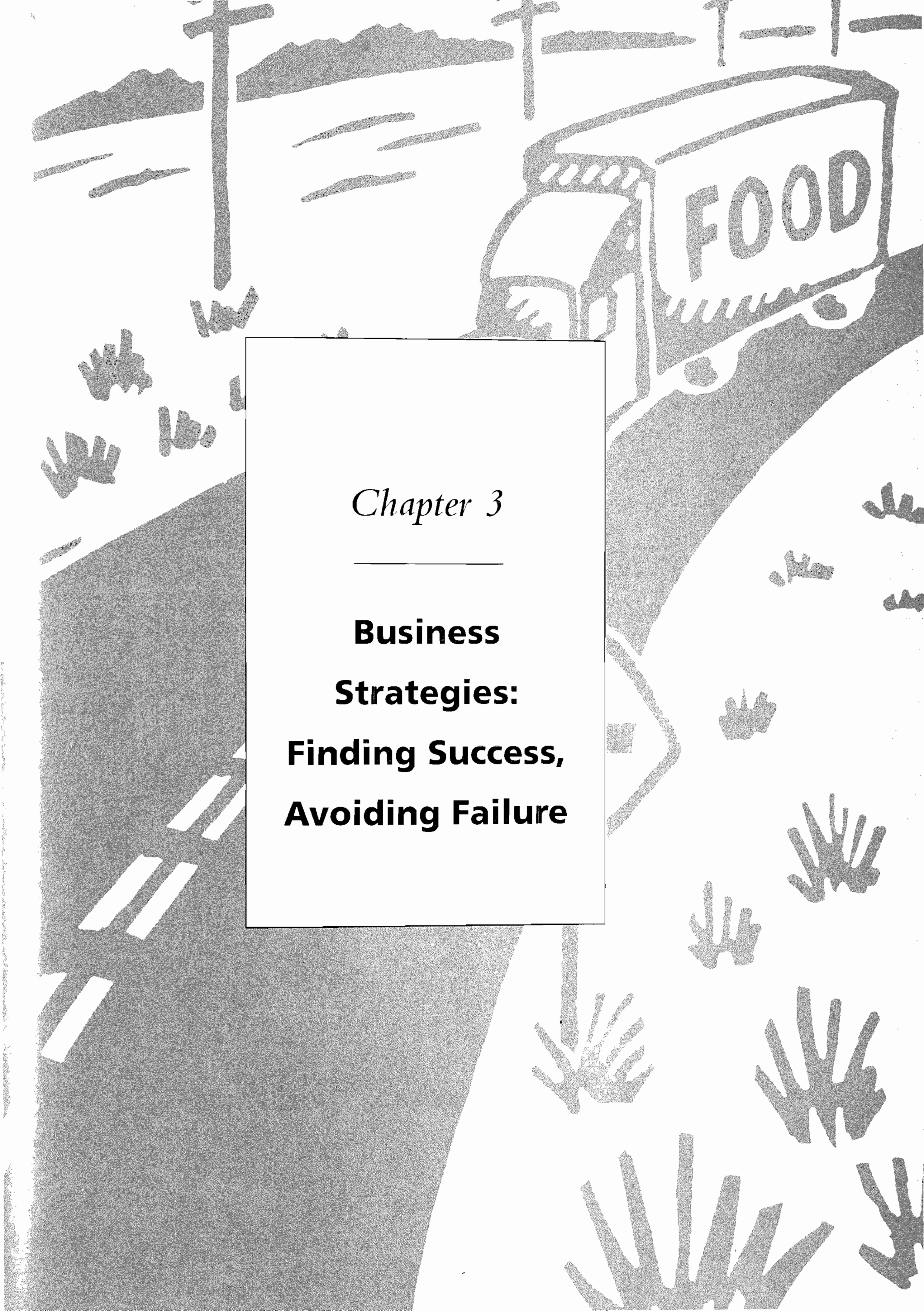
According to natural foods industry sources, natural foods suppliers are generally small and capital-poor, lacking the market savvy and finances to research, advertise, and promote a product. Retailers want sophisticated promotions, but buyers from grocery stores often lack the time or the interest to "teach" a new natural foods supplier how to get its products into stores. And natural foods suppliers have shown an aversion to paying the shelving fees that mass market foods suppliers are more willing to accept.

Bechtel pointed out that marketing non-organic natural foods (for example, those that are pesticide free or sustainably grown) with different labels may confuse consumers who are not familiar with these concepts. He also noted that lack of experience in marketing and advertising, lack of a well-recognized brand name, and limited resources to identify potential markets and consumers make the process of marketing natural foods unattractive, even intimidating, for most industry members, whether they are in the mass foods market or natural foods market.

CONCLUSIONS

Our survey and interviews strongly suggest that the marketing of natural foods, including the important element of pricing, is still a mystery to most in the food industry. Some, and possibly many, natural foods businesses lack the information, expertise, or capital — perhaps all three — to market their products to maximum advantage. It also appears that mass market foods businesses often fail to understand the critical differences between marketing natural foods and mass market foods, or are choosing not to invest the time and capital necessary to do this job properly. Such decisions may suffer from lack of the information that, if available, might lead these businesses to invest in natural foods products.

The Wallace Institute concludes that government, food trade organizations, researchers, and food industry companies can and must work in concert to eliminate the underlying causes of the obstacles associated with marketing and pricing natural foods. First and foremost it is necessary to open up communication channels between these segments, which will enable a wide ranging exchange of information.



Chapter 3

Business Strategies: Finding Success, Avoiding Failure

Chapter 3:
Business Strategies: Finding Success, Avoiding Failure

Our survey and interviews included questions related to business strategies and whether or not they are working. We found that some strategies employed by both natural foods and mass market foods companies are leading to success in the natural foods market, while other decisions have produced less than desirable results.

In this chapter, we discuss successes and disappointments, with the help of results from our survey and opinions of the experts. We asked all survey respondents if they had employed any of 11 business strategies typically found in the food industry. If the answer was "yes," the participants were then asked to rate the strategy(ies) as to effectiveness on a scale of 1 (no success) to 6 (total success).

Business Strategies

The Wallace Institute asked survey respondents if they employed the following strategies:

1. **Developed a natural foods label**
2. **Distributed newspaper/direct mail advertising**
3. **Provided in-store advertising/demonstrations/samples**
4. **Sold a unique product**
5. **Sold a high-quality product**
6. **Diversified natural foods offerings**
7. **Targeted a specific market**
8. **Contracted with sellers/buyers**
9. **Joined a cooperative/limited partnership**
10. **Hired special staff for natural foods**
11. **Increased scale of natural foods operation**

Survey Findings

In analyzing the results of this section of the survey, we determined a strategy was successful if the majority of respondents who tried it reported success or total success. We focus here on successful strategies that are underutilized by industry members.

In relation to successful endeavors, our survey indicated the following:

- **Few natural foods retailers and mass market foods manufacturers and distributors have "developed a natural foods label," but many of those who have, have succeeded.**

✦ **While few mass market foods retailers "hired special staff for natural foods," most of those who did found that this strategy worked.**

✦ **Few mass market foods producers "increased the scale of their natural foods operations," but those who did were mostly pleased with the results.**

Decisions that were less successful include:

✦ **While quite a few natural foods producers and manufacturers use "newspaper/direct advertising" to promote their products, many feel this strategy is not productive.**

✦ **Almost half of mass market foods retailers surveyed have diversified and increased the scale of their natural foods products, but less than one-fifth feel they have been successful.**

In the following sections of this chapter, we discuss these findings and present the observations of our expert panel. Note that a "successful" strategy will not always work, and an "unsuccessful" strategy is not one that should always be avoided. This discussion points out pitfalls to be avoided so that the strategies may prove more successful.

Creating Natural Foods Labels

We turn first to natural foods labels, a strategy that, not surprisingly, has been most popular with natural foods manufacturers and to a lesser degree with natural foods distributors (Fig. 22). Although few conventional foods manufacturers (29% of those in the survey) tried this strategy, 70% of those who did deemed it successful or totally successful.

Developing a Natural Foods Label

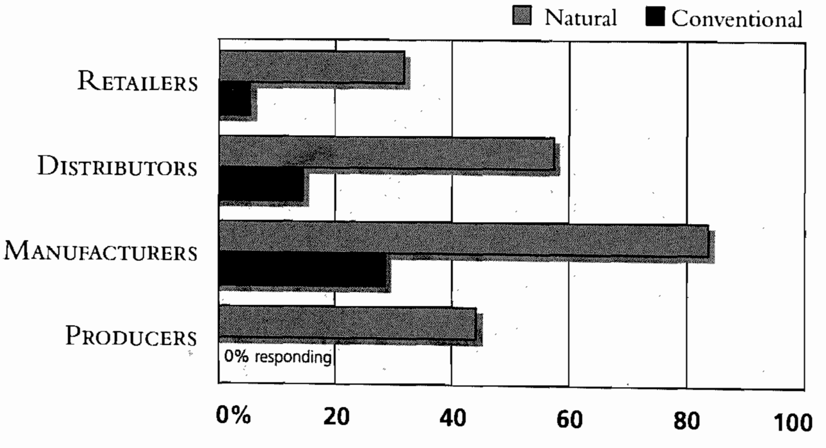


Figure 22. Percent of respondents who "Developed a natural foods label."

Although only 29% of mass market food manufacturers surveyed tried developing a natural foods label, 70% who did were successful.

Our experts had a lot to say about this subject. Woods was not surprised to see a high success rate for mass market foods manufacturers who use natural foods labels. She noted that these manufacturers will not even consider entering a market with a new product unless they have done a lot of research. Once they decide to produce a new item, they have the power to "push" and "pull" distribution through advertising and promotions.

