

CASE 33

Whole Foods Market 2010: How to Grow in an Increasingly Competitive Market? (Mini Case)

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REFLECTING BACK OVER HIS THREE DECADES OF EXPERIENCE IN THE GROCERY BUSINESS, John Mackey smiled to himself over his previous successes. His entrepreneurial history began with a single store which he has now grown into the nation's leading natural food chain. Whole Foods is not just a food retailer but instead represents a healthy, socially responsible lifestyle that customers can identify with. The company has differentiated itself from competitors by focusing on quality as excellence and innovation that allows it to charge a premium price for premium products. While proud of the past, John had concerns about the future direction Whole Foods should head.

Company Background

Whole Foods carries both natural and organic food, offering customers a wide variety of products. “Natural” refers to food that is free of growth hormones or antibiotics, whereas “certificated organic” food conforms to the standards, as defined by the U.S. Department of Agriculture (USDA) in October 2002. Whole Foods Market® is the world's leading

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retailer of natural and organic foods, with 193 stores in 31 states, Canada, and the United Kingdom.

According to the company, Whole Foods Market is highly selective about what it sells, dedicated to stringent quality standards, and committed to sustainable agriculture. It believes in a virtuous circle entwining the food chain, human beings and Mother Earth: each is reliant upon the others through a beautiful and delicate symbiosis. The message of preservation and sustainability are followed while providing high-quality goods to customers and high profits to investors.

Whole Foods has grown over the years through mergers, acquisitions, and new store openings. The \$565 million acquisition of its lead competitor, Wild Oats, in 2007 firmly set Whole Foods as the leader in the natural and organic food market and led to 70 new stores. The U.S. Federal Trade Commission (FTC) focused its attention on the merger on antitrust grounds. The dispute was settled in 2009, with Whole Foods closing 32 Wild Oats stores and agreeing to sell the Wild Oats Markets brand.

Although the majority of Whole Foods' locations are in the United States, European expansion provides enormous potential growth due to the large population and it holds a more sophisticated organic-foods market than the U.S. in terms of suppliers and acceptance by the public. Whole Foods targets its locations specifically by an area's demographics. The company targets locations where 40% or more of the residents have a college degree as they are more likely to be aware of nutritional issues.

Whole Foods Market's Philosophy

Whole Foods Market's corporate website defines the company philosophy as follows:

Whole Foods Market's vision of a sustainable future means our children and grandchildren will be living in a world that values human creativity, diversity, and individual choice. Businesses will harness human and material resources without devaluing the integrity of the individual or the planet's ecosystems. Companies, governments, and institutions will be held accountable for their actions.

While Whole Foods recognizes it is only a supermarket, management is working toward fulfilling their vision within the context of the industry. In addition to leading by example, they strive to conduct business in a manner consistent with their mission and vision. By offering minimally processed, high-quality food, engaging in ethical business practices, and providing a motivational, respectful work environment, the company believes it is on the path to a sustainable future.

Whole Foods incorporates the best practices of each location back into the chain. This can be seen in the company's store product expansion from dry goods to perishable produce, including meats, fish, and prepared foods. The lessons learned at one location are absorbed by all, enabling the chain to maximize effectiveness and efficiency while offering a product line customers love. Whole Foods carries only natural and organic products. The best tasting and most nutritious food available is found in its purest state—unadulterated by artificial additives, sweeteners, colorings, and preservatives.

Employee and Customer Relations

Whole Foods encourages a team-based environment allowing each store to make independent decisions regarding its operations. Teams consist of up to 11 employees and a team leader. The team leaders typically head up one department or another. Each store employs anywhere from 72 to 391 team members. The manager is referred to as the "store team leader."

The “store team leader” is compensated by an Economic Value Added (EVA) bonus and is also eligible to receive stock options.

Whole Foods tries to instill a sense of purpose among its employees and has been named for 13 consecutive years as one of the “100 Best Companies to Work For” in America by *Fortune* magazine. In employee surveys, 90% of its team members stated that they always or frequently enjoy their job.

The company strives to take care of its customers, realizing they are the “lifeflood of our business,” and the two are “interdependent on each other.” Whole Foods’ primary objective goes beyond 100% customer satisfaction with the goal to “delight” customers in every interaction.

Competitive Environment

At the time of Whole Foods’ inception, there was almost no competition with less than six other natural food stores in the United States. Today, the organic foods industry is growing and Whole Foods finds itself competing hard to maintain its elite presence.

Whole Foods competes with all supermarkets. With more U.S. consumers focused on healthful eating, environmental sustainability, and the green movement, the demand for organic and natural foods has increased. More traditional supermarkets are now introducing “lifestyle” stores and departments to compete directly with Whole Foods. This can be seen in the Wild Harvest section of Shaw’s, or the “Lifestyle” stores opened by conventional grocery chain Safeway.

