

To: John Mackey, CEO – Whole Foods Market, Inc.
From:
Re: Whole Foods Competitive Position and Analysis
Date: January 26, 2011

Introduction

Whole Foods Market is a multi-national retailer of organic and natural foods. According to the Organic Trade Association (OTA) and Nutrition Business Journal, the organic and natural foods industry's revenue is currently approximately \$26 billion in the U.S.¹ and \$71 billion worldwide². The OTA says that the organic and natural food category grew between 15% and 20% each year through 2008 before being stifled by the economic downturn in 2009 with only 5.1% growth³. Similar growth trends are expected for the next few years. With increased competition from more traditional grocers like Kroger and Safeway, as well as supercenters like Wal-Mart and Super Target, is Whole Foods's fate in jeopardy?

Competitive Position

Whole Foods's position in the organic and natural foods sector is dominant. With approximately 33.6% market share in the U.S. in 2010, no other single competitor comes close to the organic food volume of Whole Foods⁴. **Exhibit 1** shows Whole Foods's revenue and market share from 2003 to 2009. Since 1980, Whole Foods has concentrated on offering the highest variety of organic and natural food products⁵. With exception of Whole Foods, the organic and natural food market is fragmented with many customer buying channels. Competition exists from direct competitors like The Fresh Market, extended product offerings from traditional grocers and supercenters like Kroger and Wal-Mart, and local farmers' markets and coops such as those found around Charlottesville, VA. The threat of new entrants is high as more existing food retailers chase the product differentiation and variety of organic foods. **Exhibits 2 and 3** show a list of competitors, key figures, and strategies of those competitors.

Whole Foods has the advantage of being the first large mover in the organic retail industry. Substitutes in the organic and natural food segment are limited although more food retailers are now offering organic food selections. Whole Foods takes advantage of its above industry average selection with higher prices than most competitors on the hard to find organic products. With few complete channels to buy organics, buyer power is low for those products with limited selection, and high for those organic products being offered in many channels. According to a United States Department of Agriculture (USDA) study, suppliers are limited but are growing to larger regional and national positions⁶. Unlike the traditional grocers and supercenters, Whole Foods has the advantage of close partnerships with over 2,000 organic suppliers world-wide⁷. This enables Whole Foods to retain control, get more products year round, and keep prices as low as possible for customers. A complete five forces analysis is found in **Exhibit 4**.

Currently, Whole Foods's capabilities are well-positioned for market growth. **Exhibit 5** shows an analysis of Whole Foods's current capabilities. Whole Foods's team of highly skilled procurement specialists assists stores in buying what customers want and provides assistance to suppliers through growth loans and cost reduction consulting. These relationships ensure high quality standards and timely delivery to 299 stores. The Whole Foods's store model is focused on local customers' organic needs as well as an aesthetically pleasing atmosphere for organic food exploration and education. Whole Foods also concentrates on educating pregnant mothers and

parents on the benefits of organic foods. The company's website has a blog dedicated to organic food cooking and healthy lifestyle tips⁸. Overall, these capabilities are what the traditional grocers and supercenters are currently lacking.

However, competitors are copying Whole Foods's success. Just this week, Wal-Mart announced plans to increase the number of healthy food items available at its stores. With support from First Lady Michelle Obama, Wal-Mart will drop prices on fruits and vegetables. This plan also compliments their 2006 plan to increase organic food products available at its stores⁹. Publix has launched a chain of stores to compete directly with Whole Foods called Publix GreenWise Markets¹⁰. According to Willard Bishop, a food research firm, consumer demand for supercenter groceries will grow by 7.3% per year compared to only 1.7% per year for the fresh format (organic and natural food) grocers¹¹. If the supercenter can offer more organic product offerings, Whole Foods will suffer.

Changing Industry

According to Willard Bishop, the entire retail food industry generates approximately \$1 trillion of revenue in the U.S.¹². The industry is segmented into three main areas: 1) Traditional Grocery (~47.5% of the total market) 2) Convenience Stores (~15.4% of the total market) and 3) Non-traditional Grocery (~37% of the total market)¹³. Whole Foods plays in the traditional grocery segment under a subset called fresh format. The fresh format concentrates on a particular food segment—organic and natural foods for Whole Foods. **Exhibit 6** shows the breakdown of organic food sales by channel in 2009. According to the OTA, the sale of organic and natural foods through organic and natural food retailers was 47% in 2005—9% higher than in 2009¹⁴. The OTA says that shifts in organic buying trends to traditional grocers, club stores, and supercenters are attributed to more product availability in those channels, lower prices, and the growth of private-labeled organic products. For availability, the Food Marketing Institute says that 76% of traditional grocery stores now offer some natural and organic food selection¹⁵. These shifts in consumer purchasing trends and channels could be trouble for Whole Foods's future competitive position.