Bechtel believes that more mass market foods manufacturers have not developed natural foods labels because they lack experience in marketing natural foods products and therefore do not have a good understanding of the difference between marketing conventional foods and natural foods. Those who tried it and were successful, he surmised, did so in part because they are large enough to drive down prices.

Daugherty believes well-recognized brand names, marketing research, and strong new product launching efforts are of primary importance. He noted ConAgra, with its "Healthy Choice" brand, as an example of a company that entered the health foods field early and put the necessary resources behind its product line. It is essential to have good quality as well, he pointed out, because products with fewer potential customers absolutely need to gain the support of repeat customers.

Kinsey summarized the keys to starting and sustaining a successful natural foods label as follows: bring it in to the right place, at the right time, with the right target audience, and with no strong competition.

All of our survey respondents indicated that there must be safeguards to ensure the accuracy of natural foods labels. Woods stated that something must be done to assure truthfulness for consumers, at the store level. She believes that national standards will eventually be set, as is occurring with organic foods, but that the process for developing those standards should follow evolutionary stages. Kinsey said that natural foods labels must adhere to truth-in-labeling laws and to all labeling and nutrition regulations now in place, while Daugherty argued for clearly defined labeling standards.

Woods and Bechtel each raised the issue of private-label natural foods products. Woods believes that private labeling has been very successful, and Bechtel notes that the Whole Foods private label, called the "365" brand, meets with success because Whole Foods customers are very loyal. It is entirely possible that natural foods retailers in our survey obtained positive results from their labeling efforts because of such loyalty and consumer confidence in the ability of the stores to provide high-quality products.

Dunn believes, in relation to organic foods, that consumer understanding of the organic certification process and the national organic label will advance the organic foods market. He focused on USDA's recent experience with the public concerning the Proposed Rule for the National Organic Program. More than 280,000 responses were received, far above the number of responses for any other USDA agriculture-related public comment period. That, he said, shows organic foods are very significant in the public mind.

Hiring Special Staff for Natural Foods

Our survey showed that many natural foods industry members hire special staff for their products, while few in the mass market foods industry have done so (Fig. 23). Note that although only 13% of our mass market foods retailers tried this strategy, 60% of those who did said they had a success.

Hiring Special Staff for Natural Foods

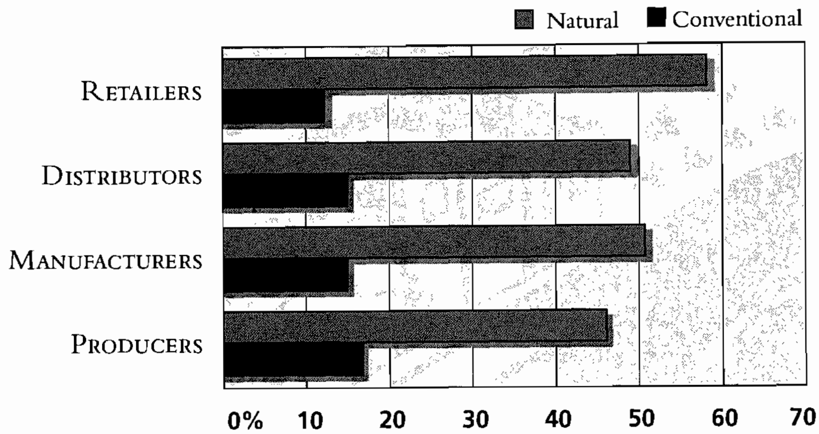


Figure 23. Percent of respondents who "Hired special staff for natural foods."

Why don't more conventional retailers employ this strategy? Why do those who have done so feel it is successful? Our experts believe the answers may lie in a combination of attitude, commitment, and simple economics.

Just 13% of mass market retailers hired special staff for natural foods, but 60% of them felt it was a good business decision.

Woods surmised that the decision as to whether special staff is worthwhile for a conventional retailer rests with the commitment that retailer has made to natural foods. Retail outlets that carry a comprehensive natural foods selection are more likely to justify hiring special staff for their natural foods.

Kinsey observed that labor is one of the highest costs at any retail supermarket and that supermarket decision-makers will not hire special staff for natural foods unless they are convinced that consumers want natural foods and need specialized staff. In fact, Kinsey said, sales per labor hour and sales per square foot are two of the most important measures used in determining whether or not to make changes in standard operating procedures. Supermarkets work on high volume and slim margins — mistakes can be very costly.

Daugherty also sees the survey responses to this issue as primarily related to resources. Mass market foods retailers generally do not view natural foods as the core of their operations. They need convincing proof of a positive impact at the front end of the store before making a commitment to hiring special staff. Like Kinsey, he pointed out that there is a significant risk when businesses make a sizable investment in something new or unusual.

Bechtel views this issue from the standpoint of an agricultural economist as well as an agricultural producer. While understanding the economic issues involved in the supermarket decision-making process, he emphasized that conventional foods retailers do not have experience in selling organic and other natural foods. These foods, he says, have to be sold differently from other foods because some of the attributes that add to their worth for consumers require additional education. Limited backing from corporate headquarters, he guesses, may have something to do with store-level hesitance in making a substantial commitment to natural foods. He concludes that if conventional foods retailers do not follow up with consumer education, their initial commitments to natural foods may well fail despite great potential for consumer interest.

Kahn agrees in that he believes cost is the main barrier to the natural foods market, and it is crucial to communicate accurately what makes natural foods cost more. In addition, he argues that safety and health issues are very important to consumers, and facts about these issues must also be communicated to consumers if the natural foods market is to succeed.

Increasing and Diversifying Natural Foods Operations

We found that all four segments of the natural foods industry responding to our survey have increased the scale of their natural foods operations: 81% of manufacturers, 66% of producers, 65% of distributors, and 64% of retailers (Fig. 24). Only 23% of conventional foods producers followed suit, but 60% of those who did were satisfied with the results.

In addition, almost half of the mass market foods retailers participating in our survey diversified (49%) and increased (49%) their natural foods offerings (Fig. 25), but fewer than 20% claimed success. To compare, the vast majority of natural foods retailers noted that their attempts to diversify and increase their natural foods offerings were successful (60% and 76%, respectively; Fig. 25).

Increasing Scale of Natural Foods Operations

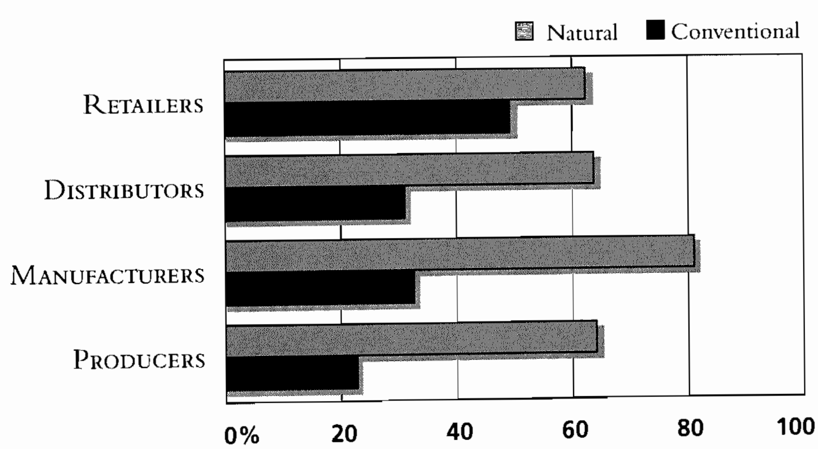


Figure 24. Percent of respondents who "Increased scale of natural foods operations."

Diversifying Natural Foods Operations

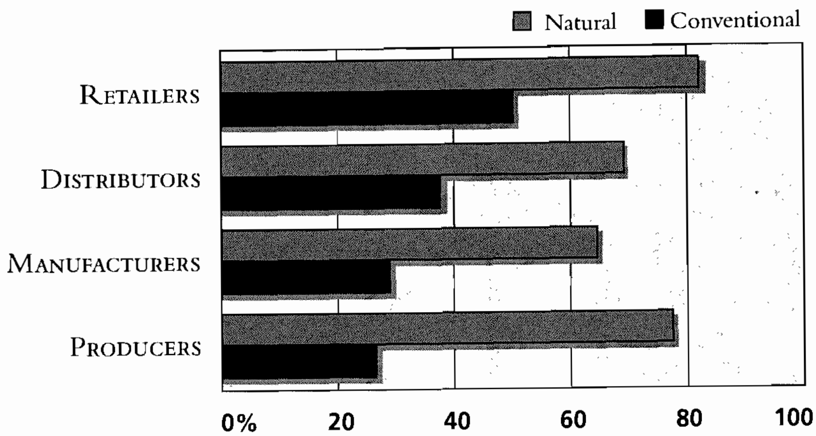


Figure 25. Percent of respondents who "Diversified natural foods operations."

As Chief Financial Officer for a sustainable organic producer, Bechtel brought a first-hand perspective to this finding. He initially argued that it is very difficult to change producers' minds about anything. He pointed out that the average age of farmers today is over 50 years. They have worked the land for a long time, using the same methods, and are very comfortable in sticking with their standard operating procedures. They are also a risk-averse population — change does not come easily to them.

Many believe that it is impossible for farmers and ranchers to change. Our survey shows that 23% of conventional agricultural producers increased the scale of their natural food operations — and 60% of those who tried believe the strategy was a success.

Upon second thought, Bechtel drew on his personal experience, noting that he has done a fair share of trying to convince older farmers that they should grow food using organic or sustainable production methods. In working with conventional foods producers to create more sustainable and organic production capacity, he says it is important to offer the right amount of money and the right amount of security. Conventional foods producers are generally interested in changing their production methods only if they can be guaranteed significantly higher prices and a long-term commitment in the form of a multi-year contract.

