

Beyond Organic: The Revolution in Consumer Food Expectations

When Walmart announced last year that it would begin selling organic food at the same low prices as its regular offerings, it was a sign, if one was needed, that specialty foods have gone mainstream.

The buzz over specialty foods has reached a fever pitch in recent years. Sales of organic foods topped \$39 billion in 2014,¹ and newer product categories, like gluten-free and ethical (e.g., locally produced, antibiotic- and hormone-free), have made major inroads. Rapidly changing consumer tastes, preferences and concerns have evolved into a complex mosaic

over the past few years – including General Mills' purchase of Annie's and WhiteWave Foods' acquisition of Earthbound Farm – these deals are just the beginning of what we see as a major transformation of the U.S. food industry. This transformation will encompass far more than just acquisitions, which have become more difficult for food and beverage companies to justify to shareholders as valuations have soared.

To understand this sea change at a deeper level, L.E.K. conducted a survey of more than 1,500 consumers in an effort to understand what motivates their food purchases, how

committed they are to buying specialty foods (e.g., natural, non-GMO, gluten-free, enhanced) and to what extent they are willing to pay a premium for these products. The results were clear: This movement goes beyond the buzz and represents a sustained shift in consumer food preferences with significant long-term ramifications. More than half of all consumers surveyed said they are committed or casual buyers of some form of specialty food, and they indicated they will spend more on these foods.

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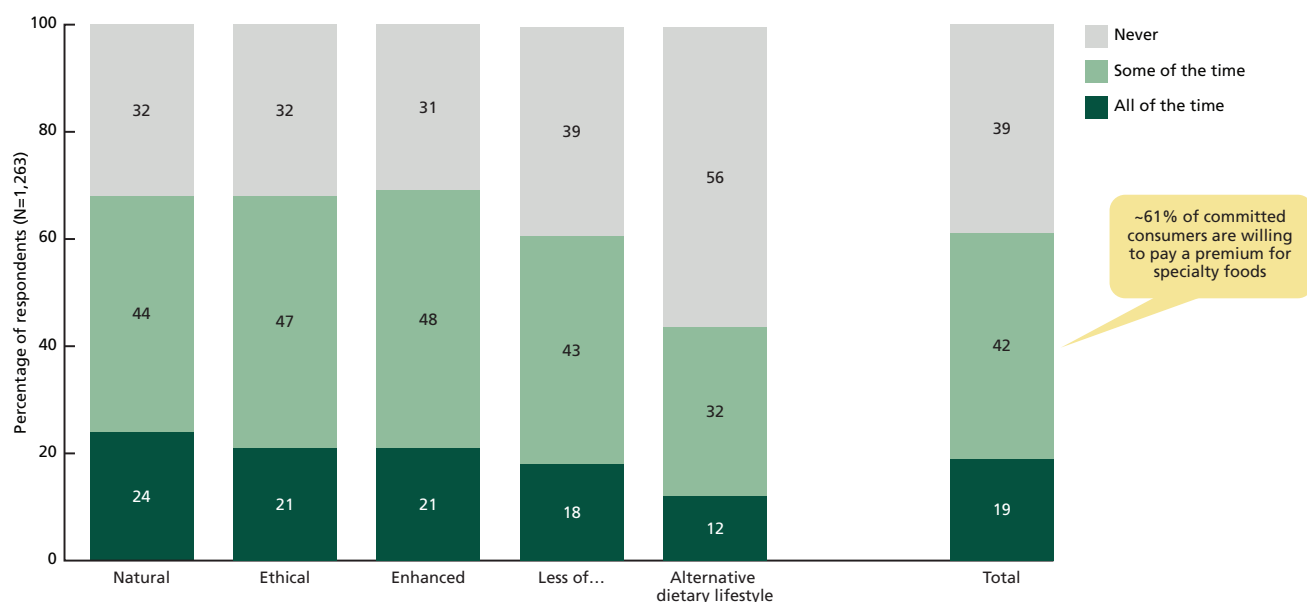
of choices that range from non-GMO and organic foods to foods with “less of” many traditional ingredients.

