

Growth of organic food industry could challenge giant Whole Foods

by Jennifer Davies

Time was, if you wanted a jar of organic peanut butter, you'd have to travel to a small mom-and-pop shop operated by a true believer, most likely dressed in Birkenstocks and hemp clothing.

No longer.

The natural grocery business has gone mainstream, and you can find that organic peanut butter as well as organic milk and juice as easily at large grocery chain stores as you can at the local organic co-op. Large grocery chains such as Vons, Ralphs and Albertsons are wading into the organic business, and even Wal-Mart has tried organic products.

But for the giant of the industry, the 190-store Whole Foods chain, this growth has proved to be a two-edged sword. Sales have soared - up 20 percent a year in recent years to reach \$5.6 billion for fiscal 2006, which ended in September. But there is also more competition.

To protect its position, Whole Foods recently announced plans to buy rival natural grocery chain Wild Oats, with 110 stores. The move could enable the company to grab a larger portion of the growing organic business and fend off challenges from the large supermarket chains.

"It's become such a mainstream business," said Ted Taft, managing director of Meridian Consulting, which tracks the grocery industry. "Whole Foods and Wild Oats needed to merge to protect themselves."

Even with the merger, Whole Foods' fate is far from clear, as is the effect the buffed-up natural food giant will have on other players in the business.

Whole Foods said it hasn't decided which Henry's stores will stay open but said it will remodel and rebrand the ones it keeps. The Henry's locations provide a challenge in that for the most part, they are smaller than a typical Whole Foods, which ranges from 40,000 to 75,000 square feet.

Shon Boney, co-founder and CEO of Sprouts, a chain of natural grocery stores based in Arizona, said the industry is rife with rumors about what's going to happen to the stores owned by Wild Oats.

Speculation has included everything from Whole Foods remaking most of the Wild Oats and Henry's or perhaps selling some or all of the Henry's stores because their size and locations don't fit Whole Foods' plans.

A sale of the Henry's properties would make sense, said George Whalin, president of Retail Management Consulting, a California firm that tracks the industry. In addition to having too small a footprint, Whalin said, Henry's appeals to a slightly different market than Whole Foods because it is less of a purist natural/organic food store.

Taft of Meridian Consulting said many smaller players could be squeezed out as they face competition from Whole Foods and the mainstream markets.

"The mom-and-pops are going to be under tremendous pressure," he said.

Taft likened the current shift in the natural grocery business to that of the drugstore business - as independent operators were pushed out, large chains such as Walgreens, CVS and Rite Aid grew.

There's no doubt that the arrival of a Whole Foods can hurt the local natural grocery, said Corinne Shindelar, CEO of the Independent Natural Food Retailer Association. In the first 12 to 18 months after a Whole Foods opens, an independent store's sales fall an average of 20 percent, she said.

"The hard thing with so many different players coming into the market is the confusion it creates," she said.

Shindelar acknowledged that Whole Foods has helped the natural food business expand, attracting customers who would never considered shopping at a smaller store and whetting their appetite for natural and organic products.

Whole Foods has clearly had an effect. Since 2002, the natural and organic business has increased almost 65 percent, climbing from \$15.9 billion to an estimated \$26 billion in 2006, according to the Nutrition Business Journal.

Still, while the natural grocery business is growing, the market share of independent retailers is shrinking, Shindelar said. According to The Natural Foods Merchandiser, 31 percent of natural foods and products are sold in mass-market stores such as Vons or Ralphs while 50 percent are sold in natural food stores. Of that 50 percent market share, independent retailers have 67 percent of the business while the merged Whole

Foods/Wild Oats would account for 23 percent. The other 10 percent is split between co-ops and mail order and Internet sales.

Jimbo Someck, owner of Jimbo's, a San Diego natural food store chain, said his stores have been able to weather the competition and even thrive, opening a fourth location. For one, independent grocers say they are better able to offer local organic produce - a key issue for many purists.

Shindelar said locally grown produce is seen to benefit the community as well as reduce the environmental impact of transporting the produce.

Shon Boney said a small store can work directly with organic farmers who may be too small to provide the volume needed by a large chain.

"I've bought my eggs from the same guy for years," said Scott Boney, who is Shon Boney's uncle and, along with his brother, owned Henry's until its sale. "The chains, they couldn't tell you where their eggs are coming from."

Taft said smaller natural grocers need to find ways to differentiate themselves, much like independent drugstores now do, by catering to people who like the intimacy and service of an independent store.

Despite the increased competition, Whalin said, most natural food stores should be able to fend off the supermarket chains because they know the business and have better contacts throughout the industry. Also, they serve a different clientele. Wal-Mart, for instance, has cut back on its ambitious plans to offer more organic products because its customers didn't want to spend the extra money.

"I don't ever see the mass-markets chains being a major player in the organic market," Whalin said. "They just don't do it that well."

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