

## Food & Marketing



California Certified Organic Farmers

# Organic Foods: Niche Marketers Venture into the Mainstream

The organic foods industry has been growing at a remarkable rate during the past several years. Sales of organic commodities in natural foods stores approached \$3.3 billion in 1998, compared with \$2.08 billion in 1995, according to industry sources. Sales of organic products in conventional supermarkets are also rising. Industry experts expect the current average annual growth rate of 20-24 percent for organic food sales to continue into the next decade.

Such growth continues to transform the organic foods industry. Firms that have been in the industry for many years face pressure to expand, and some struggle to keep up with demand for their products even as they confront competition from new entrants.

Some established firms may welcome industry growth because they expect to benefit from increasing numbers of organ-

ic growers, manufacturers, wholesalers, and distributors serving a larger national and international market. They see an expanded market as an opportunity to modify marketing approaches and bring organic products to a broader range of consumers. In contrast, other established organic foods businesses maintain that organic foods should be produced and marketed on a local or regional scale, in part to preserve opportunities for small family farms and ranches in rural areas.

Rapid growth in demand presents the organic industry with a major challenge—to ensure an adequate supply while maintaining product integrity. Firms seek to meet rising demand by developing more efficient ways to bring larger quantities of organic products to the market. At the same time, the industry seeks to combat the potential for fraud—i.e., marketing conventionally grown products as organically grown. Implementation of USDA's

This article is based on results of research partially funded by USDA's Fund for Rural America. The research project uses survey data, case studies, and industry analysis. The case studies generally include one large national firm and one smaller regional firm for each stage along the marketing chain (although both manufacturers are large national firms). The full report, *Organic Food Markets in Transition*, is published by the Henry A. Wallace Center for Agricultural & Environmental Policy, Winrock International. Copies are available from the authors.

proposed national organic program should facilitate this effort.

### *Maintaining Integrity Of Organic Products*

A unique aspect of the organic market is that it does not rely solely on economic factors to differentiate its products. Buyers of organic food products, both businesses and consumers, make purchasing decisions by considering not only price and quality, but also the perceived social and environmental benefits that organic production represents. Buyers expect that the organic characteristics for which they pay premium prices will be preserved as the commodity moves along the marketing chain. Ensuring integrity of the product may require 1) certifying to provide credible assurance that the commodity was grown organically, 2) utilizing marketing and manufacturing techniques that preserve the organic identity of the product, and 3) implementing a national standard that defines exactly what "certified organic" means.

From the industry's inception, a key problem has been lack of a universally accepted definition for "organic," making it difficult for buyers to know what they are getting when they pay higher prices for so-called organic foods. In 1973, a group of 50 California farmers was the first to address the issue. They formed the California Certified Organic Farmers (CCOF), which defined standards for organically grown food and created a certification system. The CCOF standards were used as a model for the California Organic Foods Act passed in 1990.

Since formation of the CCOF, there has been a proliferation of attempts to develop organic standards and certification. In the U.S., there are currently 13 states with certification programs and at least 36 private certifiers. Several certifiers assess providers of organic handling services, such as distributors, packers and re-packers, and processors, to ensure that organic food does not become commingled or contaminated during processing. Other countries, such as the European Union, Canada, and Japan, have their own standards for organic foods, and many are different from those in the U.S.

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In the absence of a uniform definition, rising demand combined with a premium price for most organic products provides a powerful incentive to fraudulently label conventionally grown products as organic or to compromise organic production practices. The Organic Farming Research Foundation reports that several firms were recently fined for violating the California Organic Foods Act.

In an effort to resolve these kinds of problems, Congress included the Organic Food Production Act in the 1990 farm legislation. The Act led to the creation of the National Organic Program (NOP) within USDA's Agricultural Marketing Service (AMS) and the National Organic Standards Board (NOSB). NOSB, an advisory board which includes food industry, consumer, and environmental representatives, provides recommendations to the NOP, which is charged with writing regulations to implement the Act. In March 2000, USDA released a proposed regulation that incorporates recommendations of the NOSB and responds to numerous comments from the public that emphasized the need to tighten regulations for practices permitted in organic production (AO April 2000). Based on comments received so far, the proposal appears to have moved a national definition of organic production closer to consensus among views of consumers, the organic industry, and USDA.