Woods concurs that it is difficult to get conventional foods producers to change their production methods. She believes that this is largely because they are quite removed from the consumers who are demanding more organic and sustainably produced foods and that a compelling message is needed to help conventional foods producers understand that "organic" is no longer a negative concept. By getting accurate information about the short- and long-term profitability of the organic foods market to producers, she adds, many can be convinced to change.

Kinsey also feels that producers are not getting the market information they need to make informed decisions about production methods, but she believes this is because the majority of them employ farming methods that result in a satisfactory income. Thus they have no inclination to make costly investments in changing their entire mode of operation to organic or sustainable production.

Daugherty said that the small number of producers growing organic foods or practicing sustainable agriculture is basically the result of supply and demand. He sees producers as having too few outlets to sell the amount of organic or sustainably grown foods that they could grow. Over the years, he points out, a small group of growers has developed to supply that market, many for ideological reasons. The rest of the agricultural producers will not change unless the market leads them to change. Most producers, he posited, simply do not have the business acumen necessary to "push" the market along. Instead, they want to be "pulled" by the market.

Kahn mentioned that driving down his own costs was paramount in his operations. He cited the environmental externalities[46] involved in agricultural production, which are not accounted for in the price of conventionally grown foods. However, he does not believe that these environmental costs can be convincingly conveyed to consumers who are asked to pay more for natural foods. He says that the organic industry needs to drive its prices down without losing on-farm profitability and that natural foods industry members need to enlarge their markets and reduce their costs. Lower on-farm costs are essential, but it will take considerable research to accomplish this. Kahn has an in-house staff of scientists who provide research and educational support for his growers.

Scale is a key issue here. Small and medium-sized farms face pressure to reduce the price requirements that allow them to stay in business. Kahn believes that these farms should be working with large natural foods manufacturers and retailers, not rallying against them. In so doing, he believes that they can thrive, while reducing the threat from agricultural conglomerates, such as ConAgra and ADM, which, he believes, may soon decide to enter into organic and sustainable food production. Kahn also stated that organic agriculture is following the industrial model and that regional, small-scale models may well lose their farms to large-scale operations unless they change. If they do not, the takeover would be detrimental to the environmental and social aspects of sustainable food systems.

Using Newspaper and Direct Advertising

Distributing a newspaper advertisement or conducting direct advertising was attempted by one-half or more of natural foods producers (51%), manufacturers (51%), and retailers (73%) who responded to our survey (Fig. 26). Fifty percent of these retailers reported that they experienced success or total success, but few producers (33%) and manufacturers (14%) fared that well. It appears that for natural foods producers and manufacturers, this popular business strategy — which may represent an untapped opportunity — is currently a major trouble spot.

The popular business strategy of using newspapers and direct advertising to sell natural foods is currently a major trouble spot for natural foods producers and manufacturers.

Using Newspapers/Direct Advertising

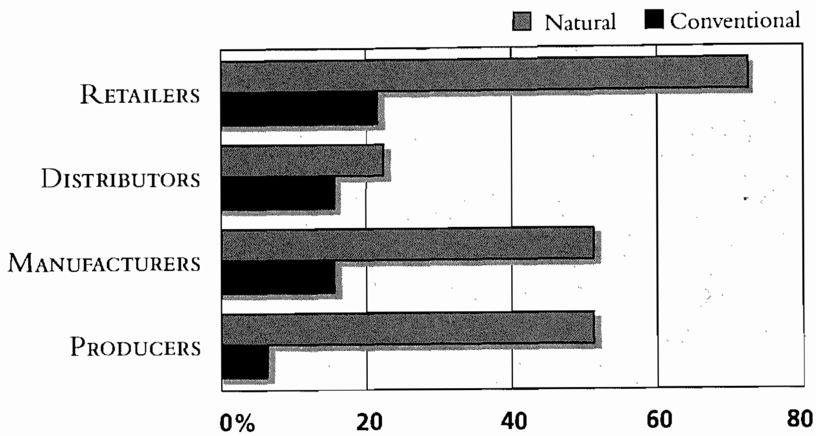


Figure 26. Percent of respondents who used "Newspapers/direct advertising."

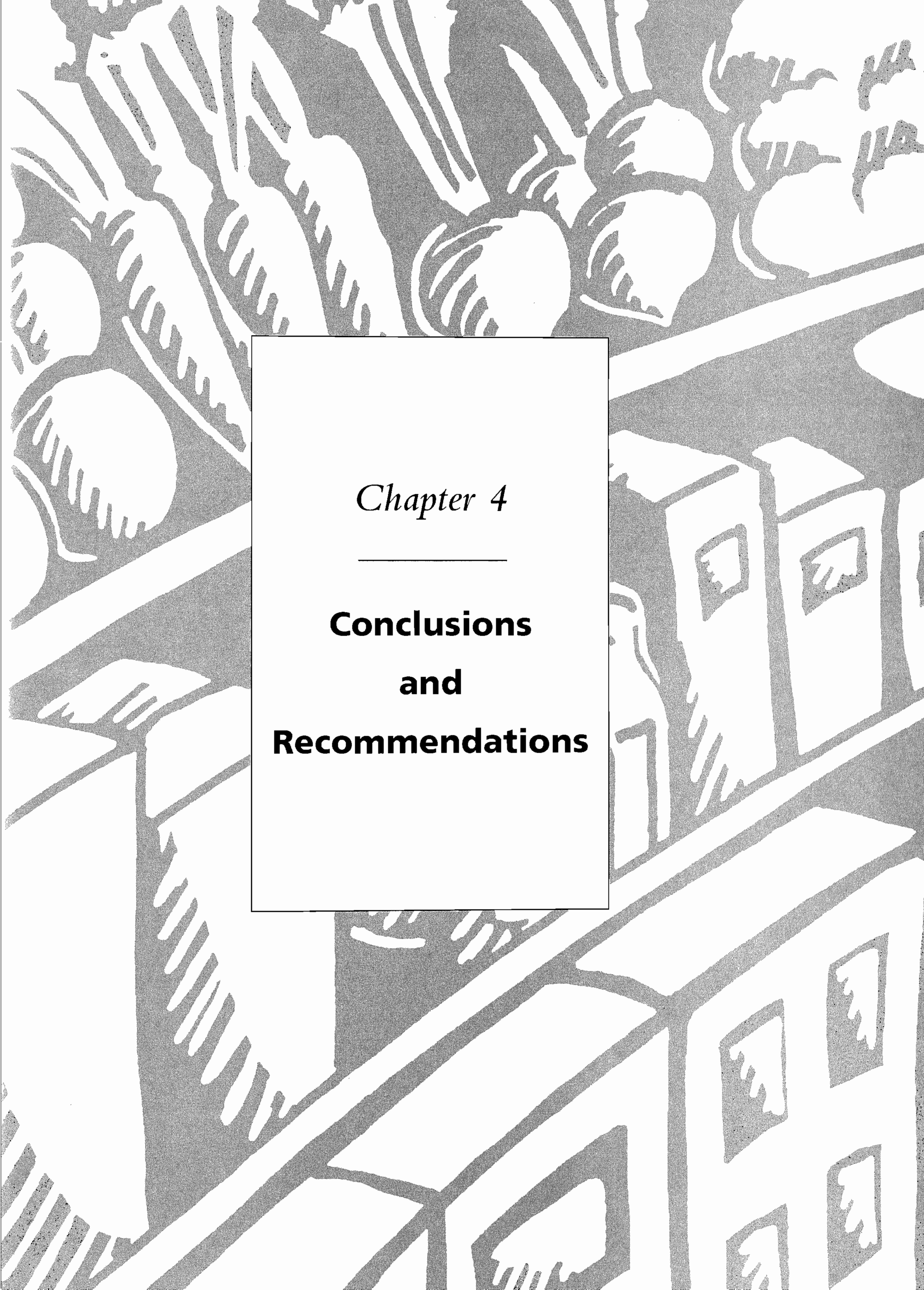
Our experts had several explanations for these findings. Bechtel believes that there is a lack of understanding about how to sell natural foods products. Businesses have to put more effort into understanding natural foods products and the consumers who buy them, in order to succeed. Working to define the basic attributes of natural foods that consumers are most interested in is a critical step in developing a newspaper advertising or direct advertising program that really works.

Daugherty postulates that the consuming public is confused by natural foods because there are simply too many products touting too many attributes. The public is not "linked into" the benefits of natural foods enough to care about buying these foods. He added that natural foods compete with mass market foods for shelf space in retail outlets.

Woods sees this issue from a different perspective. She believes that many mass market industry members simply are not putting the necessary resources into making newspaper and direct advertising succeed. A mass market retailer, for example, needs to make a commitment to a diversity of natural foods products to attract the critical mass of consumers necessary to make natural foods pay. Ten to 20 products is simply not enough.

Dunn emphasizes that consumers do not know enough about natural foods to add the appropriate value to them when making their decisions. For organic foods, he believes, a national standard with a well-recognized shield and a public education campaign will be key to making that program successful.

Kahn believes that natural foods industry members have to be better marketers and this is best achieved if companies grow, process, and market together. He sees communicating about the product so that consumers understand the cost difference between natural and mass market foods as one of the most significant obstacles in the natural foods market. Kahn stated that many natural foods businesses do not know how to simplify their messages enough and that they must capitalize more on the relative benefits of organic and natural foods, through consumer communication. For example, natural foods businesses need to "stop being the nice kids on the block" and come out strongly against pesticides. Again, he emphasized that research is necessary to make this message known and understood.



