The future of the global organic food and beverage industry - Management briefing: Current trends in the industry

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Abstract (Summary)

Consumer demand for the organic industry is concentrated in industrialized nations, with North America and Western Europe accounting for the majority of global revenues, but consumer interest is also expanding in other parts of the world. As more countries develop economically, increasing the education levels and affluence of the citizens, demand for organic products is expected to rise. Recent industry expansion mirrors the increasing diversity of the organic consumer market. The average age of an organic consumer is typically middle-aged, between 40-55 years old, but younger adults are buying more organic foods and beverages than the general population, according to the 2002 Walnut Acres Roper/ASW survey. Worldwide, in any given national market, sales of organic products rarely exceed 1% to 2% of overall sales. Yet, the growth rate of the industry surpasses almost all other sub-sectors of the worldwide food market. According to the OTA Survey (2004), organic fruit and vegetable sales in the US experienced approximately 20% growth in 2003, representing about 42% of organic food sales.

Full Text (2517 words)

Consumer snapshot

Consumer demand for the organic industry is concentrated in industrialised nations, with North America and Western Europe accounting for the majority of global revenues, but consumer interest is also expanding in other parts of the world. Traditionally, consumers interested in organic products live in urban areas, are well educated and belong to middle-high economic classes with relatively high purchasing power. When purchasing foods and beverages, these consumers consider factors such as quality, safety, sustainability and environmental impact. Because industrialised nations have a significant well-educated middle-class population, the bulk of organic sales occur in these countries. As more countries develop economically, increasing the education levels and affluence of the citizens, demand for organic products is expected to rise.

A common theme among regular purchasers of organic products is the belief that the products are nutritionally and ecologically superior. It is a "lifestyle choice." According to a 2002 Walnut Acres study conducted by Roper/ ASW, 56% of those surveyed in the US believed that organic products were healthier than conventional products. A similar percentage thought that consuming organic foods and beverages beginning in childhood would help prevent future health problems. The Hartman Group found that almost 75% of Americans are concerned about food safety and 87% of organic purchasers believe organic products to be safer.

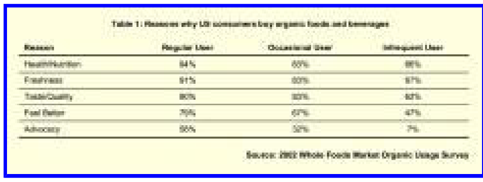
The changing face of the organic consumers

Most research into organic consumer demographics and psychographics has been conducted in the US. Recent industry expansion mirrors the increasing diversity of the organic consumer market. The average age of an organic consumer is typically middle-aged, between 40-55 years old, but younger adults are buying more organic foods and beverages than the general population, according to the 2002 Walnut Acres Roper/ASW survey. The same study found that 68% of 18 to 24-year-olds say they purchase organic beverages "every time" or "sometimes" when they go shopping. This compares with 51% of adults overall. Additionally, 78% of the 18-24 age group believe that consuming organic products is a smart choice for long-term health and well being, compared to 59% of adults overall.

Consumers of organics span diverse ethnic groups; the Hartman Group explains that a high incidence of organic consumption exists among Asian Americans, African Americans and people of Hispanic descent. Compared to Caucasian populations, certain ethnic groups are much more motivated to buy organic products because of family health and safety reasons and are less deterred by price.

A 2003 study by US retailer Whole Foods Markets revealed that 54% of Americans have tried organic foods with almost one-third (29%) claiming to consume more organic foods and beverages than one year ago. The Organic Consumer Trends Report of 2004 (Natural Marketing Institute/ SPINS 2004) reports that of the 40% of regular organic users in the US, 7.5% are "devoted users" who frequently or almost always use organic products daily, 25.1% are "temperate users" purchasing organic products sometimes, and 7.3% are "dabblers,"using organic products once in a while.