Whole Foods’ competitors now include big box and discount retailers who have made a foray into the grocery business. Currently, the United States’ largest grocer is Wal-Mart. Not only does Wal-Mart compete in the standard supermarket industry, but it has even begun offering natural and organic products in its supercenter stores. Other discount retailers now competing in the supermarket industry include Target, Sam’s Club, and Costco. All of these retailers offer grocery products, generally at a lower price than what one would find at Whole Foods.

Another of Whole Foods’ key competitors is Los Angeles-based Trader Joe’s, a premium natural and organic food market. By expanding its presence and product offerings while maintaining high quality at low prices, Trader Joe’s has found its competitive niche. It has 215 stores, primarily on the west and east coasts of the United States, offering upscale grocery fare such as health foods, prepared meals, organic produce, and nutritional supplements. A low cost structure allows Trader Joe’s to offer competitive prices while still maintaining its margins. Trader Joe’s stores have no service department and average just 10,000 square feet in store size.

A Different Shopping Experience

The setup of the organic grocery store is a key component to Whole Foods’ success. The store’s setup and its products are carefully researched to ensure that they are meeting the demands of the local community. Locations are primarily in cities and are chosen for their large space and heavy foot traffic. According to Whole Foods’ 10-K, “approximately 88% of our existing stores are located in the top 50 statistical metropolitan areas.” The company uses a specific formula to choose store sites that is based upon several metrics, which include but are not limited to income levels, education, and population density.

Upon entering a Whole Foods supermarket, it becomes clear that the company attempts to sell the consumer on the entire experience. Team members (employees) are well trained and the stores themselves are immaculate. There are in-store chefs to help with recipes, wine tasting, and food sampling. There are “Take Action food centers” where customers can access

information on the issues that affect their food such as legislation and environmental factors. Some stores offer extra services such as home delivery, cooking classes, massages, and valet parking. Whole Foods goes out of its way to appeal to the above-average income earner.

Whole Foods uses price as a marketing tool in a few select areas, as demonstrated by the 365 Whole Foods brand name products priced less than similar organic products that are carried within the store. However, the company does not use price to differentiate itself from competitors. Rather, Whole Foods focuses on quality and service as a means of standing out from the competition.

Whole Foods spends much less than other supermarkets on advertising, approximately 0.4% of total sales in the fiscal year 2009. It relies heavily on word-of-mouth advertising from its customers to help market itself in the local community. The company advertises in several health conscious magazines, and each store budgets for in-store advertising each fiscal year.

Whole Foods also gains recognition via its charitable contributions and the awareness that they bring to the treatment of animals. The company donates 5% of its after-tax profits to not-for-profit charities. It is also very active in establishing systems to make sure that the animals used in their products are treated humanely.

The Green Movement

Whole Foods exists in a time where customers equate going green and being environmentally friendly with enthusiasm and respect. In recent years, people began to learn about food and the processes completed by many to produce it. Most of what they have discovered is disturbing. Whole Foods launched a nationwide effort to trigger awareness and action to remedy the problems facing the U.S. food system. It has decided to host 150 screenings of a 12 film series called “Let’s Retake Our Plates,” hoping to inspire change by encouraging and educating consumers to take charge of their food choices. Jumping on the bandwagon of the “go green” movement, Whole Foods is trying to show its customers that it is dedicated to not only all natural foods, but to a green world and healthy people. As more and more people become educated, the company hopes to capitalize on them as new customers.¹

Beyond the green movement, Whole Foods has been able to tap into a demographic that appreciates the “trendy” theme of organic foods and all natural products. Since the store is associated with a type of affluence, many customers shop there to show they fit into this category of upscale, educated, new age people.

The Economic Recession of 2008

The uncertainty of today’s market is a threat to Whole Foods. The expenditure income is low and “all natural foods” are automatically deemed as expensive. Because of people being laid off, having their salaries cut, or simply not being able to find a job, they now have to be more selective when purchasing things. While Whole Foods has been able to maintain profitability, it’s questionable how long this will last if the recession continues or worsens. The reputation of organic products being costly may be enough to motivate people to not ever enter through the doors of Whole Foods. In California, the chain is frequently dubbed “Whole Paycheck.”²

However, management understood that it must change a few things if the company was to survive the decrease in sales felt because customers were not willing to spend their money so easily. They have been working to correct this “pricey” image by expanding offerings of private-label products through their “365 Everyday Value” and “365 Organic” product lines. Private-label sales accounted for 11% of Whole Foods’ total sales in 2009, up from 10% in 2008. They have also instituted a policy that their 365 product lines must match prices of similar products at Trader Joe’s.³

Organic Foods as a Commodity

When Whole Foods first started in the natural foods industry in 1980 it was a relatively new concept. Over its first decade, Whole Foods enjoyed the benefits of offering a unique value proposition to consumers wanting to purchase high-quality natural foods from a trusted retailer. Over the last few years, however, the natural and organic foods industry has attracted the attention of general food retailers that have started to offer foods labeled as natural or organic at reasonable prices.

