

4

Natural and Organic Foods

Executive Summary

Surging interest in natural and organic foods has transformed a small market niche into a double-digit growth sector with sales estimated at \$12.6 billion in 2001. These foods are a key component in the major consumer trend known as whole health solutions — diets that promote health and well-being, prevent disease, help cure illnesses and protect the environment. Retailers, suppliers and producers — both natural and mainstream — are meeting this demand with new foods and organic alternatives to conventional products.

The 2002 implementation of the National Organics Program holds the industry to strict standards in the production and sale of organic foods. Despite the higher entrance hurdles to this market segment, the increased consumer demand and organic's bottom-line appeal are convincing more retailers to add organic foods to their mix. For the same reasons, food suppliers and producers are adding organic line extensions or converting to organic entirely.

1. Are natural and organic foods the same?

No, although organic foods are natural by definition. The term "natural" applies broadly to foods that are minimally processed and free of synthetic preservatives; artificial sweeteners, colors, flavors and other artificial additives; growth hormones; antibiotics; hydrogenated oils; stabilizers; and emulsifiers. Most foods labeled natural are not subject to government controls beyond the regulations and health codes that apply to all foods. Exceptions include meat and poultry. The Food Safety and Inspection Service (FSIS) of the U.S. Department of Agriculture (USDA) requires these to be free of artificial colors, flavors, sweeteners, preservatives and ingredients that do not occur naturally in the food. Natural meat and poultry must be minimally processed in a method that does not fundamentally alter the raw product. In addition, the label should explain the use of the term natural, e.g., no artificial ingredients.

"Organic" refers not only to the food itself, but also to how it was produced. Foods labeled organic must be certified under the National Organic Program (NOP), which took effect October 21, 2002. They must be grown and processed using organic farming methods that recycle resources and promote biodiversity — two key elements of environmentally sustainable agriculture. Crops must be grown without using synthetic pesticides, bioengineered genes, petroleum-based fertilizers and sewage sludge-based fertilizers. Organic livestock must have access to the outdoors and be given no antibiotics or growth hormones. Organic foods may not be irradiated. Question 8 of this backgrounder details the certification process.

These foods are a key component in the major consumer trend known as whole health solutions — diets that promote health and well-being, prevent disease, help cure illnesses and protect the environment.

"Organic" refers not only to the food itself, but also to how it was produced. Foods labeled organic must be certified under the National Organic Program.

Food Marketing Institute (FMI) conducts programs in research, education, industry relations and public affairs on behalf of its 2,300 member companies — food retailers and wholesalers — in the United States and around the world. FMI's U.S. members operate approximately 26,000 retail food stores with a combined annual sales volume of \$340 billion — three-quarters of all food retail store sales in the United States. FMI's retail membership is composed of large multi-store chains, regional firms and independent supermarkets. Its international membership includes 200 companies from 60 countries.



655 15th Street, N.W., Washington, DC 20005
202.452.8444 fax: 202.429.4519
fmi@fmi.org ■ <http://www.fmi.org>

2. Why the current consumer interest?

The growing demand for foods that are healthful, tasty and environmentally friendly are the principal drivers of organic food sales. Six in 10 U.S. shoppers (60 percent) believe that organic foods are better for their health, according to *Shopping for Health 2003*, a report by FMI and *Prevention* magazine. Many believe that pure, pesticide-free, all-natural foods can serve as preventive medicine against the health risks and help cure illnesses.

Because organic production methods emphasize the use of renewable resources and the conservation of soil and water, organic foods also appeal to environmental concerns. They are especially appealing to opponents of bioengineered foods, which they believe pose risks to health and the environment.

Also contributing to the increased interest are the federal rules clarifying which foods can be deemed organic. Before the NOP was finalized, the term organic was defined by disparate state, regional and private certifier standards, generating confusion making it difficult to assess just how organic any one item was. The new USDA Organic sticker, shown at right, is designed to make it easy for consumers to identify organic foods, and its introduction received widespread media attention. Use of the sticker is voluntary; companies that choose not to use the sticker incorporate the term "organic" in labels and other merchandising materials.