Chapter 4

Conclusions and Recommendations

Chapter 4: Conclusions and Recommendations

A Healthy Market

Natural foods are still a very small part of the U.S. retail foods market, but sales are increasing rapidly. All indications are that this trend will continue, making this segment of the overall market an increasingly prominent part of the food system. Natural foods fit well with major market trends toward food safety, health and convenience, and increased interest in the environmental impacts of agriculture practices.

Industry analysts predict that the natural foods market will continue to chart a path of strong growth.

Based on the findings of our survey, expert interviews, and extensive research, the Wallace Institute concludes that as this market grows, it will also continue to expand out of traditional settings, such as small health food stores, and into mass market settings, such as chain supermarkets. In doing so, the natural foods market will spur some of the needed modifications to existing market information sources and institutions, carving a space for natural foods within these institutions. Other modifications will require public policy intervention. These latter modifications are crucial in creating a natural foods market that meets rising consumer demand.

We believe that there are no unconquerable obstacles affecting the natural foods market, but the means needed to help the natural foods market are not all in place. The appropriate government agencies and non-governmental organizations, in concert with members of the food industry and food trade associations, have the important task of assuring that the natural foods market reaches its full potential.

Credibility is Key

Credibility is key to long-term success in the natural foods market. Many of the attributes that are bundled into natural foods are not apparent in the end products that consumers pick up at the store. Thus consumers must be made aware of these attributes — through standards, labels, advertising, etc. — if their confidence is to be gained.

To help build consumer trust and loyalty, health and safety standards for natural foods operations should meet or exceed those for conventional mass market foods operations. Ecolabeling and organic labeling must be held to a very high standard for certification. There is much work to be done to ensure the credibility of the natural foods market in consumers' minds.

Surveys tell us that consumers want safe, healthful, convenient food. They also care about the environment and the fate of U.S. farmers. To many, this translates into a desire to buy natural foods in supermarkets. While some people enjoy going to alternative retail outlets such as farmers' markets, many more want to buy natural foods without changing where they normally shop. Thus, the success of natural foods in conventional supermarkets is critical.

Natural foods businesses and entities interested in the success of the natural foods market need to plan strategically. Today's natural foods market promises profits to those who act quickly and decisively, but their actions must be backed by careful research and planning prior to product introduction.

The survey and interviews conducted for this report illuminated several public policy themes that are important to success in the natural foods market. Among them are the following:

- ✦ The natural foods market must be afforded the same types of assistance that the mass foods market enjoys, in relation to implementation of standards and minimally necessary regulations aimed at serving consumers and the public good.
- ✦ Mass market channels need to be cleared of obstacles that limit access for natural foods businesses.
- ✦ There is need to address the current lack of systematic processes for tracking the natural foods market — especially for conducting basic research on the production, manufacture, distribution, retailing, marketing, and pricing of natural foods — and to initiate the proper means of disseminating the resulting information to a wide range of users, including food industry businesses and the general public.
- ✦ Mechanisms must be put in place to assist in the organizing aspects of the natural foods market, from forming partnerships, coalitions, and working groups, to building trade associations and other institutions that are dedicated to overcoming the difficulties and meeting the challenges posed by the growing natural foods market.

The following recommendations build upon these themes.

Recommendations

The Wallace Institute has developed the following recommendations for major sectors involved in the U.S. food system, with the goal of helping the natural foods market reach its full potential.

Government Agencies

1. National Agriculture Statistics Service: Include new questions directly related to the organic and sustainable agriculture market on existing surveys. Investigate the potential for a new organic and sustainable producer sample frame and marketing survey. Work with the USDA Economic Research Service, Organic Farming Research Foundation, Sustainable Agriculture Working Group network, USDA Sustainable Agriculture Research and Education Program, and others to develop these efforts.

2. Agricultural Marketing Service: Formulate a set of guidelines for companies developing natural foods labels. Work with food trade organizations including the Food Marketing Institute, Organic Trade Association, and National Natural Foods Association to complete this task. Educate food industry members about these guidelines and assist them in ensuring that their natural foods labels are credible and, consequently, have a greater chance at long-term success.

3. Agricultural Marketing Service and Extension: Work with the Organic Alliance, the Sustainable Agriculture Working Group network, and others to create educational materials and teach extension professionals how to help producers learn about markets for organic and sustainable agricultural products.

Trade Organizations

1. Investigate and analyze the impacts that current trends, such as interest in functional foods and whole health marketing, have on the natural foods market and how these impacts may affect your members. Many of your members may not have the resources or experience to do this.

2. Develop standards and a system for self-regulating your members' natural foods products and explore developing third-party certification mechanisms to make sure consumer expectations for natural foods are met. The goal is to help your members build consumer satisfaction and ensure long-term success in the natural foods market.

3. Create recommended standard operating procedures for your members to make their interactions with members of the mass market as easy and successful as possible. Because business relationships are becoming more complex and technologically sophisticated, it is important that your members be "on the same page" with their new partners.

Research and Educational Institutions

1. Examine the attributes of natural foods that have led to greater consumer demand for these products. What product characteristics are most attractive to consumers (for example, environmental, food safety, nutrition)? Which types of labels have the most impact?

2. Investigate industry responses to the natural foods market. How are natural foods businesses adapting to changing times? Why and how do mass market foods businesses enter the natural foods market? How have lack of government standards, third-party certification, and industry norms helped or hindered the development of the natural foods market?

3. Analyze the impacts that the growing natural foods market is having on rural communities, the environment, and food safety. Are they discernible impacts? What are the benefits to rural communities, the environment, and food safety of a fully developed natural foods market?

Industry Members

1. Inform the USDA that you are interested in learning more about natural foods. Ask them to develop guidelines for companies that want to enter the natural foods market and to collect more comprehensive market and price information on the natural foods market.

2. Tell your trade organization(s) that you want them to supply you with information about how the natural foods market works. Ask them to develop standards for developing third-party certification mechanisms, and for self-regulating those products to ensure that they meet consumer expectations for natural foods. Ask them to create guidelines for interacting with other businesses involved in the natural foods market. Ask them to conduct more research and analysis on the issues in the natural foods market that are most pertinent to your success in the natural foods market.

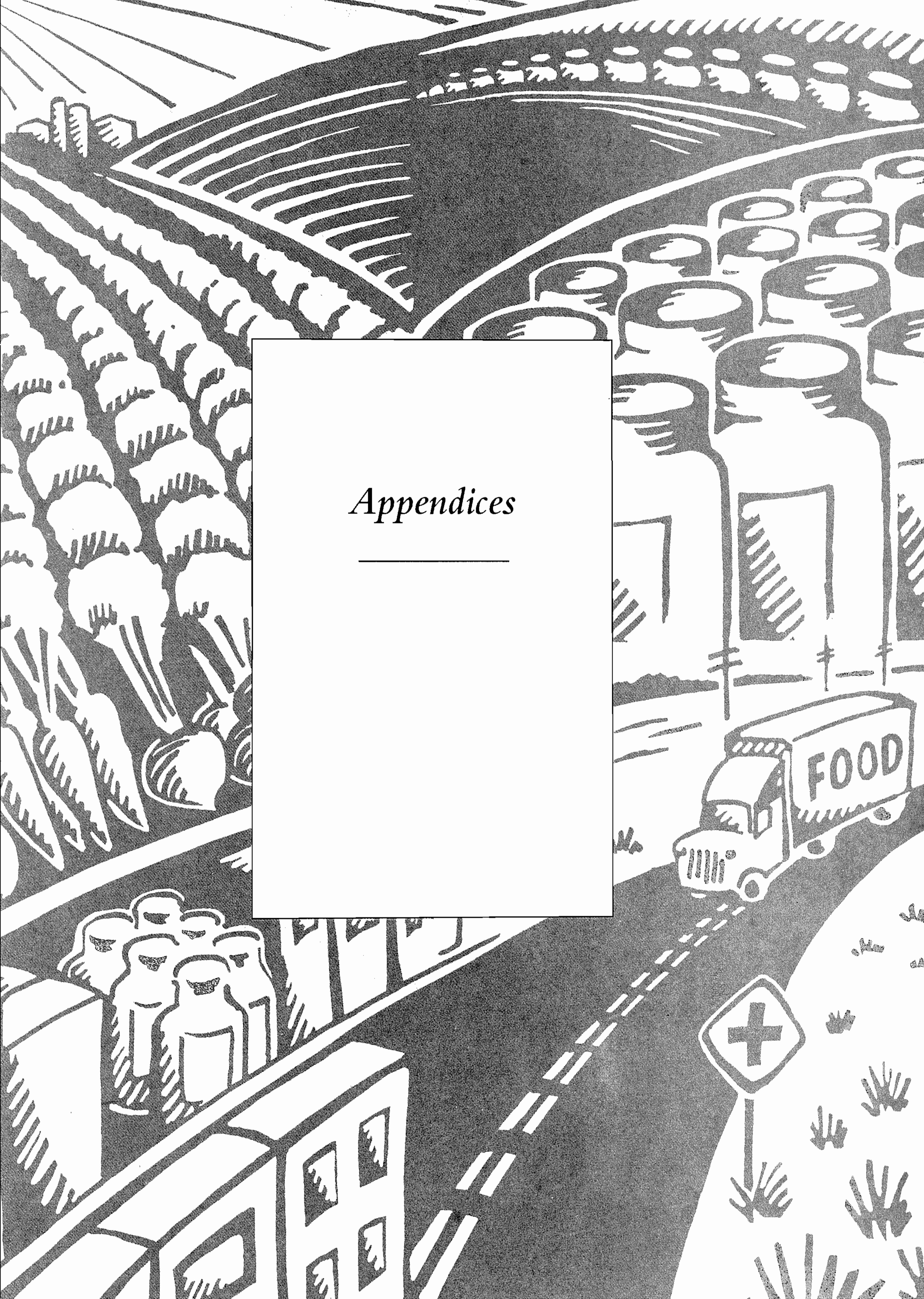
3. If you are already involved in the natural foods market or are deciding to enter the natural foods market for the first time, develop a well-researched aggressive marketing plan for your product(s). This may include working with outside natural foods marketing professionals or developing your own in-house capacity related to natural foods marketing. Take advantage of all relevant expert public and private resources to maximize your chances of success.