By 2007, the global demand for organic and natural foods far exceeded the supply. This is becoming a huge issue for Whole Foods, as more traditional supermarkets with higher purchasing power enter the premium natural and organic foods market. The supply of organic food has been significantly impacted by the entrance of Wal-Mart into the competitive arena. Due to the limited resources within the United States, Wal-Mart began importing natural and organic foods from China and Brazil, which led to it coming under scrutiny for passing off non-natural or organic products as the “real thing.” Additionally, the quality of natural and organic foods throughout the entire market has been decreased due to constant pressure from Wal-Mart.

The distinction between what is truly organic and natural is difficult for the consumer to decipher as general supermarkets have taken to using terms such as “all natural,” “free-range,” and “hormone free,” confusing customers. Truly organic food sold in the United States bears the “USDA Organic” label and needs to have at least 95% of the ingredients organic before it can get this distinction.⁴

In May 2003 Whole Foods became America’s first Certified Organic grocer by a federally recognized independent third-party certification organization. In July 2009, California Certified Organic Growers (CCOF), one of the oldest and largest USDA-accredited third-party organic certifiers, individually certified each store in the United States, complying with stricter guidance on federal regulations. This voluntary certification tells customers that Whole Foods has gone the extra mile by not only following the USDA’s Organic Rule, but opening its stores up to third-party inspectors and following a strict set of operating procedures designed to ensure that the products sold and labeled as organic are indeed organic—procedures that are not specifically required by the Organic Rule. This certification verifies the handling of organic goods according to stringent national guidelines, from receipt through repacking to final sale to customers. To receive certification, retailers must agree to adhere to a strict set of standards set forth by the USDA, submit documentation, and open their facilities to on-site inspections—all designed to assure customers that the chain of organic integrity is preserved.

Struggling to Grow in an Increasingly Competitive Market

Whole Foods has historically grown by opening new stores or acquiring stores in affluent neighborhoods targeting the wealthier and more educated consumers. This strategy has worked in the past; however, the continued focus on growth has been impacting existing store sales. Average weekly sales per store have decreased over the last number of years despite the fact that overall sales have been increasing. It is likely that this trend will continue unless Whole Foods starts to focus on growing sales within the stores it has and not just looking to increase overall sales by opening new stores. It is also increasingly difficult to find appropriate locations for new stores that are first and foremost in an area where there is limited competition and also to have the store in a location that is easily accessible by both consumers and the distribution network. Originally Whole Foods had forecast to open 29 new stores in 2010 but this has since been revised downward to 17.

Opening up new stores or the acquisition of existing stores is also costly. The average cost to open a new store ranges from \$2 to \$3 million, and it takes on average 8 to 12 months. A lot of this can be explained by the fact that Whole Foods custom builds the stores, which reduces the efficiencies that can be gained from the experience of having opened up many new stores previously. Opening new stores requires the company to adapt its distribution network, information management, supply, and inventory management, and adequately supply the new stores in a timely manner without impacting the supply to the existing stores. As the company expands, this task increases in complexity and magnitude.

The organic and natural foods industry overall has become a more concentrated market with few larger competitors having emerged from a more fragmented market composed of a large number of smaller companies. Future acquisitions will be more difficult for Whole Foods as the FTC will be monitoring the company closely to ensure that it does not violate any federal antitrust laws through the elimination of any substantial competition within this market.

Over the last number of years there has been an increasing demand by consumers for natural and organic foods. Sales of organic foods increased by 5.1% in 2009 despite the fact that U.S. food sales overall only grew by 1.6%.⁵ This increase in demand and high margin availability on premium organic products led to an increasing number of competitors moving into the organic foods industry. Conventional grocery chains such as Safeway have remodeled stores at a rapid pace and have attempted to narrow the gap with premium grocers like Whole Foods in terms of shopping experience, product quality, and selection of takeout foods. This increase in competition can lead to the introduction of price wars where profits are eroded for both existing competitors and new entrants alike.

Unlike low-price leaders such as Wal-Mart, Whole Foods dominates because of its brand image, which is trickier to manage and less impervious to competitive threats. As competitors start to focus on emphasizing organic and natural foods within their own stores, the power of the Whole Foods brand will gradually decline over time as it becomes more difficult for consumers to differentiate Whole Foods' value proposition from that of its competitors.

NOTES

1. "Whole Foods Market; Whole Foods Market Challenge: Let's Retake Our Plates!" *Food Business Week* (April 15, 2010).
2. "Eating Too Fast At Whole Foods," *Business Week* (2005).
3. Katy McLaughlin, "As Sales Slip, Whole Foods Tries Health Push," *Wall Street Journal* (August 15, 2009).
4. "Whole Foods Markets Organic China California Blend," http://www.youtube.com/watch?v=JQ3ILjd9T_Y (April 10, 2010).
5. Organic Trade Association, http://www.organicnewsroom.com/2010/04/us_organic_product_sales_reach_1.html.