Finally, demand is growing for more flavored foods. Although taste is subjective, many consumers and chefs believe that organic products taste better.

3. How large is the market for natural and organic foods?

U.S. retail sales of natural and organic foods and beverages reached \$20.5 billion in 2003 with organics accounting for \$9.4 billion or 46 percent, according to the *2004 Health and Wellness Trends Report* by the Natural Marketing Institute. The report projects that the organic segment will cross the 50 percent milestone over the next five years, increasing to \$15 billion in sales by 2007. The annual growth rate will remain in double digits over that span, according to the report, although the rate will decline from 16 percent in 2003 to 10 percent. Conventional food, drug and mass merchandise retailers account more than three-quarters of natural food sales, according to the *Natural Foods Merchandiser* June 2003 Annual Market Overview and SPIN's *Natural Products Marketplace Report*, 2003.

Half of U.S. shoppers (50 percent) bought organic foods in the last six months, according to *Shopping for Health 2003*. Packaged Facts, a market research firm, says that produce accounted for 42 percent of U.S. organic food sales, followed by packaged groceries (15 percent), dairy (11 percent), bulk and frozen foods (8 percent each), soy-based products (6 percent), beverages (5 percent), meat (3 percent) and snacks and candy (2 percent).

The growing demand for foods that are healthful, tasty and environmentally friendly are the principal drivers of organic food sales.



Half of U.S. shoppers bought organic foods in the last six months.

— FMI and *Prevention* magazine, *Shopping for Health 2003*.

4. How widespread are natural and organic foods today?

They are now available in seven out of 10 retail food stores, according to shoppers surveyed in FMI's *Trends in the United States: Consumer Attitudes and the Supermarket, 2003*. USDA's Economic Research Service (ERS) reports that organic products are available in nearly 20,000 natural foods stores nationwide and in 73 percent of all conventional grocery stores.

The mainstreaming of organic food has attracted mainstream brand manufacturers. At the same time, today's organic startups tend to be more sophisticated than their predecessors. Many are circumventing new-business challenges by hiring seasoned industry executives, using mainstream distribution contracts and crafting strategic business plans that incorporate organic foods.

Farmers are devoting more acreage to organic products. Organic cropland and pasture increased by 74 percent between 1997 and 2001, bringing the total to 2.35 million acres in 48 states, according to ERS. Various studies have shown that organic farming systems can be more profitable than chemical-intensive ones. The reasons include higher yields in drier areas or periods, lower costs, higher revenues due to crop mix and higher profits due to price premiums. About 5 percent of lettuce, 4 percent of carrots, 3 percent of apples, 2 percent of dry peas and lentils, 1 percent of oats, dry beans, tomatoes, grapes and citrus, 0.3 percent of soybeans and 0.2 percent of corn in the United States were grown under certified organic farming systems in 2001.

The U.S. trails other countries in the percentage of cropland used to grow organic foods. ERS says the following countries have the highest percentage of organically managed farmland: Switzerland (9.0 percent), Austria (8.6 percent), Italy (6.8 percent), Sweden (5.2 percent), the Czech Republic (3.9 percent) and the UK (3.3 percent).

5. Are natural and organic foods healthier or safer than conventional foods?

Not necessarily. USDA makes no claims that organic food is safer or more nutritious than conventionally produced food, and indeed many organic foods — e.g., milk, butter, ice cream, meat — are likely to match their conventional counterparts for fat and calories.

There are, however, specific health reasons that motivate shoppers to buy natural or organic foods. For instance, people with food allergies, chemical allergies or intolerance to preservatives can substitute organic foods, personal care products and clothing. To reduce fat and cholesterol in their diets, consumers can replace meat with products made from organic soy, wheat or vegetables.