Looking Forward

It is the hope of the Wallace Institute that this report will be useful to all those involved in the food industry in this country. We believe that it offers valuable information about what members of the food industry perceive in relation to the growing natural foods market, and excellent observations and advice from experts in the food industry. It also presents data about the natural foods market, and recommendations that we trust will prove useful to businesses engaged in natural and mass market foods production, manufacture, distribution, and retailing.

We see tremendous opportunities for the natural foods market. We intend to continue to work for policies and actions that will contribute to the future success of this market, for the eventual benefit of the consumer and the broader public good.

Appendices



End Notes

a. *Trends in the United States: Consumer Attitudes and the Supermarket* (Washington, DC: Food Marketing Institute, 1997), p. 69. Hereinafter, *Trends* 1997, op. cit.

b. *Shopping for Health: Balancing Convenience, Nutrition, and Taste* (Washington, DC: Food Marketing Institute, 1997), p. 8. Hereinafter, *Shopping for Health*, op. cit.

c. *Trends* 1997, op. cit., p. 19.

d. Craig S. Hollingsworth, M.J. Paschall, Nancy L. Cohen, and William M. Coli, "Support in New England for certification and labeling of produce grown using integrated pest management," *American Journal of Alternative Agriculture* 8(2):78–84 (1993). Hereinafter, Hollingsworth, op. cit. See also Ramu Govindasamy and John Italia, *Consumer Response to Integrated Pest Management and Organic Agriculture: An Econometric Analysis* (New Brunswick, NJ: State University of New Jersey, Rutgers, 1997), p. 6. Hereinafter, Govindasamy, op. cit.

e. *Shopping for Health*, op. cit., p. 32.

f. *Trends* 1997, op. cit., p. 72.

g. Roper poll for the Times Mirror Company (1995).

h. *Shopping for Health*, op. cit., p. 32.

i. Hollingsworth, op. cit.; Govindasamy, op. cit.

j. *The Greening of Consumers* (Washington, DC: Food Marketing Institute, 1997).

k. Ibid.

l. Hollingsworth, op. cit.

m. Hollingsworth, op. cit.

n. *Shopping for Health*, op. cit., p. 31.

o. Govindasamy, op. cit.

p. *Trends in the United States: Consumer Attitudes and the Supermarket* (Washington, DC: Food Marketing Institute, 1995).

q. *A Retailers' Guide to Natural Foods and Related Products* (Washington, DC: Food Marketing Institute, 1997), p. 10. Hereinafter, *Retailers' Guide*, op. cit.

r. Ibid.

1. "Definitions of Natural Products," New Hope Communications Web site http://www.newhope.com/magazines/research/definition.html (Dec. 6, 1998).

2. *Retailers' Guide*, op. cit., p. vii.

3. Federal Trade Commission, "Proposed Trade Regulation Rule on Food Advertising: Staff Report and Recommendations," (Washington, DC: U.S. Government Printing Office, September 25, 1978).

4. Michael Royzne, Executive Director, Red Tomato, letter to the author (March 25, 1998).

5. Gene Kahn, Corporate Executive Officer, Small Planet Foods, interview with the author (May 15, 1998).

6. USDA Agricultural Marketing Service, "Proposed National Organic Program Rule" (Washington, DC: U.S. Government Printing Office, April 30, 1998).

7. Mary Ellen Lo Bosco, "The box fights back," *Supermarket News*, p. 1 (December 28, 1998).

8. Nessa Richman, *Toward A More Sustainable Food System: The Role of the Henry A. Wallace Institute for Alternative Agriculture in Improving the Efficiency and Long-Term Welfare of the U.S. Food System* (Cambridge, MA: Harvard University, John F. Kennedy School of Government, 1997), Policy Analysis Exercise.

9. No precise estimate of the growth rate for natural foods is available because those who track sales of natural foods principally look at sales in natural foods stores and vitamin and supplement stores, not in conventional supermarkets. Because natural foods comprise a significant portion of the entire natural products market and because organic foods make up a significant portion of the natural foods market, it is possible that growth rates for all natural products and organic foods indicate trends in the natural foods market. Karen Raterman ("Natural products sales top $14B," *Natural Foods Merchandiser*, June 1998; hereinafter, Raterman, op. cit.) notes that natural products sales totals since 1990 indicate that growth in this sector increased from 10% between 1990 and 1991, to 28.7% between 1996 and 1997. Kate Murphy ("There's big green in organic food," *Business Week*, p. 170, October 6, 1997) reports that organic foods sales have been growing 20% to 25% annually since 1990.

10. Anthony Gallo, *The Food Marketing System in 1996* (Washington, DC: U.S. Dept. of Agriculture, Economic Research Service, 1998), p. 2, Agriculture Information Bulletin no. 743.

11. *The Kiplinger Agriculture Letter*, p. 1 (December 10, 1997).

12. Raterman, op. cit., p. 50.

13. Danny Wells, "Retailing 2000: Back to the future," *Natural Foods Merchandiser*, p. 38 (May 1997).

14. *Shopping for Health*, op. cit., p. 31.

15. "Supermarkets still developing game plans," *Natural Foods Merchandiser* (June 1997).

16. *The Food Marketing Industry Speaks* (Washington, DC: Food Marketing Institute, 1995). Hereinafter, *Speaks*, op. cit.

17. Julie Anton Dunn, *Certified Organic Production in the U.S.: Half a Decade of Growth* (Wind Gap, PA: Agrisystems International, 1997), p. 8.

18. Mark Lipson, *Searching for the "O" Word* (Santa Cruz, CA: Organic Farming Research Foundation, 1997), p. 6. Hereinafter, *Searching*, op. cit.

19. A supermarket is defined by the Food Marketing Institute as "any full line, self-service grocery store with annual sales of $2 million or more."

20. Shekar Jayanthi, Bart Kocha, and Kingshuk K. Sinha, *Competitive Analysis of U.S. Food Processing Plants* (St. Paul, MN: Retail Food Industry Center, 1996), Working Paper no. 96-04.

21. Ibid.

22. Martin Baily, *Manufacturing Productivity* (Washington, DC: McKinsey Global Institute, 1993), cited in Jayanthi et al.

23. Ronald Cotterill, "The food distribution system of the future: Convergence towards the U.S. or U.K.?," *Agribusiness* 13(2):123-135 (1997).

24. Ann Woods, Executive Director, Organic Alliance, interview with the author (November 20, 1997).

25. John Connor, *Concentration and Mergers in U.S. Wholesale Grocery Markets* (Lafayette, IN: Purdue University, Department of Agricultural Economics, 1997), p. 1, Staff Paper no. 97-09.

26. "United Natural Foods, Inc. Completes Acquisition of Stow Mills, Inc.," press release from United Natural Foods, Inc. (October 31, 1997).

27. *Trends* 1997, op. cit.

28. *Retailers' Guide*, op. cit., p. 1.

29. Raterman, op. cit., p. 1.

30. *Food Institute Report* (Washington, DC: Food Institute, July 28, 1997), p. 3.

31. *Trends* 1997, op. cit., p. 69.

32. Emily Esterson, "Supermarkets still developing game plans," *Natural Foods Merchandiser* (June 1997).

33. "Nature trails: The two main natural foods players chart a course for rapid growth," *Supermarket News*, p. 1 (March 24, 1997). Hereinafter, Nature trails, op. cit.

34. "Whole Foods plans expansion," *Food Institute Report* (Washington, DC: Food Institute, April 14, 1997), p. 5. Hereinafter, Expansion, op. cit.

35. Nature trails, op. cit., p. 1.

36. Expansion, op. cit., p. 5.

37. "Natural selection," *Supermarket News* 47(49):44-49 (December 8, 1997).

38. James R. Kahn, *The Economic Approach to Environmental and Natural Resources*, 2nd ed. (Knoxville, TN: Dryden Press, 1997), pp. 14-27. Hereinafter, Kahn, op. cit.

39. David L. Weimar and Aidan R. Vining, *Policy Analysis: Concepts and Practice*, 2nd ed. (Englewood, NJ: Prentice Hall, 1992), p. 208.

40. The Wallace Institute's definition of natural foods was read to survey respondents before the survery was administered.

41. Julie Caswell, "How Green Is Thy Product?," *Resources and Environment: Management Choices* (Amherst, MA: University of Massachusetts Cooperative Extension System, March 1993).

42. James Q. Wilson, *Bureaucracy: What Government Agencies Do and Why They Do It* (HarperCollins, 1989).

43. *Searching*, op. cit.

44. *Speaks*, op. cit., p. 29.

45. Research indicates that, all in all, variations between farming in organic and non-organic production are greater than variations among farms within each of these two groups. In other words, there is no clear winner in relation to profit. See Rick Welsh, "The Economics of Organic Grain and Oilseed Production in the U.S.," paper presented at the Organic Farming and Marketing Workshop: New Partnerships and Priorities (Washington, DC: U.S. Dept., of Agriculture, Economic Research Service, October 29, 1998).

46. Kahn, op. cit., pp. 40–48.

Appendix A: Survey Methodology and Sample Origins

The information in much of this report is based on a survey completed by the Henry A. Wallace Institute for Alternative Agriculture in May 1998. The survey was titled "Emerging Trends in the Natural Foods Industry." It was administered by telephone to marketing managers of 290 food industry businesses, by Westat, Inc. of Rockville, Maryland.