When polled in the 2002 Whole Foods Market Organic Usage Survey, 94% of regular US organic consumers responded that they bought organic foods and beverages because of health and nutrition; 90% of regular users reported taste and quality as an essential motivator, while 56% of this group reported advocacy as a reason for purchase. Consumers surveyed by the Hartman Group gave the following reasons for purchasing organic: nutrition (66%), taste (38%), environment (26%), and availability (16%).



[illegible]

Reason	Regular User	Occasional User	Infrequent User
Health/Nutrition	94%	[illegible]	[illegible]
Freshness	91%	[illegible]	67%
Taste/Quality	90%	[illegible]	[illegible]
Feel Better	[illegible]	67%	47%
Advocacy	56%	32%	7%

Source: 2002 Whole Foods Market Organic Usage Survey

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Table 1: Reasons why US consumers buy organic foods and beverages

Product category sale

Worldwide, in any given national market, sales of organic products rarely exceed 1 to 2% of overall sales. Yet, the growth rate of the industry surpasses almost all other sub-sectors of the worldwide food market. According to the OTA Survey (2004), organic fruit and vegetable sales in the US experienced approximately 20% growth in 2003, representing about 42% of organic food sales. Indeed, fruits and vegetables continue to be a favourite among shoppers - the Hartman Group states that 92% of all organic users buy fruits and vegetables. Data collected by the Hartman Group (2000) indicated that the top ten organic purchases were strawberries, lettuce, carrots, other fresh fruit, broccoli, apples, other fresh vegetables, grapes, bananas and potatoes. In European markets, experts predict a higher demand than supply for organic produce (IFOAM).

The OTA Survey indicates that organic beverages comprise 15% of organic food sales in the US, with dairy and prepared foods both following at 13%. Though some reports indicate that the dairy segment in Europe is undergoing high growth, other sources suggest that the milk sector in the UK is most under threat. The Organic Farmers and Growers Report (2004) documents that production has exceeded national demand for the last three to four years.

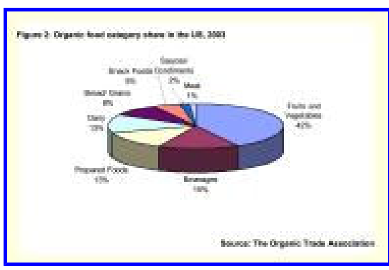

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Figure 2: Organic food category share in the US, 2003

Despite the category of meat, poultry and fish only representing about 1% of 2003 organic food sales in the US, this sector experienced the largest growth spurt, expanding by almost 78%. Steve French, NMI, reveals, "The organic food category experiencing the highest sales growth percentage is frozen and refrigerated meats, poultry and seafood, followed by energy bars and gels. Next in sales growth percentage is puddings and shelf stable desserts; coffee, coffee substitutes and cocoa; and candy and individual snacks, respectively."

Many convenience items are being introduced that are lunchbox- and kidfriendly, such as individual servings of apple sauce, yogurt, puddings and veggies with dip. Families with children are one of the leading markets for organic products, according to Lisa Everitt, business editor for Natural Foods Merchandiser, a trade publication of the organic food and beverage industry: "More and more products are being developed with convenience and ease of preparation in mind to suit the lifestyles of parents today."

Beverages and convenience products lead the way in new product introductions in the US this year, with the specific categories being tea, fruit and fruit flavoured drinks, coffee, soup, meals and entrees, pizza, hot snacks and sandwiches. "Organic beers and wines are an emerging sector. It is moving slowly, but more choices are becoming available," notes Katherine DiMatteo, executive director, OTA. With the introduction of new products comes improved taste and flavour. "More focus is being placed on the taste of organic and natural products," says Lisa Everitt, Natural Foods Merchandiser.

Price premiums remain a barrier for some consumers

Economies of scale related to production, distribution and packaging costs, along with strict certification standards, contribute to the elevated price premiums of organic versus conventional foods and beverages. Organic farming is typically more labour- and management-intensive because of stricter regulations to meet organic certification, including the elimination of pesticides, requiring additional labour to combat weeds and pests. Small-scale farmers must pay more per acre to grow crops and tend to incur added distribution costs. Other factors account for differentiation in pricing. For example, with fruits and vegetables, perishability, availability, demand, distribution costs, region and season are all factors that affect price.