Buyers of organic baby foods may want to avoid the pesticide residues in conventional baby foods. A 2002 study by the National Institute of Environmental Health Sciences found that children who eat organic foods are exposed to "significantly lower" levels of Organophosphorus (OP) pesticides than those who eat conventional foods ("Organophosphorus Pesticide Exposure of Urban and Suburban Pre-School Children With Organic

Organic products are available in nearly 20,000 natural foods stores nationwide and in 73 percent of all conventional grocery stores.

To reduce fat and cholesterol in their diets, consumers can replace meat with products made from organic soy, wheat or vegetables.

and Conventional Diets," Oct. 31, *Environmental Health Perspectives*). OP pesticides were used in the study because they are commonly used on the crops that are processed into baby foods and juices.

Some organic foods also have significantly higher levels of cancer-fighting antioxidants, according to a study of corn, strawberries and marionberries, which was published in Feb. 26, 2003, in the *Journal of Agriculture and Food Chemistry*, a peer-reviewed publication of the American Chemical Society ("Bitter or Harsh Phenolics Guard the Plant Against These Pests").

Some officials say, however, that organic foods may at times be less safe than conventional foods. In October 2002, USDA's undersecretary for food safety warned that organic foods' lack of preservatives makes them vulnerable to bacteria and parasites. The following month, the Institute of Food Technologies issued a release stating that organics "have the potential for greater pathogen contamination." Also in 2002, records from the U.S. Food and Drug Administration and Health Canada revealed that organic and all-natural products are eight times more likely to be recalled for safety problems, including bacterial contamination, and mislabeling.

Organic products are as safe as conventional ones, according to the Organic Trade Association. "Certified organic growers follow strict guidelines for safe and hygienic food production. As with all food producers, they must comply with local, state and federal health standards. Pasteurization, selected use of chlorine and other food safety practices are allowed and followed in organic production.

"Organic growers not only are inspected by third party, independent certifiers in order to qualify for organic certification, but they also follow strict guidelines for safe and hygienic food production."

6. What types of consumers buy organic and natural foods?

Other than those with the health concerns listed above, most buyers are not radically different from those of conventional foods. *Shopping for Health 2003* found they tend to be younger: 72 percent of generation X and Y shoppers buy or are likely to buy organic foods, along with 69 percent of baby boomers. Mature shoppers are the least interested with nearly half (46 percent) opting not buy organic foods. Organic food buyers also tend to be better educated (61 percent have had at least some college, compared with 54 percent for nonorganic shoppers) and to have higher incomes (35 percent make more than \$50,000, compared with 30 percent). They spend an average of \$100.90 per week on groceries, compared to \$87.80 for nonorganic shoppers. Geographically, organic shoppers tend to be more prevalent in the Midwest and West.

7. Why don't more consumers buy organic and natural foods?

Limited availability remains a barrier to some, although this appears to be diminishing. Price is another. ERS cites various studies finding organic price premiums that range from 35-53 percent for baby food, 72 percent for frozen broccoli, 94 percent for spring wheat and 177 percent for soybeans. With more mass production, organic products will increasingly be

Certified organic growers follow strict guidelines for safe and hygienic food production. As with all food producers, they must comply with local, state and federal health standards.

— Organic Trade Association

Most buyers are not radically different from those of conventional foods. They tend to be younger, better educated and have higher incomes.

Limited availability remains a barrier to some, although this appears to be diminishing.

priced to compete with conventional brands.

Other barriers include organic foods' shorter shelf life (fresh foods and foods without preservatives tend to deteriorate quickly) and safety concerns. Question 5 of this backgrounder addresses the safety issue.