The businesses were classed in four categories:

Category	Number of respondents
agricultural producers	78
food manufacturers/processors	77
food distributors/brokers/wholesalers	63
retail supermarkets	72

Within each category, there were "natural" foods and "conventional" (or mass market) foods groups, as follows:

Category	Number of respondents
mass market agricultural producers	43
natural agricultural producers	35
mass market foods manufacturers/processors	34
natural foods manufacturers/processors	43
mass market foods distributors/brokers/wholesalers	26
natural foods distributors/brokers/wholesalers	37
mass market foods retail supermarkets	39
natural foods retail supermarkets	33

See next page for the origins for the sample.

All surveys are subject to sampling error. Sampling error is a product of sample size and response rate. In addition, there are limitations in survey data related to small sample size. Taking into account these weaknesses (associated with all surveys using samples), we believe, nevertheless, that the conclusions drawn from this survey provide an accurate representation of the food industry's views on the natural foods market.

Origins of the Sample

1. Mass market foods producers: random sample from "Farmail" Company, a marketing service of Farm Journal, Inc.

2. Natural foods producers: randomly sampled by the author from lists provided by:
   - Michigan Agricultural Stewardship Association
   - Northern Plains Sustainable Agriculture Society
   - American Livestock Breeds Conservancy
   - Florida Certified Organic Growers and Consumers
   - Tennessee Land Stewardship Association
   - Texas Sustainable Agriculture Working Group
   - Northeast Sustainable Agriculture Working Group
   - Northwest Sustainable Agriculture Working Group
   - California Sustainable Agriculture Working Group
   - New York Sustainable Agriculture Working Group
   - Pennsylvania Association for Sustainable Agriculture
   - Midwest Sustainable Agriculture Working Group
   - Land Stewardship Project
   - Illinois Sustainable Agriculture Society
   - Indiana Sustainable Agriculture Association
   - Nebraska Sustainable Agriculture Society
   - Ohio Ecological Food and Farm Association
   - Practical Farmers of Iowa
   - Acadiana Sustainable Agriculture Working Group
   - Arkansas Land and Farm Development Corporation
   - Carolina Farm Stewardship Association
   - Community Farm Alliance
   - Georgia Land Stewardship Association
   - Indian Springs Farmers' Cooperative
   - National Contract Poultry Growers
   - Ozark Organic Growers Association
   - Virginia Association for Biological Farming

3. Mass market foods manufacturers: random sample from Thomas Publishing Company business lists.

4. Natural foods manufacturers: random sample from Whole Foods source book and random number table (food only, no supplements).

5. Mass market foods distributors: random sample from Thomas Publishing Company business lists.

6. Natural foods distributors: random sample from Whole Foods source book and random number table (foods only, no supplements).

7. Mass market foods retailers: random sample from Trade Dimensions Company (used by the *Natural Foods Merchandiser*)

8. Natural foods retailers: random sample from Venture Direct Worldwide, Inc., a list management service.

Appendix B: Survey Results — Independent Samples T-Tests

Part 2: Barriers in the Natural Foods Market

All Twenty Barriers Rated by Mean Score

(1 - 6 scale; 1 = "not a barrier" and 6 = "a major barrier')

BARRIER:	MEAN OVERALL SCORE: *(Scale of 1–6)*
Finding timely, complete market prices and quantity information	2.7
Integrating new natural foods ventures into existing operations	2.7
Linking with natural foods input suppliers	2.7
Gaining new skills, training, financing, equipment, and/or processes	2.9
Maintaining quality and safety standards	2.6
Allocating staff time	2.6
Implementing efficient production management methods	2.6
Packaging natural foods products	2.4
Linking with buyers' interest in environment, health, and safety	2.7
Pricing and marketing natural foods products	2.9
Difficulty finding agricultural producers	2.8
Difficulty finding manufacturers	2.5
Difficulty finding distributors	2.4
Difficulty finding retailers	2.3
Market demand insufficient	2.7
Market supply insufficient	2.7
Unreliable market quality	2.7
Lack of government standards for natural foods	2.9
Lack of industry standards for natural foods	2.7
Uncertainty about future standards for natural foods	3.4

Barriers Rated Above 3.0 within Eight Market Sub-segments

(1–6 scale; 1 = "not a barrier" and 6 = "a major barrier')

BARRIER:	SUB-SEGMENT SCORE:
Finding timely, complete market prices and quantity information	
Integrating new natural foods ventures into existing operation	*Conventional Distributors:* 3.2
Linking with natural foods input suppliers	*Conventional Retailers:* 3.4
Maintaining quality and safety standards	
Gaining new skills, training, financing, equipment, and/or processes	*Natural Producers:* 3.2 *Conventional Retailers:* 3.2
Allocating staff time	*Conventional Retailers:* 3.1 *Natural Retailers:* 3.1
Implementing efficient production management methods	
Packaging natural foods products	
Linking with buyers' interest in environment, health, and safety	
Pricing and marketing natural foods products	*Conventional Producers:* 3.3 *Conventional Retailers:* 3.2
Difficulty finding agricultural producers	*Natural Distributors:* 3.1 *Conventional Retailers:* 3.4
Difficulty finding manufacturers	*Conventional Manufacturers:* 3.1
Difficulty finding distributors	*Natural Producers:* 3.2
Difficulty finding retailers	
Market demand insufficient	*Conventional Producers:* 3.1 *Conventional Distributors:* 3.4 *Conventional Retailers:* 3.1
Market supply insufficient	*Natural Distributors:* 3.2
Unreliable market quality	*Conventional Retailer:* 3.1
Lack of government standards for natural foods	*Natural Producers:* 3.6 *Natural Manufacturers:* 3.5
Lack of industry standards for natural foods	*Natural Producers:* 3.1
Uncertainty about future standards for natural foods	*Conventional Producers:* 3.3 *Natural Producers:* 4.4 *Natural Manufacturers:* 3.6 *Conventional Distributors:* 3.2 *Natural Distributors:* 3.4 *Natural Retailers:* 3.3

Note: Only Sub-segment Scores over 3.0 are included.

Statistical Significance Key:

*	=	Statistically significant at the 10% level
**	=	Statistically significant at the 5% level
***	=	Statistically significant at the 1% level

Tests to Determine Differences Between Natural and Conventional Producer Perceptions

BARRIER:	**STATISTICAL SIGNIFICANCE:**	**COMPARATIVE MEANS:** *(1–6 scale; 1 = "not a barrier" and 6 = "a major barrier")*
Finding timely, complete market prices and quantity information	.966	
Integrating new natural foods ventures into existing operations	.607	
Linking with natural foods input suppliers	.088 *	*Conventional:* 2.91 *Natural:* 2.35
Gaining new skills, training, financing, equipment, and/or processes	.049 **	*Conventional:* 2.62 *Natural:* 3.31
Maintaining quality and safety standards	.910	
Allocating staff time	.007 ***	*Conventional:* 1.92 *Natural:* 2.90
Implementing efficient production management methods	.523	
Packaging natural foods products	.616	
Linking with buyers' interest in environment, health, and safety	.082 *	*Conventional:* 2.94 *Natural:* 2.32
Pricing and marketing natural foods products	.236	
Difficulty finding agricultural producers	.248	
Difficulty finding manufacturers	.773	
Difficulty finding distributors	.137	
Difficulty finding retailers	.898	
Market demand insufficient	.126	
Market supply insufficient	.633	
Unreliable market quality	.521	
Lack of government standards for natural foods	.214	
Lack of industry standards for natural foods	.795	
Uncertainty about future standards for natural foods	.007 ***	*Conventional:* 3.33 *Natural:* 4.41

Note: Comparative Means are included only for statistically significant results.

Tests to Determine Differences Between Natural and Conventional Manufacturer Perceptions

BARRIER:	STATISTICAL SIGNIFICANCE:	COMPARATIVE MEANS: *(1–6 scale; 1 = "not a barrier" and 6 = "a major barrier")*
Finding timely, complete market prices and quantity information	.941	
Integrating new natural foods ventures into existing operations	.567	
Linking with natural foods input suppliers	.445	
Gaining new skills, training, financing, equipment, and/or processes	.570	
Maintaining quality and safety standards	.692	
Allocating staff time	.128	
Implementing efficient production management methods	.688	
Packaging natural foods products	.240	
Linking with buyers' interest in environment, health, and safety	.452	
Pricing and marketing natural foods products	.496	
Difficulty finding agricultural producers	.780	
Difficulty finding manufacturers	.100 *	*Conventional:* 1.89 *Natural*: 2.47
Difficulty finding distributors	.230	
Difficulty finding retailers	.174	
Market demand insufficient	.440	
Market supply insufficient	.982	
Unreliable market quality	.939	
Lack of government standards for natural foods	.061	*Conventional:* 2.67 *Natural:* 3.48
Lack of industry standards for natural foods	.281	
Uncertainty about future standards for natural foods	.168	

Tests to Determine Differences Between Natural and Conventional Distributor Perceptions

BARRIER:	**STATISTICAL SIGNIFICANCE:**	**COMPARATIVE MEANS:** *(1–6 scale; 1 = "not a barrier" and 6 = "a major barrier')*
Finding timely, complete market prices and quantity information	.980	
Integrating new natural foods ventures into existing operations	.188	
Linking with natural foods input suppliers	.870	
Gaining new skills, training, financing, equipment, and/or processes	.844	
Maintaining quality and safety standards	.622	
Allocating staff time	.932	
Implementing efficient production management methods	.493	
Packaging natural foods products	.442	
Linking with buyers' interest in environment, health, and safety	.615	
Pricing and marketing natural foods products	.844	
Difficulty finding agricultural producers	.284	
Difficulty finding manufacturers	.521	
Difficulty finding distributors	.682	
Difficulty finding retailers	.023 **	*Conventional:* 2.57 *Natural:* 1.83
Market demand insufficient	.013 **	*Conventional:* 3.38 *Natural:* 2.41
Market supply insufficient	.163	
Unreliable market quality	.722	
Lack of government standards for natural foods	.288	
Lack of industry standards for natural foods	.529	
Uncertainty about future standards for natural foods	.763	