Additionally, there are other environmental factors affecting the industry. The USDA says consumer awareness of organic food benefits is high and will continue to grow. It is estimated that 69% of consumers purchased organic products in 2008¹⁶. Whole Foods, through its organic and natural foods message, has driven much of the trend towards this food group. Supply for organic and natural foods does not always meet demand, particularly in areas of the country with low organic farms density¹⁷. **Exhibit 7** shows organic farms by location and size. Most are located in the western U.S. As a result, according to a 2004 USDA study, approximately 38% of organic handlers had to import organic products to meet consumer demand. This effort is compounded by strict USDA procedures and a three year waiting period before a farm can sell certified organic foods¹⁸. One of Whole Foods's largest risks is the ability to get organic products as demand continues and more retailers fight for organic products.

Conclusion

As a first mover, Whole Foods has gained a competitive advantage in the organic foods retail market. However, stiff competition and consumer demand for lower prices will pose a problem for Whole Foods going forward. More competitors will try and imitate Whole Foods's success model in the organic foods segment. Thus, Whole Foods's competitive position may be at risk.

Exhibit 1: Whole Foods's Revenue and Market Share Trend^{19,20}

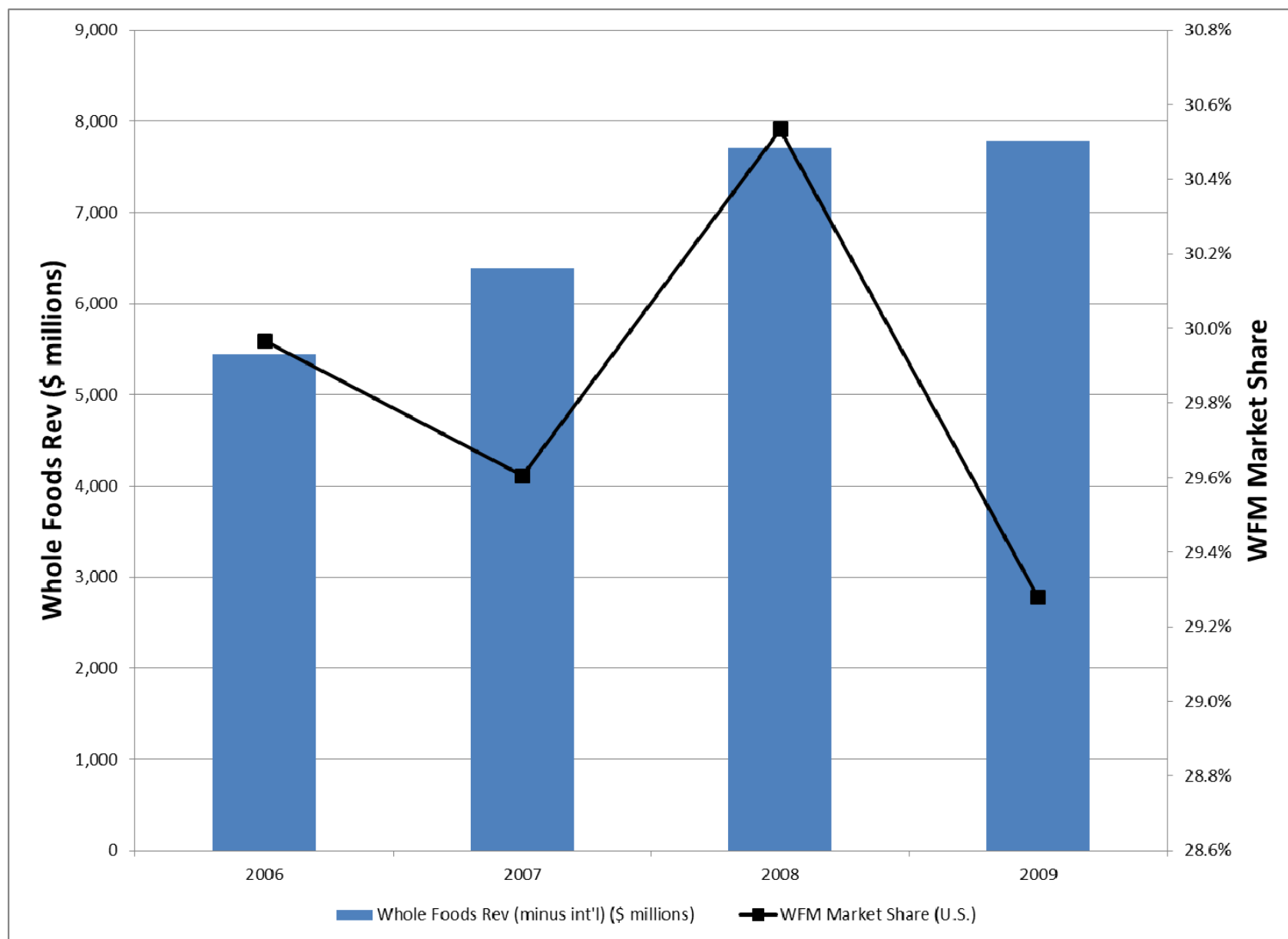


Exhibit 2: Whole Foods Financials and Comparison to Competitors²¹

Company	Revenues (\$ millions)	ROA	ROE	Forward P/E	Profit Margin	# of Stores	Mkt / Rev	Revenue / store (\$ mils)	Locations	Notes
Whole Foods Market, Inc.	9,010	7.25%	11.14%		2.73%	299	0.40%	30	U.S., Canada, U.K.	299 Stores, Uses United Natural Foods, Inc. for 27% of distribution
Organic Food Retailers										
Trader Joe's	6,500					310		21	U.S.	
The Fresh Market	941			37.45	4.04%	95	0.20%	10	U.S.	As of April 30, 2010, it operated 95 stores. Uses outsourced distribution
Traditional Grocers										
Safeway	40,940	4.93%	-21.11%	12.36	-3.05%	1,725		24	U.S., Canada	As of December 31, 2009, Safeway operated approximately 1,725 stores in California, Oregon, Washington, Alaska, Colorado, Arizona, Texas, the Chicago metropolitan area, and the Mid-Atlantic region, as well as British Columbia, Alberta and Manitoba/Saskatchewan.