8. How does the certification process work?

The Organic Foods Production Act of 1990 required the USDA to develop national standards for organically produced products. That resulted in the NOP certification process, which took effect October 21, 2002. All organic production and handling operations must be certified by third-party organizations that have been accredited by the USDA. The labeling requirements are as follows:

- Products labeled "100 percent organic" must contain only organically produced materials.
- Products labeled "organic" must contain at least 95 percent organic ingredients. Products in this or the first category may (but are not required to) display the USDA Organic seal shown on page 2.
- Products that contain between 70 and 95 percent organic ingredients may use the phrase "made with organic ingredients" on the label and may list up to three of the organic ingredients (e.g., carrots) or food groups (e.g., vegetables) on the principal display area.
- Products with less than 70 percent organic ingredients may not use the term organic other than to identify specific organic ingredients.

Producers whose gross agricultural income from organic sales is \$5,000 or less are exempt from certification. Complete information about the National Organic Program, including regulations and penalties, is available at <http://www.ams.usda.gov/nop/>.

9. How do the certification requirements affect food retailers?

Food retailers that sell or process organic foods are not required to undergo the certification process, although they may choose to obtain certification for marketing or other business reasons. However, they are subject to numerous regulatory requirements under the NOP, including prohibitions on:

- Knowingly selling or labeling a product as organic unless it meets NOP requirements. Violators are subject to penalties of up to \$10,000 per violation. (Retailers are not subject to penalties if this product is later found to be mislabeled, unless they knew it was mislabeled.)
- Allowing unpackaged organic products to contact unpackaged conventional products.
- Allowing organic products to contact prohibited substances, e.g., residual synthetic fungicides, preservatives or fumigants in packaging materials or storage containers.

All organic production and handling operations must be certified by third-party organizations that have been accredited by the USDA.

Food retailers that sell or process organic foods are not required to undergo the certification process, although they may choose to obtain certification for marketing or other business reasons.

These and other aspects of the NOP are spelled out in greater detail in FMI's summary: *The USDA National Organic Program Requirements for Food Retailers and Distribution Centers*. This summary is available at the FMI Web site (http://www.fmi.org/gr/Country_of_Origin.htm/). Further information, including frequently asked questions about the NOP, is available at the USDA Web site (<http://www.ams.usda.gov/nop/>).

10. How else are food retailers responding to the growth of organic and natural foods?

Retailer marketing strategies for natural and organic foods include in-store advertising, cooking demonstrations and having knowledgeable employees on site. Retailers offer personalized programs such as inviting customers to e-mail diet-related questions to the store's resident specialist. Such services can especially help conventional food retailers whose customers may be apprehensive about trying unfamiliar foods. Also, by advertising one or two organic items each week, stores send the message that they are serious about organics. Other strategies and features include:

- **Flexibility** — Organic foods are at the mercy of Mother Nature, so retailers are willing to accept organic produce that comes in various sizes, shapes or colors. Organic shoppers tend to be less concerned about appearance as long as the item is fresh.
- **Conventional Counterparts** — Shoppers are more likely to try an organic item if retailers carry its conventional counterpart.
- **Narrow Focus** — Rather than carrying a few organic products in each of several categories, retailers specialize in targeted categories such as organic salads.
- **Added Value** — Stores feature value-added organic items such as salad kits, pre-packed vegetables and packaged salads to attract both conventional and organic shoppers.
- **Promotional Prices** — By using promotions to price organics the same as conventional foods, retailers can alleviate perceptions that organics are too expensive and induce customers to try organics when they are in season and available.

Retailer marketing strategies for natural and organic foods include in-store advertising, cooking demonstrations and having knowledgeable employees on site.

Stores feature value-added organic items such as salad kits, pre-packed vegetables and packaged salads to attract both conventional and organic shoppers.

11. What's ahead for natural and organic foods?

Organic will continue to take a growing share of the natural-organics sector as demand rises and more companies convert their products from natural to organic. Natural and organic foods will appear in more venues. Besides conventional retailers developing organic programs, states and municipalities, along with conservation organizations and others, will continue to foster the development of local farmers markets that sell directly to consumers. Restaurants, college cafeterias and other foodservice providers will also incorporate natural and organic foods into their menus. Yale University and University of California, Berkeley, are among the institutions of higher education that are moving in this direction.