Yet Big Food has largely struggled to keep up. Many food manufacturers have been slow to respond to the shift in consumer preference, and agribusiness and food ingredient manufacturers are even further behind. While there has been a spate of acquisitions of specialty food and drink companies

This shift affects companies at every link in the food chain, and those that take consumers' evolving food preferences into account will be better positioned to improve their brand image, increase revenues and generate potentially greater shareholder returns over the long term.

Beyond Organic: The Revolution in Consumer Food Expectations was written by **Manny Picciola** and **Peter Walter**, managing directors at L.E.K. Consulting. **Maria Steingoltz**, a senior manager, also contributed to this article. Manny and Maria are based in Chicago and Peter is based in New York. For more information, contact consumerproducts@lek.com.

Figure 1
Committed Consumers' Willingness to Pay by Food Category



Note: "Committed" defined as "purchased frequently or always"
Source: L.E.K. consumer survey

Changes won't be easy for Big Food. Major food producers and marketers have built their businesses by selling low-cost, branded food to the masses and distributing it worldwide. This has been a boon to American consumers, who spend far less of their household incomes on sustenance than they used to. But as consumers' tastes change, food manufacturers must respond to these permanent shifts in the American palate.

Moving into specialty markets such as organic or non-GMO will require overhauling or rebuilding supply chains, launching or acquiring new brands, and figuring out how to manage input costs in order to still make money. Not all companies will respond in the same way, given that the risks and opportunities for manufacturers of high-carb, processed foods are much different than those for chicken farmers or fresh produce growers. Nonetheless, every company along the farm-to-fork chain must figure out how best to play this trend.

For the Big Food players that get it right, there is an upside: Consumers are willing to pay more for many of these new products. Among committed consumers, for example, our survey found that 61% would pay a premium of between 9% and 18% for specialty foods at least some of the time (see Figure 1).

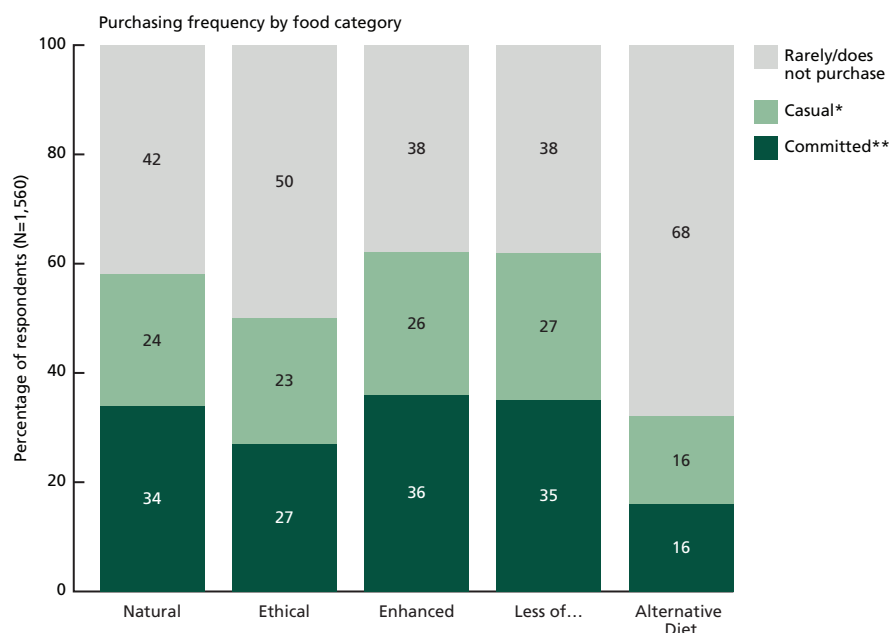
A Tectonic Shift

L.E.K.'s previous survey of consumers' food preferences looked at the entire mosaic of specialty food categories, including ethical (locally produced, antibiotic- and hormone-free), enhanced (with added proteins, omega-3 fatty acids), restricted (low-calorie, low-salt, sugar-free), alternative (gluten-free, vegan, paleo) and natural (organic, non-GMO). Although these categories fall under "specialty foods," they've become mainstream (see Figure 2).

