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Whole Foods Abandons the Field

The natural products movement pioneer opts for efficiency over authenticity, opening a huge market gap for independents to capture.

BY JAY JACOBOWITZ

Well, that didn't take long.

"Day One," of the Amazon acquisition of Whole Foods Market on Aug. 28, 2017, saw significant—and reportedly permanent—price cuts in Whole Foods' stores on everyday market basket items like milk, eggs and bananas. Plus, the chain cut prices on key fresh proteins, fresh produce, and other pantry staples around the store. In addition, Amazon made a limited assortment of Whole Foods' price-cut "365 Everyday Value" private label line available online to its Amazon Fresh and Amazon Pantry customers, generating an estimated $1.6 million in sales in the first month, according to ecommerce analytics company One Click Retail, as reported by *The Wall Street Journal*.

This is all to the good for Amazon Whole Foods. Foot traffic in the stores jumped 17% in the first week and remained up 4% through Sept. 16, according to Thasos Group, which analyzes location data from millions of mobile phones. You'll remember, immediately pre-acquisition, Whole Foods had turned in two years' worth of *negative* comparable store sales.

And where did the increased foot traffic come from? In this same Aug. 28 through Sept. 16 period, 24% of new customers came from…Walmart! This is not as surprising as it seems. Walmart serves 140 million customers a week; Whole Foods, about 6 million. For Whole Foods' store traffic to increase 17% it would need to add about 1 million transactions per week. For Walmart to drive 24% of that increase, the mass merchandiser would have to donate about 250,000 of its customers, or less than two-tenths of one percent (0.2%). The second greatest source of new customers? Kroger, the largest conventional supermarket chain with 2,400 stores in 31 states, contributed 16% to Whole Foods' increased foot traffic. The laws of scale also apply to Kroger; the company probably lost about the same percentage of its customers to Whole Foods as did Walmart. Club store Costco, mass merchandiser Target, and club store Sam's Club (owned by Walmart) contributed 15, 11, and 5% to Whole Foods' increased customer count, respectively.

Viewed from the perspective of lost sales, Trader Joe's actually suffered the greatest percentage of customer defections, losing 10% of its regular shoppers; those who shop at least twice per month. Sprouts Farmers Markets, perhaps Whole Foods' most direct competitor, saw 8% of its regular shoppers head across town—or across the parking lot—to the nearest Whole Foods store. Target lost 3% of its regular customers, and Costco and conventional supermarket Safeway lost 2% each.

The new shoppers to Whole Foods, from all sources including Walmart, mirrored the demographic profile of the company's traditional upper-income customer. So, even those relatively few regular Walmart shoppers who decided to shop Whole Foods came from that select set of wealthier households atypical of Walmart's bread-and-butter lower-to-middle-income customer type.

No more direct-ships

Within a couple of weeks of the acquisition, and in time for Natural Products Expo East in Baltimore—the big annual trade show for the natural products industry in mid-September—the vendors that sell mostly shelf-stable, non-perishable vitamins, supplements, and personal care items directly to Whole Foods got word that, by March, 2018, they must instead go through United Natural Foods, Inc. (UNFI), Whole Foods' primary wholesale distributor. These "Whole Body" department direct vendors and the brokers that have represented them for decades will no longer enjoy direct access to Whole Foods stores or their regional buyers. Direct vendors must first go through Austin, TX headquarters to negotiate terms, and may not do so through UNFI.

Language we reviewed in a September memo to suppliers from Steven Benoit, global Whole Body buyer for Whole Foods, read the Whole Body department is "…evolving into a consumer-centric category management approach," which means streamlining the supply chain to "…improve execution at store level for both our customers and team members." To do this, "…we are moving away from a direct ship model for supplement and body care to distribution through UNFI."

UNFI, customarily chronically tight for warehouse space in its 17 U.S. distribution centers totaling 6.5 million square feet, will most certainly have difficulty freeing up slots to accommodate the estimated 5,000 to 10,000 additional supplement and body care SKUs cut adrift by Whole Foods. Does Amazon Whole Foods really want to risk losing all these unique lines by next March?

Watch for Jeff Bezos, Amazon's CEO, to make his move in the second quarter of next year. In contrast to UNFI, Amazon is quickly moving towards 250—mostly non-perishable—U.S. warehouses totaling about 100 million square feet; many orders of magnitude greater than the natural foods distributor. Where UNFI is squeezed, Amazon has plenty of room.

Next step, come April, 2018, former direct Whole Body vendors may get a friendly phone call from Amazon Whole Foods suggesting, since they can't get into UNFI's warehouses, and can't sell direct to the Whole Foods stores anymore, how about, uh, listing with Amazon directly? "We can ship daily to all the Whole Foods stores from everywhere in the country, and icing on the cake, we can expand your distribution to Amazon online!" the imaginary conversation may go.

Lest you think this possibility remote, UNFI in its annual report released Sept. 26, added language in the section discussing customer risk factors that, "…our failure to comply with the terms of our distribution agreement with Whole Foods Market could materially and adversely affect our business." Now, we're not saying the newly added language necessarily refers to UNFI's sudden obligation to carry many thousands more SKUs for Whole Foods, but the same section goes on to say that Whole Foods might also divert purchases from UNFI beyond the minimum amounts it is required to purchase under their distribution agreement; an additional risk. You sense the tension, don't you?

Independent opportunity

Reading our headline, you may be wondering by now where the opportunity for independent natural products retailers lies in all this. Point taken. But consider this: at Expo East, and in several conversations since, we've spoken with direct Whole Body supplement and body care vendors who are now taking a hard look at their Whole Foods business and deciding whether or not to make the switch to UNFI.

In cases where the percentage for a former direct line to Whole Foods is a minority of sales, or where their lines have so many SKUs that going through UNFI is impractical, a significant chunk of these vendors may decide to take the hit and move on. Which leaves the question, where do the shoppers who used to get these products at Whole Foods now go to find them? Online at Amazon? Not so fast.

The former Whole Foods direct body care and supplement lines face a defining moment in their business lives. Do they have the financial and brand equity equal to that of, say, Nike, which just, after many years of fighting it, went direct with Amazon? Can they withstand the full-on, unrelenting pressure of a direct hook-up with this $130 billion behemoth? This is the point of no return for these—let's be honest—smaller, specialty vendors, and a wrong decision here means no coming back.

Fortunately, there is a solution. Historically in our industry, before Whole Foods became dominant in the mid-90s, the first and easiest path to market was through the independent natural retail channel. Back then, natural and organic manufacturers *loved* how easy it was to work and grow with independents. But once Whole Foods came along, the temptation of vastly greater sales took over distribution decisions.

Other than hurt feelings, I see no reason for independents not to embrace—or re-embrace—these newly repentant vitamin, supplement, and body care companies whose naan has been spread with Whole Foods' ghee for many years, sometimes to the exclusion of and reduction in support to the independents. But in terms of low hanging fruit available for independents to capture new sales and new—or returning—customers, we can't think of an event with greater potential impact in the last 20 years.

Putting it together

In our reading of it, within the next six months, there should be two large, newly and highly motivated groups—buyers on one side, sellers on the other—making common cause and getting together. There are no new systems or business models that need to come into existence. Direct lines already ship and invoice directly. Independents already order and receive multiple direct lines as a matter of course.

What remains is facilitating an effective communication pathway. We've reached out to some likely industry constituents whose missions align with the independents. What could it take? A central website matching up independents looking for a few new direct lines? Direct vendors posting their interest in connecting with high-quality independents to quickly grow the business? Independents have never let go of the authentic core of the natural products industry. This can work. **JJ**