Tests to Determine Differences Between Natural and Conventional Retailer Perceptions

Barrier:	**Statistical Significance:**	**Comparative Means:** (1–6 scale; 1 = "not a barrier" and 6 = "a major barrier")
Finding timely, complete market prices and quantity information	.092 *	*Conventional:* 3.00 *Natural:* 2.33
Integrating new natural foods ventures into existing operations	.031 **	*Conventional:* 3.00 *Natural:* 2.21
Linking with natural foods input suppliers	.001 ***	*Conventional:* 3.42 *Natural:* 2.27
Gaining new skills, training, financing, equipment, and/or processes	.495	
Maintaining quality and safety standards	.137	
Allocating staff time	.985	
Implementing efficient production management methods	.324	
Packaging natural foods products	.260	
Linking with buyers' interest in environment, health, and safety	.016 **	*Conventional:* 2.86 *Natural:* 2.06
Pricing and marketing natural foods products	.005 ***	*Conventional:* 3.15 *Natural:* 2.10
Difficulty finding agricultural producers	.909 *	*Conventional:* 3.41 *Natural:* 2.77
Difficulty finding manufacturers	.001 ***	*Conventional:* 3.11 *Natural:* 1.77
Difficulty finding distributors	.009 ***	*Conventional:* 2.77 *Natural:* 1.80
Difficulty finding retailers	.104	
Market demand insufficient	.011 **	*Conventional:* 3.05 *Natural:* 2.18
Market supply insufficient	.344	
Unreliable market quality	.017 **	*Conventional:* 3.11 *Natural:* 2.25
Lack of government standards for natural foods	.651	
Lack of industry standards for natural foods	.652	
Uncertainty about future standards for natural foods	.099 *	*Conventional:* 2.55 *Natural:* 3.25

Tests to Determine Differences between All Natural Companies Surveyed and All Conventional Companies Surveyed

BARRIERS:	STATISTICAL SIGNIFICANCE:
Finding timely, complete market prices and quantity information	.954
Integrating new natural foods ventures into existing operations	.648
Linking with natural foods input suppliers	.954
Gaining new skills, training, financing, equipment, and/or processes	.116
Maintaining quality and safety standards	.842
Allocating staff time	.000 ***
Implementing efficient production management methods	.525
Packaging natural foods products	.870
Linking with buyers' interest in environment, health, and safety	.199
Pricing and marketing natural foods products	.447
Difficulty finding agricultural producers	.043 **
Difficulty finding manufacturers	.318
Difficulty finding distributors	.494
Difficulty finding retailers	.162
Market demand insufficient	.064 *
Market supply insufficient	.305
Unreliable market quality	.743
Lack of government standards for natural foods	.239
Lack of industry standards for natural foods	.619
Uncertainty about future standards for natural foods	.277

Part 3: Business Strategies in the Natural Foods Market

Means and Success Ratings for Barriers: Overall Sample

BUSINESS STRATEGY	PERCENT USING STRATEGY	SUCCESS RATING (1 - 6 SCALE) *(1–6 scale; 1 = "not a barrier" and 6 = "a major barrier"*
Developed a natural foods label	34	4.8
Distributed newspaper/direct mail advertising	32	3.7
Provided in-store advertising/demonstrations/samples	55	4.2
Sold a unique product	53	4.7
Sold a high quality product	79	4.9
Diversified natural foods offerings	54	4.2
Targeted a specific market	54	4.5
Contracted with sellers/buyers	47	4.2
Joined a cooperative/limited partnership	25	3.7
Hired special staff for natural foods	33	4.1
Increased scale of natural foods operations	52	4.4

Means and Success Ratings for Barriers: Eight Sub-Segments

BUSINESS STRATEGY	PERCENT USING	MEAN SUCCESS RATING *(1–6 scale; 1 = "not a barrier" and 6 = "a major barrier"*
Developed a natural foods label		
Conventional Producers	0	0
Natural Producers	46	4.3
Conventional Manufacturers	29	5.0
Natural Manufacturers	84	5.0
Conventional Distributors	15	4.8
Natural Distributors	57	4.4
Conventional Retailers	5	4.0
Natural Retailers	33	5.4

Continued next page

Distributed newspaper/direct mail advertising		
Conventional Producers	7	5.0
Natural Producers	51	3.6
Conventional Manufacturers	15	2.8
Natural Manufacturers	51	3.2
Conventional Distributors	15	2.3
Natural Distributors	24	4.3
Conventional Retailers	23	3.9
Natural Retailers	73	4.3
Provided in-store advertising/demonstrations/samples		
Conventional Producers	9	3.0
Natural Producers	51	4.1
Conventional Manufacturers	44	3.7
Natural Manufacturers	77	4.3
Conventional Distributors	27	4.0
Natural Distributors	84	4.2
Conventional Retailers	56	4.3
Natural Retailers	88	4.6
Sold a unique product		
Conventional Producers	14	3.2
Natural Producers	77	4.8
Conventional Manufacturers	44	4.5
Natural Manufacturers	84	5.2
Conventional Distributors	31	4.3
Natural Distributors	70	4.9
Conventional Retailers	26	3.6
Natural Retailers	76	4.7
Sold a high quality product		
Conventional Producers	56	4.8
Natural Producers	94	5.2
Conventional Manufacturers	76	5.0
Natural Manufacturers	95	5.2
Conventional Distributors	50	4.6
Natural Distributors	95	4.9
Conventional Retailers	69	4.1
Natural Retailers	91	5.4
Diversified natural foods offerings		
Conventional Producers	28	3.1
Natural Producers	77	4.3
Conventional Manufacturers	29	4.3
Natural Manufacturers	65	4.3
Conventional Distributors	38	3.4
Natural Distributors	68	4.7
Conventional Retailers	49	3.5
Natural Retailers	82	4.7

Continued next page

Targeted a specific market		
Conventional Producers	30	3.5
Natural Producers	77	4.6
Conventional Manufacturers	50	4.8
Natural Manufacturers	77	5.1
Conventional Distributors	46	3.8
Natural Distributors	65	5.0
Conventional Retailers	28	3.5
Natural Retailers	64	4.2
Contracted with sellers/buyers		
Conventional Producers	37	4.3
Natural Producers	54	3.5
Conventional Manufacturers	44	4.1
Natural Manufacturers	58	4.4
Conventional Distributors	35	3.8
Natural Distributors	57	4.4
Conventional Retailers	31	4.5
Natural Retailers	58	4.1
Joined a cooperative/limited partnership		
Conventional Producers	28	4.2
Natural Producers	46	3.9
Conventional Manufacturers	12	4.5
Natural Manufacturers	23	3.0
Conventional Distributors	19	3.8
Natural Distributors	27	2.5
Conventional Retailers	13	4.0
Natural Retailers	30	4.4
Hired special staff for natural foods		
Conventional Producers	16	3.6
Natural Producers	46	3.1
Conventional Manufacturers	15	3.2
Natural Manufacturers	51	4.2
Conventional Distributors	15	3.0
Natural Distributors	49	4.7
Conventional Retailers	13	4.2
Natural Retailers	58	5.1
Increased scale of natural foods operations		
Conventional Producers	23	4.7
Natural Producers	66	4.3
Conventional Manufacturers	32	4.1
Natural Manufacturers	81	4.6
Conventional Distributors	31	3.5
Natural Distributors	65	4.7
Conventional Retailers	49	3.6
Natural Retailers	64	5.

Appendix C:
1998 Survey of Emerging Trends in the Natural Foods Industry

Wallace Institute Marketing Project

1998 Survey of Emerging Trends in the Natural Foods Industry

Please answer all questions in every section by checking a box (☑), circling a number (①), or "writing in" your response.

As you provide your answers, please use the following definitions:

1. The term "natural foods" refers to foods which do not contain synthetic or artificial ingredients and are not more than minimally processed, and foods which are produced organically or with other sustainable farming methods.
2. The term "supplier" means the businesses/individuals from whom you purchase your inputs.
3. The term "consumer" means the business/individuals to whom you sell your products.
4. The term "barriers" refers to impediments to market entry and market success.

Please know that all responses will be kept strictly confidential. Your answers will be used only for statistical tabulation purposes in combination with all other replies.

Your response should be returned in the attached business reply envelope no later than April 10, 1998.

If you want to receive a summary of our survey findings, please provide your name and address here:

Your name: ____________________

Your organization's name: ____________________

Street address: ____________________

City: ____________________ State: ________ Zip: ____________________

Part I. General Information

1. Please check the single primary function of your business. If your business is equally involved in more than one function, please select the most important function performed by your company.

Agricultural Producer..☐
Food manufacturer/processor............................☐
Food distributor/broker/wholesaler ....☐
Retail supermarket ....☐
Other *(Specify*______________________*)* ☐

2. In which state(s) do you sell your product(s)?

National (all states)....................................☐

Individual States:

AL ☐	IL ☐	MT ☐	RI ☐
AK ☐	IN ☐	NE ☐	SC ☐
AZ ☐	IA ☐	NV ☐	SD ☐
AR ☐	KS ☐	NH ☐	TN ☐
CA ☐	KY ☐	NJ ☐	TX ☐
CO ☐	LA ☐	NM ☐	UT ☐
CT ☐	ME ☐	NY ☐	VT ☐
DE ☐	MD ☐	NC ☐	VA ☐
DC ☐	MA ☐	ND ☐	WA ☐
FL ☐	MI ☐	OH ☐	WV ☐
GA ☐	MN ☐	OK ☐	WI ☐
HI ☐	MS ☐	OR ☐	WY ☐
ID ☐	MO ☐	PA ☐	

3. Does your company sell its products internationally?

Yes ....☐ No ....☐ Don't know ....☐

If yes,what countries are major markets for your products?