More than 80% of participants in our survey are committed consumers of at least one specialty food category, and more than half are committed or casual consumers of natural, ethical, enhanced or "less of" foods. Committed consumers always or frequently purchase specialty foods, whereas casual consumers do so occasionally. This commitment cuts across age, gender, income, education and geography, though younger and wealthier consumers are the most committed (see Figure 3).

What are the underlying reasons why consumer tastes are changing? L.E.K.'s survey found that most consumers believe that organic and non-GMO foods are healthier, so they tend to feel better about themselves when they eat these foods.

Figure 2
Specialty Food Has Gone Mainstream



Note: *Casual defined as "purchased occasionally." **Committed defined as "purchased frequently or always." — Natural includes organic and non-GMO; "ethical" includes locally-produced, antibiotic-free and hormone-free; enhanced includes foods with added proteins or omega-3 fatty acids; "less of" includes low-calorie, low-salt and sugar-free; and "alternative diet" includes gluten-free, vegan and paleo.

Source: L.E.K. consumer survey

For many of these consumers, their commitment to eating specialty foods is more than just a casual connection. Food choices have become core to some consumers' identities in a way that used to be reserved for whether they drove a Ford station wagon or a Prius. Committed specialty food buyers stay on top of food trends, read food blogs and publications, and watch cooking shows. They also seek and experience social benefits from their food choices and admire people who eat food that has dietary, nutritional or ethical benefits.

Implications for Big Food

When John Mackey founded Whole Foods Market in 1980 in Austin, Texas, the idea of such a national specialty food chain seemed fantastical, but now Whole Foods has hundreds of stores and \$14.2 billion in revenues. Today, most major supermarkets offer some organic, enhanced and gluten-free items, and Walmart's move in that direction will only accelerate the shift. But while food retailers have added specialty items to their shelves to meet consumer demand, the bulk of these new products come from niche companies, not Big Food. The largest food conglomerates have been slow to