Kroger	80,810	5.69%	21.76%	11.23	1.35%	2,468		33	U.S.	As of March 9, 2010, it operated 2,468 supermarket and multi-department stores
SuperValu	38,080	4.08%	-74.51%	6.11	-3.96%	2,349		16	U.S.	It operates 2,349 traditional and hard-discount retail food stores
Metro Inc.	11,340	7.20%	16.65%	10.32	3.45%	600		19	Canada	As of December 10, 2009, it operated 600 food stores and 250 drugstores.
Wm Morrison Supermarkets	16,090	6.17%	11.76%	0.11	3.57%	425		38	U.K.	As of January 31, 2010, it operated 425 stores.
Ingles Markets Inc.	3,390	4.56%	7.82%		0.94%	200		17	U.S.	As of September 26, 2009, the company operated 200 supermarkets, including 73 in Georgia, 68 in North Carolina, 36 in South Carolina, 20 in Tennessee, 2 in Virginia, and 1 in Alabama
Winn-Dixie Stores Inc.	7,210	0.01%	-0.25%		-0.55%	514		14	U.S.	As of June 30, 2010, it operated 514 stores in 5 states in the southeastern United States
Weis Markets, Inc.	2,630	7.36%	9.93%		2.65%	160		16	U.S.	As of December 31, 2009, it operated 160 retail food stores comprising 24 stores in Maryland, 3 stores in New Jersey, 12 stores in New York, 119 stores in Pennsylvania, and 2 stores in West Virginia under the Weis Markets trade name
Sainsbury's	20,550	4.72%	14.50%	0.13	3.31%	872		24	U.K.	The company operates approximately 872 stores comprising 537 supermarkets and 335 convenience stores
Tesco	58,880	4.37%	17.96%	0.11	4.22%	4,308		14	U.K.	As of May 1, 2009, it operated 4,308 stores
Super Center and Clubs										
Wal-Mart (Asda)	419,240	8.86%	22.69%	12.52	3.59%	4,304		97	U.S., Canada, U.K.	As of January 31, 2010, it operated 803 discount stores, 2,747 supercenters, 158 neighborhood markets, and 596 Sams Clubs in the United States; 43 units in Argentina, 434 in Brazil, 317 in Canada, 252 in Chile, 170 in Costa Rica, 77 in El Salvador, 164 in Guatemala, 53 in Honduras, 1 in India, 371 in Japan, 1,469 in Mexico, 55 in Nicaragua, 56 in Puerto Rico, and 371 in the United Kingdom, as well as 279 stores in the Peoples Republic of China.
Costco	79,890	5.51%	12.52%	19.1	1.69%	560		143	U.S., Canada, U.K.	As of October 8, 2009, the company operated a chain of 560 warehouses comprising 407 in 40 states and Puerto Rico, 77 in Canada, 21 in the United Kingdom, 7 in Korea, 6 in Taiwan, and 9 in Japan, as well as 32 warehouses in Mexico and 1 in Australia
Target	66,910	7.01%	18.90%	12.69	4.22%	1,740		38	U.S., Canada	As of June 2, 2010, it operated 1,740 stores in 49 states and the District of Columbia.