### *Links in the Marketing Chain*

As the quest for a uniform national standard nears resolution, the organic food industry continues to focus on how to move ever larger quantities of quality products from farm gate to consumer. Maintaining quality at each step along the marketing chain presents challenges for each agent. Although premium prices at the farm gate give farmers a strong incentive to grow a high quality commodity, food products pass through a number of intermediaries as they travel from producer to retailer. Producers who use organic farming methods want to be sure the food they grow will be handled and processed according to standards that allow consumers to buy with confidence, especially

### What Do Consumers Look For in Organic Foods?

Consumers shopping for organic foods look for many of the same qualities that are valued in nonorganic products. Taste, appearance, and freshness top the list, followed by convenience and price, and then certain critical qualities unique to organic foods. In a 1994 survey commissioned by The Food Alliance in Portland, Oregon, 600 consumers—all of whom had indicated an interest in environmental issues—rated possible considerations in their organic food choices. Eight qualities rated as “extremely important” by at least 50 percent of the sample were:

- *absence of* 1) synthetic pesticides, 2) synthetic herbicides, 3) *e-coli* or other harmful bacteria, 4) artificial ingredients or preservatives, and 5) synthetic fertilizers;
- *production facilities* 6) in compliance with their environmental permits, 7) using only earth-sustainable techniques, and 8) using techniques that protect water resources.

In addition, well over half of survey respondents reported they preferred organic foods to be “certified by an independent testing laboratory” and that they were willing to “pay more for an eco-labeled product.”

since the products usually command a price premium for qualities that are often unobservable. Maintaining quality from grower to retailer assures that all who participate in providing organic foods have an opportunity to realize the profit potential from this market.

Moving the product quickly to the next agent is key to maintaining the value that underlies the organic price differential, particularly for products to be sold as fresh, but also for those destined for processing. Food processors often specify their own organic standards, along with freshness and other required characteristics such as shape and size. Transmitting accurate demand information back through the industry's marketing chain from consumers to retailers, then to wholesalers, manufacturers, and farmers, enables the industry to offer what consumers wish to purchase.

*Farmers* using organic agricultural methods to produce food commodities face a market that has become significantly larger and more complex. To succeed in this market, farmers must grow the right product and be able to ensure the quality of their output. Some organic farmers market their products through direct sales—e.g., at farmers' markets and onfarm stands, or to local restaurants and grocery stores—

but most market through wholesalers. Commercial buyers (manufacturers, distributors, and retailers) often have the best knowledge of what consumers want and what they are willing to pay for organic foods. Farmers are often able to get accurate and timely information about prices and market opportunities by listening carefully to buyers.

Even with access to information about what consumers want, organic farmers often face major challenges in finding markets, negotiating prices, and delivering food commodities while maintaining product integrity. Marketing agreements and strategic alliances among various combinations of farmers and shippers—organic or conventional—are designed to enable participants to draw on each other's inventories and distribution networks, thereby increasing their ability to service a larger market share. For example, in 1999, the country's second-largest conventional lettuce grower (Tanimura and Antle) and the nation's largest organic vegetable shipper (Natural Selection Foods, marketer of the Earthbound Farm brand) became partners in supplying organic lettuce to large, mass-market supermarkets. Strategically allied farmers and shippers gain an advantage by providing a wider range of crops and varieties than each could supply independently.

**From grower case studies:**

Pavich Family Farms is the world's largest grower of certified organic table grapes, as well as a marketer of more than 100 products from a network of other organic farmers. Like conventional produce shippers, Pavich strives to provide year-round supplies of fresh produce by working with certified organic fruit growers in Chile, Costa Rica, El Salvador, and South Africa. Flickerville Mountain Farm and Groundhog Ranch is a small, highly diversified farming operation located in south central Pennsylvania. The operators handle most of the marketing themselves, selling most of their products through farmers' markets and direct sales to restaurants in Washington, DC.

*Manufacturers* of both conventional and organic foods face problems associated with buying adequate amounts of ingredients at reasonable prices, producing a uniformly consistent product, and securing shelf space in the supermarket. However, manufacturers of organic products have added challenges in dealing with organic ingredients: locating sufficiently large supplies, verifying they are organic, and maintaining organic integrity of the commodities during processing.