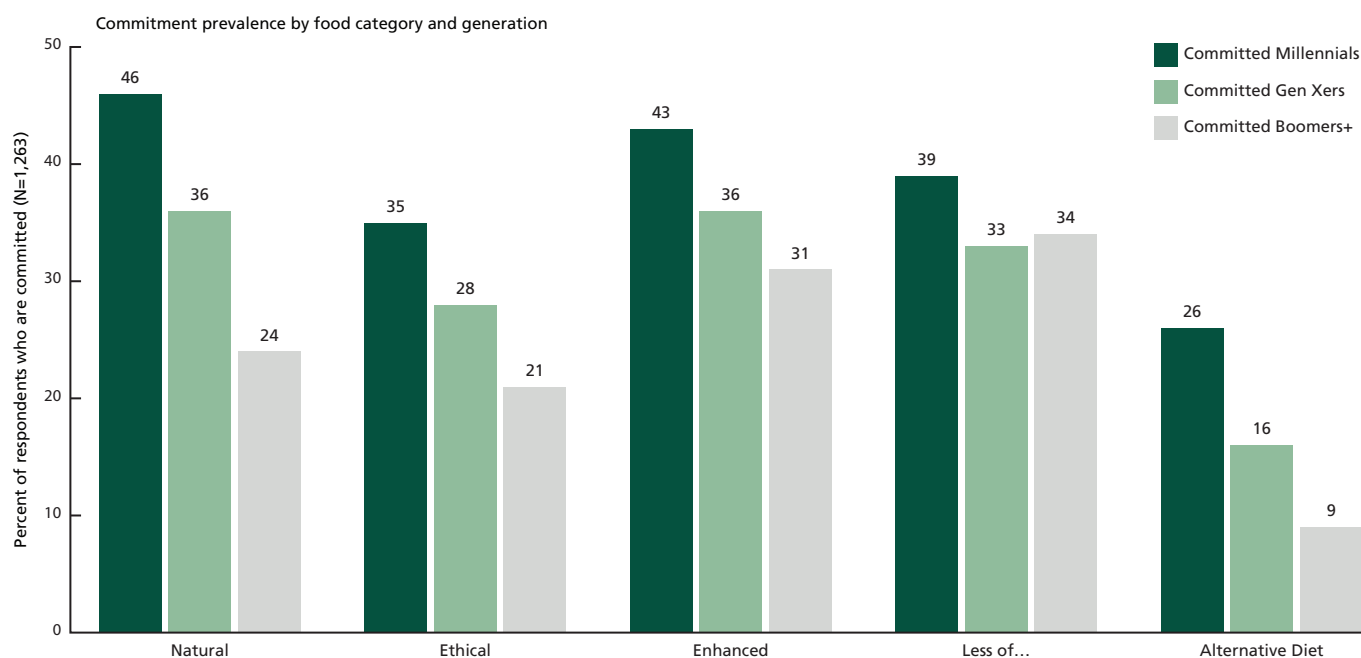
change their product mixes, and their agribusiness supply chains remain stuck in old ways of doing business.

As we know — and as our survey shows — Big Food must change to meet consumer demand and reverse consumers' negative perceptions of Big Food itself. Consumers don't want processed foods heavy on sugar, salt and other unhealthy ingredients; they do want more foods with omega-3 fatty acids or additional protein. They want food companies and farmers to do more to produce sustainable and healthy food free of unneeded chemicals, antibiotics and other unwanted ingredients. In fact, when we asked consumers what they want — and what would cause them to buy more — the top response, by 57% was offering healthier foods.

For Big Food, these new consumer demands raise questions about how to alter existing portfolios of brands without becoming unprofitable, and whether to invest in new, non-GMO supply chains or launch new, healthier brands. Some large food manufacturers have bought their way into the specialty food markets by acquiring existing brands like Annie's and Applegate Farms. This is one answer, but it isn't a panacea. As demand for the best specialty food makers has soared, these deals have become increasingly costly, and integrating any acquisition without losing what made that company special is no easy feat.

Whether food manufacturers alter their product mixes through internal expansion or acquisition, they increasingly will need to establish alternative supply chains of organic, sustainable and other specialty ingredients to meet growing demand. Agribusiness will need to respond, and the risks are great. Newer specialty food makers are more likely to source their corn, wheat and other ingredients from niche suppliers, whether domestic or overseas, that meet their specific requirements for non-GMO, sustainability and the like. While

Figure 3
More Than Just Millennials



Source: L.E.K. consumer survey

there are costs to creating new products and new supply chains, there are also potentially attractive growth opportunities.

Big Food must quickly answer numerous questions — and make the appropriate changes — if it is to compete in the specialty food segment:

- How will growers, producers and consumers share the higher costs of specialty foods?
- Will specialty foods provide the same profit margins that Big Food has come to expect from branded, packaged foods?
- How will consumer spend change across food and retail segments?

- How much should companies spend to develop new supply chains that use organic fertilizers rather than chemical ones, and how fast can these supply chains be brought on board?

The bottom line is clear: Consumers want more choice about the food they put in their bodies. Kale may wane and almonds may trend, but the broader move toward organic foods, non-GMO foods and other specialty foods is here to stay. The companies that quickly figure out how to meet consumer demand for more specialty food options will outperform those that are slow to react.

¹Organic Trade Association, State of the Organic Industry: 2015.

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