Exhibit 3: Competitor Analysis

What Drives The Competitor	What The Competitor is Doing or is Capable of Doing
<ul style="list-style-type: none"> • Objective: Gain market share of organic food market as well as traditional food sales • Provide profit while meeting customer needs 	<ul style="list-style-type: none"> • Strategy Grocer: Provide total food supply for customer demands • Strategy Supercenter: Provide large retailing needs with one-stop convenience
<ul style="list-style-type: none"> • Assumption: Competitors want to move into organic foods to meet customer demand • Assumption: Competitors have resources to procure what customer prefers • Assumption: Competitors can procure quality organics to meet customer needs 	<ul style="list-style-type: none"> • Wal-Mart: Extensive supplier leverage, lack organic food buying power and knowledge • The Fresh Market: Completely outsourced distribution, more limited organic selection compared to Whole Foods

Exhibit 4: Five Forces Analysis of Whole Foods^{22,23,24}

According to Willard Bishop, a leading food research marketing firm, the retail food industry is fragmented among 13 retail formats. The major categories are traditional grocery (which includes traditional supermarkets, fresh format stores, limited-assortment stores, super warehouse, and other small grocers), convenience stores, and non-traditional grocers (which includes wholesale clubs, supercenters, dollar stores, drug stores, mass stores, and military stores). The industry is expected to grow only 2.39% CAGR over the next five years. The Fresh Format category in which Whole Foods, The Fresh Market, and other similar competitors play is expected to grow at 1.7% CAGR. Customer trends, although shifting towards natural and organic offerings, show concern for lower cost and more convenient locations for food needs. Willard Bishop's research indicates that the fastest growing retail formats will be supercenters such as Wal-Mart and Target, as well as limited-assortment grocers such as Aldi, Trader Joe's, and Smart & Final.

<p>Potential Entrants: Due to the relatively large amount of current players, entry barriers appear rather low in the retail food sector at the smaller end and increase slightly with the number of SKUs, and thus interactions with suppliers are necessary. Existing supermarkets such as Kroger, Publix, and Safeway have lower barriers to entry compared to new organic and natural food retailers as they are already in the food retail business. The supercenter is the fastest growing food retail segment and has even lower barriers to entry due to the volume purchasing power and already strong customer base.</p>	<p>Buyers: Compared with the traditional retail food industry, the organic and natural food segment has less buyer power since there are fewer retailers that offer complete offerings. As a result, Whole Foods can pass prices along to customers in this segment. Customers are beginning to have some choice and thus are exerting downward pressure on prices.</p>
<p>Suppliers: In organic and natural foods, suppliers have a little more power than the traditional food space. According to the USDA, customer demand is driving organic food sales, and demand often exceeds supply. Farmers are struggling to keep up with demand and as a result have a higher advantage due to the relatively low number of organic farms. There are two main reasons for the shortages of organic farms: 1) the USDA requires a three-year waiting period before a farm's yield can be sold as organic 2) farmers are reluctant to change strategy to a risky investment that may not pan out or turn out to be a fad. Organic farms and natural food producers have higher costs due to the economies of scale for production (i.e. free-range chickens need lots of land to produce masses). Mike Pollen, author of <i>The Omnivore's Dilemma</i>, argues that processed food cost is artificially low due to government subsidies and mass engineering efforts. He argues that organic prices more accurately reflect real food prices.</p>	<p>Substitutes: Retail outlets with complete offerings of organic and natural food products are underdeveloped for consumer demand. As a result, fewer substitutes exist for organic and natural foods. As other retailers develop more complete lines of organic food products, substitutes will become more prevalent.</p>