For many consumers, price is a barrier to purchasing organic foods some or all of the time. In the 2002 Roper/ASW survey by Walnut Acres, 64% of consumers surveyed cited price as the main reason for not purchasing organic food, with 45% citing price as the major reason. Similarly, the Hartman Group (Whole Foods Survey, 2002) found that 63% of non-buyers stated that organic products were too expensive to buy. "There is a certain amount of resistance to buying organic products because of the price, but it is becoming less important over time as consumer interest in health and food safety increases. It is a question of value and what is most important to consumers," notes Chuck Benbrook, Ph.D., of the OCEP.

Table 2: Reasons cited for not purchasing organic foods/ beverages in the US

Reason	Percentage Who Cited That Factor
Cost	64%
Lack of variety/selection	57%
Health benefits unproven	53%
See no benefit from purchasing	49%
No standards for organic foods	49%
Products aren't available where I shop	48%
Products don't taste as good	44%
Don't understand what 'organic' means	27%

Source: Walnut Acres Roper/ASW Certified Organic Future Study

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Table 2: Reasons cited for not purchasing organic foods/ beverages in the US

The price barrier and elasticity related to organic food and beverage products has led some retailers and manufacturers to position organic products based on lower prices. For example, Trader Joe's in the United States, acquired in 2003 by Karl Albrecht and Theo Albrecht, who also own the Aldi supermarket chain in Western Europe and the US, targets mainstream suburban consumers with its discount strategy.

Previous business owners and key management from Horizon Organic Dairy, Boulder, Colo., recently formed Aurora Organic Dairy, with the business strategy of producing a lower-cost organic milk to make it affordable for more consumers. Says co-founder and chief operating officer Mark Retzloff, "As the organic industry continues to expand, economies of scale will help down the prices for organic goods. The two trends go hand in hand." As well, a move toward private-label organic products is also reducing the price for organic staple food items, including organic milk.

Mainstreaming of products

What was once only available in specialty and natural products stores, organic food and drink is becoming more mainstream everyday. Katherine DiMatteo, OTA, identifies the widespread availability of organic products as an important trend in the industry. "Organic products are available almost everywhere, from conventional grocery stores to convenience stores and even in food service. Organic items are showing up in places you would not expect." According to the Food Marketing Institute, organic items are now offered in almost three out of four conventional supermarkets in the US. In 2003, 47% of organic food sales were carried out in the natural food channel including independent natural product and health food stores as well as natural grocery chains (Trader Joe's, Whole Foods Markets and Wild Oats), while 44% of organic sales were attributed to supermarkets and grocery stores, mass merchandisers and club stores. This is a significant increase from 1998 when the mass-market channel held 31% of sales, according to OTA. The remaining 9% of sales occurred at farmers' markets, through food service, exports and other non-retail stores (OTA Survey, 2004).

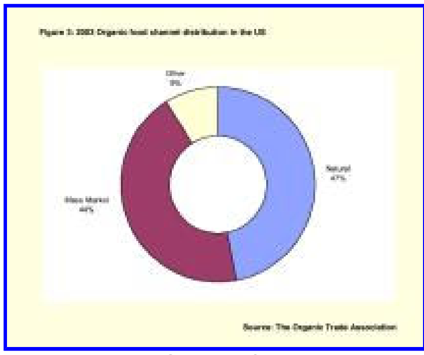

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Figure 3: 2003 Organic food channel distribution in the US

Accompanying the flood of organic products into mainstream venues is the introduction of private label products, or supermarkets' own house brands. In the United States, Natural food markets such as Trader Joe's, Whole Foods Markets and Wild Oats introduced the concept, and other companies quickly joined the movement including Safeway, Kroger, Harris Teeter, Hy-Vee, Wegmans and the Canadian firm Loblaw. The numbers and types of products offered by these private label entities vary from store to store. Some offer a few items, while other stores carry 300 or more organic items.