____________________ ____________________

____________________ ____________________

4. What percentage of your company's sales are in the following categories?
(SUPERMARKETS GO TO Q5)

Grain products .... _____ %
Fruits .... _____ %
Vegetables .... _____ %
Dairy .... _____ %
Meat, poultry, fish, and eggs .... _____ %
Legumes and nuts .... _____ %
Fats and oils .... _____ %
Sweets (including soft drinks) .... _____ %
Alcoholic beverages .... _____ %
Other *(Specify:*______________________*)* _____ %
100%

5. What percent of your company's sales come from natural foods? Remember, the term "natural foods" refers to foods which do not contain synthetic or artificial ingredients and are not more than minimally processed, and foods which are produced organically or with other sustainable farming methods.

Percent: ______ % .Not involved in natural foods.... ☐ (GO TO QUESTION 9)

6. **How long has your company been involved in the natural foods market?**

Number of years ....☐ Less than 1 year ....☐ Don't know..........☐

---

7. **Do you have any personnel SOLELY dedicated to natural foods activity In your firm?**

Yes ....☐ No ....☐ Don't know ....☐

If yes, how many people in your company are dedicated to natural foods? Number: ______

---

8. **Please list the top three selling natural foods marketed by your company:**

1. ______________________________
2. ______________________________
3. ______________________________

---

9. **Efficient Consumer Response (ECR), as you may know, enables food retailers, distributors, manufacturers and producers to be linked together electronically and cooperate closely in order to improve the efficiency of the food delivery system. Are you working with your suppliers and/or buyers to implement any of the following ECR techniques?**

9.1 **Category Management:** *Merchandising of product groupings based on actual consumer purchasing patterns?*

Yes ....☐ No ....☐ Don't know ....☐

If yes, are natural foods included in your category management initiatives?

Yes ....☐ No ....☐

9.2 **Electronic Data Interchange (EDI):** *Transfer of data between trading partners in a standardized, paperless environment?*

Yes ....☐ No ....☐ Don't know ....☐

If yes, are natural foods included in your EDI initiatives?

Yes ....☐ No ....☐

9.3 **Activity-based Costing:** *Distribution of costs to specific activities performed in divisions of an organization?*

Yes ....☐ No ....☐ Don't know ....☐

If yes, are natural foods included in your ABC initiatives?

Yes ....☐ No ....☐

9.4 **Continuous Replenishment:** *System of electronic custom inventory replenishment using EDI-standard formulas?*

Yes ....☐ No ....☐ Don't know ....☐

Are natural foods included in your continuous replenishment initiatives

Yes ....☐ No ....☐

Part 2. Barriers in the Natural Foods Market

1. The following items examine your perceptions about barriers in the natural foods market. Remember, the term "barriers" refers to impediments to market entry and market success. Please circle a number between 1 and 6 for each of the following items to indicate whether you feel a barrier exists in the market. If you have "No Opinion." circle 9.

1.1 POTENTIAL FIRM LEVEL BARRIERS	NOT A BARRIER AT ALL					MAJOR BARRIER	NO OPINION
a. *Strategically Planning Natural Food Ventures*							
• Finding timely, complete market price and quantity information	1	2	3	4	5	6	9
• Integrating new natural food ventures into existing operations	1	2	3	4	5	6	9
b. *Launching Natural Food Ventures*							
• Linking with natural food input suppliers	1	2	3	4	5	6	9
• Gaining new skills, training, financing, equipment and/or processes	1	2	3	4	5	6	9
c. *Managing Natural Food Ventures*							
• Maintaining quality and safety standards	1	2	3	4	5	6	9
• Allocating staff time	1	2	3	4	5	6	9
• Implementing efficient production management methods	1	2	3	4	5	6	9
• Packaging natural food products	1	2	3	4	5	6	9
d. *Selling Natural Food Products*							
• Linking with buyers' interest in environment, health, and safety	1	2	3	4	5	6	9
• Pricing and marketing natural food products	1	2	3	4	5	6	9
1.2 POTENTIAL INDUSTRY LEVEL BARRIERS							
a. *Market Issues*							
• Difficulty finding agricultural producers	1	2	3	4	5	6	9
• Difficulty finding manufacturers	1	2	3	4	5	6	9
• Difficulty finding distributors	1	2	3	4	5	6	9
• Difficulty finding retailers	1	2	3	4	5	6	9
• Market demand insufficient	1	2	3	4	5	6	9
• Market supply insufficient	1	2	3	4	5	6	9
• Unreliable market quality	1	2	3	4	5	6	9
b. *Policy Issues*							
• Lack of government standards for natural foods	1	2	3	4	5	6	9
• Lack of industry standards for natural foods	1	2	3	4	5	6	9
• Uncertainty about future standards for natural foods	1	2	3	4	5	6	9

2. Please describe any other MAJOR barriers you perceive in the natural foods market:

Part 3. Business Strategy

1. The following Items determine what, if anything, you have done to lower barriers in the market for natural foods. If you have used a strategy, please rate its success on the following 6-point scale by circling the appropriate number. If you have "No Opinion," circle 9.

	Used? No	Used? Yes	No Success 1	2	3	4	5	Total Success 6	No Opinion
• Developed a natural foods label	☐	☐→	1	2	3	4	5	6	9
• Distributed newspaper/direct mail advertising	☐	☐→	1	2	3	4	5	6	9
• Provided in-store advertising/demonstrations/samples	☐	☐→	1	2	3	4	5	6	9
• Sold a unique product	☐	☐→	1	2	3	4	5	6	9
• Sold a high-quality product	☐	☐→	1	2	3	4	5	6	9
• Diversified natural foods offerings	☐	☐→	1	2	3	4	5	6	9
• Targeted a specific market	☐	☐→	1	2	3	4	5	6	9
• Contracted with sellers/buyers	☐	☐→	1	2	3	4	5	6	9
• Joined a cooperative/limited partnership	☐	☐→	1	2	3	4	5	6	9
• Hired special staff for natural foods	☐	☐→	1	2	3	4	5	6	9
• Increased scale of natural foods operation	☐	☐→	1	2	3	4	5	6	9
• Other strategies *(Please specify)*									
1.	☐	☐→	1	2	3	4	5	6	9
2.	☐	☐→	1	2	3	4	5	6	9
3.	☐	☐→	1	2	3	4	5	6	9

2. Please indicate which of the following resources for information and assistance you find to be the most useful for your natural foods-related business. If you have used a source, please rate its usefulness on the following 6-point scale by circling the appropriate number. If you have "No Opinion," circle 9.

	Used? No	Used? Yes	Not Useful at All 1	2	3	4	5	Very Useful 6	No Opinion
• Internal staff resources	☐	☐→	1	2	3	4	5	6	9
• Other industry members	☐	☐→	1	2	3	4	5	6	9
• Federal government	☐	☐→	1	2	3	4	5	6	9
• State government	☐	☐→	1	2	3	4	5	6	9
• Trade organizations (e.g. Food Marketing Institute, Grocery Manufacturers Association, Organic Trade Association, etc.)	☐	☐→	1	2	3	4	5	6	9
• Research/academic institution	☐	☐→	1	2	3	4	5	6	9
• Private consultants	☐	☐→	1	2	3	4	5	6	9
• Other sources *(Please specify)*									
1.	☐	☐→	1	2	3	4	5	6	9
2.	☐	☐→	1	2	3	4	5	6	9
3.	☐	☐→	1	2	3	4	5	6	9

Section 4. Profile Questions

Keeping in mind that all of your responses will be kept strictly confidential, please answer the following questions:

1. What were your total (gross) sales in 1997? .... **$ __ . __ __ __ . __ __ __ . __ __ __ . 00**

2. What percentage of your total (gross) sales was from natural foods in 1997? .... ______%

3. What percentage of your total gross sales do you estimate will be from natural foods in 3 years? .... ______%

HENRY A. WALLACE INSTITUTE FOR ALTERNATIVE AGRICULTURE is a nonprofit, tax-exempt research and educational organization.

Established in 1983, the Institute encourages and facilitates the adoption of low-cost, resource-conserving, and environmentally-sound farming systems. It works closely with producers groups, public research and education institutions, and government agencies in promoting a sustainable agricultural system.

Its programs include providing a national information clearing house, serving as a voice for agricultural sustainability in Washington, D.C., and developing and implementing research and educational outreach programs. In addition to publishing Policy Studies Reports, it holds an annual lecture series, and publishes the monthly newsletter *Alternative Agriculture News* and the quarterly *American Journal of Alternative Agriculture*. It also hosts a Visiting Scholar Program.

The Institute is governed by a diverse Board of Directors which includes commercial-scale organic and other farmers, university and governmental scientists, representatives from non-governmental organizations, and others. It maintains a small professional staff. It is supported by memberships, donations, grants from foundations, corporations, and individuals, and competitive research project awards.

For membership information, and to learn more about the work of the Wallace Institute, write, call, fax, e-mail, or consult our Web site:

Henry A. Wallace Institute for Alternative Agriculture
9200 Edmonston Road, Suite 117
Greenbelt, Maryland 20770-1551
USA
301.441.8777
fax: 301.220.0164
e-mail: hawiaa@access.digex.net
Web site: http://www.hawiaa.org

Henry A. Wallace Institute for Alternative Agriculture

Greenbelt, Maryland