Exhibit 5: Whole Foods Capability Analysis²⁵

	Procurement	Distribution	Retail Stores	Innovation
Processes	<ul style="list-style-type: none"> Source local organic and natural foods (regionally and nationally) Two procurement centers Provide loans to local producers through the Local Loan Producer Program 	<ul style="list-style-type: none"> Four seafood distribution facilities, coffee and tea processing center, 10 regional distribution centers, five kitchens, six bake house facility Clear transparency from “Farm to Fork” 	<ul style="list-style-type: none"> Custom tailored to neighborhood and region Information and suggestions for parents and kids healthy food education Brand 	<ul style="list-style-type: none"> Whole Story Blog Continual Store Improvement Health Starts Here training program
People (Skills)	<ul style="list-style-type: none"> Highly skilled people trained to teach organic farmers proper techniques for optimal quality 	<ul style="list-style-type: none"> Highly knowledgeable staff for quality inspection and timely distribution to stores 	<ul style="list-style-type: none"> Employees ensure customer satisfaction and high customer loyalty High employee knowledge of organic food handling techniques and benefits 	<ul style="list-style-type: none"> Experts in the organic food industry
Systems/Tech	<ul style="list-style-type: none"> Model for minimizing organic food costs 	<ul style="list-style-type: none"> Model for minimizing distribution costs to stores 	<ul style="list-style-type: none"> Extreme effort into laying out stores for optimal customer experience 	<ul style="list-style-type: none"> Company Blog Online Recipes Classes
Alignment & Sustainability	<ul style="list-style-type: none"> Strong relationships/partnerships with 2000 vendors. Uses United Natural Foods for 27% of purchases (partnership) Ability to scale organics 2200 private label organics 	<ul style="list-style-type: none"> The most complete line of organic distribution in the industry 	<ul style="list-style-type: none"> Locally focused style and product offering attracts customers who remain loyal First “Certified Organic” grocer 	<ul style="list-style-type: none"> Electric car charging Informed consumer