Some large organic food manufacturers have recently begun to follow the lead of conventional food processors to overcome the sourcing problem by working closely with farmers to provide guidelines for the kinds of products they require, or by entering into formal contract agreements.

Organic foods have traditionally been manufactured by small businesses that fit into a profitable niche market in a region. Their success, like many other organic food businesses, can be attributed in many cases to buyers ascribing quality, taste, safety, and environmental characteristics to organic products, and consumers' partiality toward local production. However, the market for organic foods was fairly small and very specialized when many of these businesses first opened their doors. That market is much larger now, and as mass-market food businesses enter, many long-time organic foods manufacturers are realizing they must expand and/or merge in order to stay competitive.

Rising demand presents opportunities for traditional organic manufacturers that have been able to increase their scale of operations, although increased market size and competition may erode the market premium that their product once commanded. Survival for these manufacturers depends in large part on whether they can carve out a niche for themselves and maintain market share through quality and price competitiveness.

Until recently, most organic products were sold in "natural foods" markets. As the organic market grows, manufacturers of organic foods are increasingly interested in selling in mass-market venues. Many lack the expertise and experience of their competition (mass-market distributors) when it comes to gauging customer preferences. They have been slow to adopt supply-chain management techniques, which can be invaluable in streamlining and minimizing the costs incurred on the path from assembly line to shopping cart. In fact, many organic foods manufacturers that have been growing swiftly without well-defined management plans have run into severe logistical problems such as matching the flow of inputs to consumer purchasing patterns.

**From manufacturer case studies:**

Cascadian Farm, the world's largest organic foods company, produces, manufactures, distributes, and markets a wide variety of organic products. The company contracts directly with farmers and helps them to make the transition from conventional to organic farming. Following the lead of most conventional dairy producers, Wisconsin-based Coulee Region Organic Produce Pool (CROPP) Cooperative represents small and mid-sized farmers from Maine to Oregon to manufacture and sell a line of organic dairy products, as well as meat, poultry, and produce. CROPP's gross revenue topped \$30 million in 1999.

*Distributors* of organic foods sit between producers (for foods sold as fresh) or manufacturers (for processed foods), and retailers in the marketing chain. Distributors warehouse food products from manufacturers and deliver them to retailers. Ten years ago, these distributors were specialized, regional businesses that served

**Use of the Term "Natural" in Food Marketing**

In the 1970's, the Federal Trade Commission determined that food to be advertised as "natural" could not contain synthetic or artificial ingredients, and could not be more than minimally processed—i.e., processed with a technique that could not be used in a home kitchen. In 1982, USDA's Food Safety and Inspection Service issued a policy for labeling meat and poultry products, stating that the term "natural" may be applied only to products that contain no artificial ingredients, coloring ingredients, or chemical preservatives; and the product and its ingredients are not more than minimally processed."

The term "natural" is still used rather loosely in the food industry. For example, "natural" may be used to describe organic foods, meat or poultry meeting USDA's conditions for "natural" labeling, or vitamins and other food supplements. Natural foods markets frequently specialize in selling organic foods, but characteristics of these markets and the products they stock vary greatly. Therefore, a natural foods store cannot be defined as one that sells only organic products.

small, regional health food stores. Now, changes in the natural foods business environment (including but not limited to organic foods) have made it possible for a few of these distributors to become nationally recognized corporations.

Whether large or small, today's natural foods distributors are operating in an increasingly competitive environment that in some respects is more risky than for distributors in the well-established mass market. Organic foods distributors may have to develop working relationships with unfamiliar mass-market retailers whose buyers are new to the natural foods industry. Mass-market buyers may use a different type of language when ordering and lack familiarity with some of the constraints of organic product marketing—e.g., timing product purchases to accommodate seasonal variation or dealing with occasional shortages. At the same time,

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organic foods distributors continue to do business with traditional organic buyers, quite often small and sometimes uninformed about current industry pricing practices. In addition, new competition emerges as many mass-market distributors begin to carry organic products.

Margins in the natural foods distribution field are shrinking by most accounts. The *Natural Foods Merchandiser*, a trade journal, estimates that margins for distributors of natural products (the difference between acquisition cost and selling price) were 19-21 percent in 1995, down from 33 percent in previous years, although still higher than the 12 percent or less realized by their mass-market counterparts. As competition increases, natural foods distributors may respond by adding new products, carrying brand-name commodities, or simply becoming larger.