Organic food manufacturers are responding to consumer demand to move into mainstream outlets as well. Lisa Everitt, Natural Foods Merchandiser, uses Rudi's Organic Bakery, which produces organic artisan breads, as an example. "Rudi's Organic Bakery introduced a product line that is analogous to what conventional supermarket shoppers buy. The packaging and look of the products are similar to conventional breads, but the Rudi's Organic products are organic."

Consolidation

Historically, the organic industry has been represented by small family farms and modest production. However, increasing sales accompanied by the migration of organic foods and beverages into the mainstream has also attracted major food corporations that recognise the vast potential for developing their own organic lines. In the US, companies such as Dean Foods, Unilever, General Mills, Kraft, Coca-Cola, JM Smucker, Weetabix, Mars and Danone are a few of the large corporations that have acquired or established organic lines. Recently, Dean Foods, Dallas, Tex., consolidated the organic brands of White Wave, (producer of Silk and Sun Soy soymilk), and Horizon Organic Dairy. Many experts believe that consolidation in the industry will help grow the organic industry overall. Lisa Everitt, Natural Foods Merchandiser, agrees. "Involvement of large corporations, with their research and development, marketing, manufacturing, and distribution expertise, can help organic products reach mainstream outlets, therefore increasing consumer demand and organic production," she says. "This will help the industry flourish. With large corporations involved, I hope that the industry continues to grow in a sensible way."

Also dipping into the organic market are ingredient suppliers interested in producing ingredients that can be used in organic production. Large ingredient suppliers are targeting natural foods and organic manufacturers. Aside from providing manufacturers with more organic ingredients, the suppliers are also providing "functional" ingredients like pre- and probiotics, antioxidants, fibre and resistant starch, which are all promising elements in the industry. Ingredient manufacturers and suppliers must comply with the USDA NOP standards in the US, and European manufacturers and suppliers must comply with the EU organic standards.

Keeping the industry unified

Big business coupled with ongoing innovations of smaller organic producers have created a dynamic industry and kept the standards of organic food production on track. Steve French, NMI, believes that small and larger producers can work together to unify and build the industry. "Increased product range can help stimulate consumer demand, in turn, helping the industry as a whole to grow." Participation by large-scale corporations and the addition of private label organic lines will aid in lowering the price premium of the organic market, making it a viable option for all people; not only those with high purchasing power.

"Larger scale farms and operations are entering into organic agriculture as it is becoming economically more feasible. These large-scale farms are able to reach a higher level of sustainable practices and efficiency, with the cost of management spread out over more acres. These factors help lower the price differential, making organic products more affordable for consumers," says Mark Retzloff, Aurora Organic Dairy.

Fairness to farmers

Kathy DiMatteo, OTA, identifies the challenges of making organic products affordable while maintaining fairness to farmers and producers. "One thing we'll struggle with is organic distribution not falling prey to market forces that will drive the price down too far. We started off as wanting a sustainable market with family farmers playing a big role. Most people in a farming economy are not making a liveable wage." DiMatteo indicates that the question of who makes the sacrifices to get that lower price will be important, whether it's farmers, distributors or others. "It's not bad if savings come from the middle of the supply chain. Expansion of production would be a good thing for the organic industry, because it will help some of those middle range costs."

In OFRF's 2004 Farmers' Survey, about 52% of the US farmers surveyed said prices for their organic produce have remained steady, while 27% were wary of prices falling in the future, as more farmers and big businesses try to capitalise on the sector's success. In a report released in 2004 by Organic Farmers and Growers in the UK, 63% of farmers queried felt that their rate of profitability was low or borderline, while 12% said their businesses were unviable at current prices. According to the report, situated at the bottom of the supply chain with relatively little bargaining power vis à vis those above, farmers feel that they are predominantly price takers rather than price makers.

Approximately one-third of farmers surveyed said they are undecided as to what the next five years holds for them. Foremost among the challenges for organic farmers is the imbalance of bargaining power along the supply chain, with (as farmers see it) supermarkets in the driving seat and farmers in the begging seat.

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