Exhibit 6: U.S. Organic Food Sales by Channel (2009)²⁶

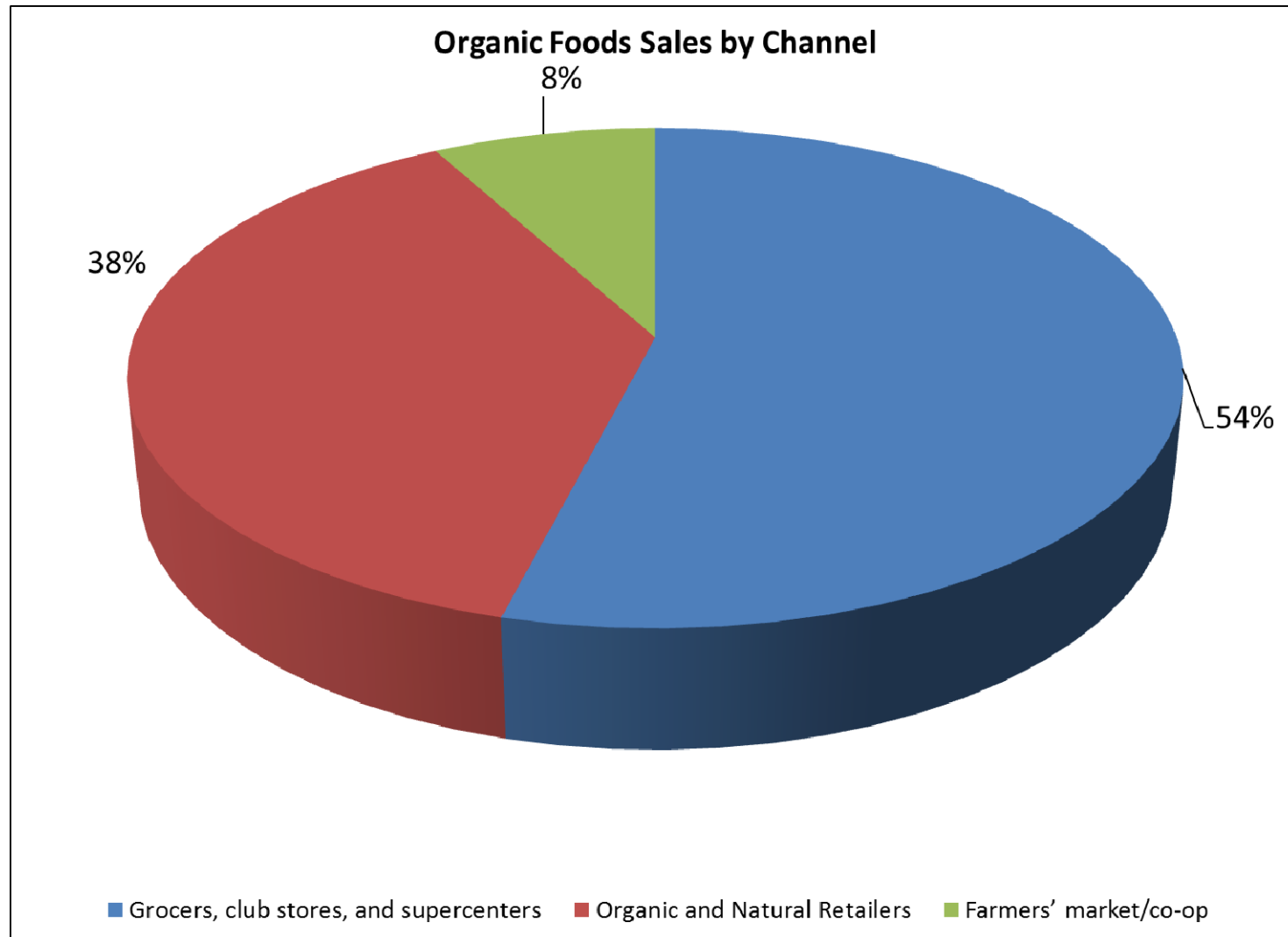
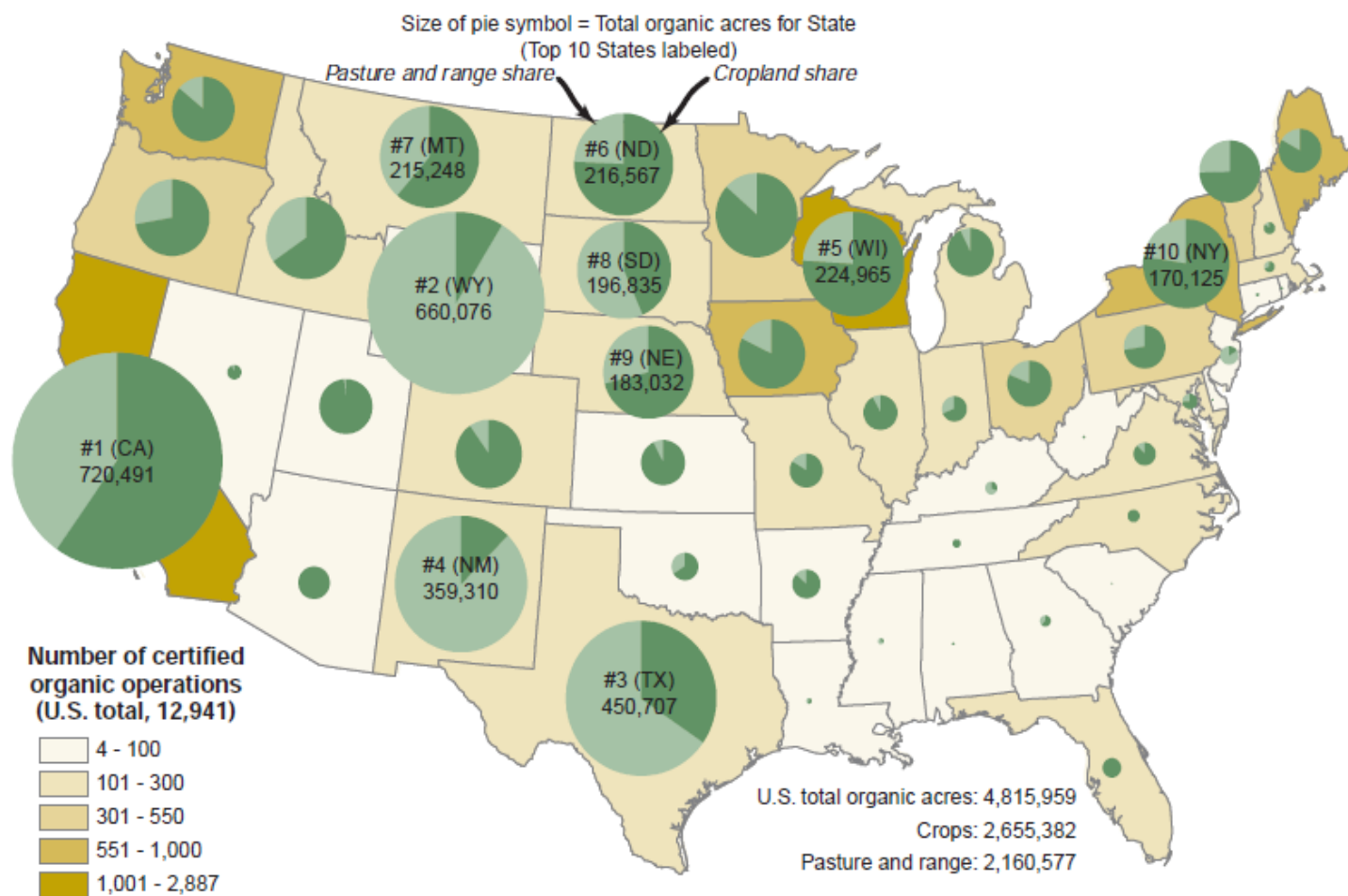