### From distributor case studies:

A large national publicly held organic distributor, United Natural Foods, indicates the company uses many techniques employed by mass-market distributors such as offering a range of products (e.g., food, general merchandise, and personal care products), streamlining administrative functions, consolidating systems applications between physical locations and between regions, and reducing geographic overlap of the regions. Rootabaga Enterprises, a regional Washington State distributor, specializes in distributing transitional (moving toward organic production) and organic apples, pears, fruit, vegetables, jams, jellies, and apple juices, and emphasizing customer service and personal relationships in business dealings.

Retailers in the organic and natural foods industry behave much like their mass-market counterparts by working to choose the optimal product mix and price structure. To meet these goals, retailers attempt to provide customers with a wide variety of high-quality foods. Traditional purveyors of natural products have functioned in this fashion since the inception of the organic movement. However, as consumer demand for organic products increases, a growing number of mass-market retailers has become interested in selling organic foods. Organic foods are usually clustered together in "natural" food sections, but

they may be integrated with nonorganic foods on supermarket shelves.

All retailers of organic foods want consistent supplies of products, and want assurances that the foods they sell as organic will generally meet purchasers' expectations. Consequently, retailers work to establish long-term relationships with wholesalers, who keep the retailers' needs in mind when purchasing commodities. More recently, however, a significant number of mass-market retailers have begun purchasing directly from organic growers or manufacturers. Most of these retailers have their own warehouses and distribution centers.

### From retailer case studies:

Marketing strategies used by Whole Foods, the nation's largest natural foods supermarket chain (gross sales \$8.4 billion in 1997), are similar to those used by mass-market stores, and include in-store advertising, cooking demonstrations, food samples, private labels, and handling much of its own distribution. My Organic Market is a regional, relatively small natural foods retailer (sales over \$100,000 per week in 1998) in the suburbs of Washington, DC, that has focused primarily on providing personally selected, high-quality organic produce and personalized customer service, in addition to product demonstrations and samples.

### Looking Ahead

Trends in the organic foods industry indicate the organic market is growing and that the market structure—from farmer to retailer—is shifting as it adjusts to change. However, definitive statistics on market changes are currently unavailable. USDA has measured some segments of organic production (e.g., acreage devoted to organic production and livestock produced organically), although for most commodities the market appears too small to warrant separate farm-to-retail tracking. Several private firms track the organic foods industry, but the data are not comprehensive and not readily available.

Despite shortcomings in the data, it is possible to point to some next steps for the growing organic foods market. Traditional small local or regional firms that have been in the organic foods indus-

try for decades will increasingly share the market with large, corporate firms that are just beginning to enter. Producers and manufacturers will likely expand product lines. A greater variety of organic commodities will be sold in a widening array of retail outlets as the organic industry remains specialized but becomes more mainstream.

Participants would benefit from a national organic regulation, and from using procedures to maintain the integrity of their products until they reach the consumer. Purchasers would then be able to rely on uniform and consistent national standards for defining the term "organic." USDA's proposed national organic standards are expected to be finalized this year. Operations that grow or process organic foods would be certified by USDA-accredited certifying agents.

If the industry addresses the challenges of adjustment to an expanding market in a timely fashion, and participants have the benefit of detailed information to guide decisionmaking, the future of the organic foods industry looks bright. **AO**

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### Upcoming Reports—USDA's Economic Research Service

The following reports are issued electronically on dates and at times indicated.

#### June

- 2 *Outlook for U.S. Agricultural Trade (3 pm)\**
- 9 *World Agricultural Supply & Demand (8:30 am)*
- 12 *Cotton & Wool Outlook (4 pm)\*\**  
*Oil Crops Outlook (4 pm)\*\**  
*Rice Outlook (4 pm)\*\**
- 13 *Feed Outlook (9 am)\*\**  
*Wheat Outlook (9 am)\*\**
- 23 *U.S. Agricultural Trade Update (3 pm)*
- 28 *Livestock, Dairy & Poultry (4 pm)\*\**

\* Summary released 3 pm

\*\* Available electronically only