Exhibit 7: Organic Farms by Location, Number, and Acreage (2008)²⁷



Source: USDA, Economic Research Service, based on information from USDA-accredited certifiers.

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- ¹ "U.S. Organic Industry Overview." *Organic Trade Association*. Web. 23 January 2011. www.ota.com/pics/documents/2010OrganicIndustrySurveySummary.pdf.
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- ⁴ "Annual Stakeholders' Report 2010." *Whole Foods Market*. Web 21 January 2011. http://www.wholefoodsmarket.com/company/pdfs/2010_10k.pdf.
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- ⁷ "Annual Stakeholders' Report 2010."
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- ¹¹ Fry, Chad. "The Future of Food Retailing." *Willard Bishop*. June 2010. Web. 22 January 2011. http://www.willardbishop.com/comp_edge.php.
- ¹² Fry, Chad. "The Future of Food Retailing."
- ¹³ Fry, Chad. "The Future of Food Retailing."
- ¹⁴ "U.S. Organic Industry Overview." *Organic Trade Association*.
- ¹⁵ "The Fresh Market, Inc. Form 424B4." Web. 24 January 2001. <http://secwatch.com/tfm/424b4/prospectu/2010/11/5/7421656>.
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- ¹⁷ Greene, Catherine. McBride, William. Slattery, Edward. "America's Organic Farmers Face Issues and Opportunities." *United States Department of Agriculture*. Web 23 January 2011. <http://www.ers.usda.gov/AmberWaves/june10/Features/AmericasOrganicFarmers.htm>.
- ¹⁸ Greene, Catherine. McBride, William. Slattery, Edward. "America's Organic Farmers Face Issues and Opportunities."
- ¹⁹ "Annual Stakeholders' Report 2010."
- ²⁰ "U.S. Organic Industry Overview."
- ²¹ Yahoo Finance. *Yahoo*. Web 22 January 2011. <http://finance.yahoo.com/>.
- ²² Fry, Chad. "The Future of Food Retailing." *Willard Bishop*. June 2010. Web. 22 January 2011. http://www.willardbishop.com/comp_edge.php.
- ²³ Dimitri, Carolyn. Oberholtzer, Lydia. "Marketing U.S. Organic Foods: Recent Trends From Farms to Consumers."
- ²⁴ Michael Pollan. "Unhappy Meals." *The New York Times Magazine*. 2007 January 2007. Web. 23 January 2011. < http://www.nytimes.com/2007/01/28/magazine/28nutritionism.t.html?_r=1&scp=1&sq=unhappy%20meals&st=cse>.
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