2017

Whole Foods Case Analysis

Michael Lenard (Class of 2017)

Michael Lenard
November 23, 2016
MGT-401: Strategic Management
Whole Foods Case Analysis

Background

Since its debut in 1980, Whole Foods Market has been a pioneer in the natural and organic food industry, and with America's rising interest in these healthy, alternative products, the company found itself experiencing many years of success and growth throughout the 20th century. Headquartered in Austin, Texas, Whole Foods owns 462 retail stores – approximately 95% of these are located in the United States of America, and the others can be found in Canada and the United Kingdom. Much of Whole Foods' historical growth was achieved through mergers and acquisitions of other grocery stores throughout the United States. In the new millennium, their markets have evolved from just stores into eateries that sell chef-prepared entrees and bakery items, in addition to standard grocery fare. The company operates in the segment defined as "natural and organic foods," but separates its main product and revenue lines into the following trio: prepared foods, other perishable foods, and non-perishables (MarketLine, 2016).

As the demand for natural foods has grown more rapidly over the last fifteen years, Whole Foods has paradoxically experienced a plateau in its success. In 2004, Whole Foods saw a same-stores fiscal growth rate of approximately 15%; this figure would fall to 11% in 2006, and to 7% in 2007 (Gray, 2016). While the company was still experiencing financial growth, it had begun to transition into a state of diminishing returns. At the time, CEO John Mackey defended his company, stating that organizations cannot continue to "compound at the same rate" (Gray, 2006). However, moving forward one decade, the metric of comparable stores-sales has moved into negative territory, with the final two quarters of 2016 marking 2.6% and 2.4% declines, and becoming the fifth and sixth consecutive quarters of decline for Whole Foods (Haddon, 2016). A few strategic issues have been identified as the cause for this lethargic turn of events, with the main one being an influx of competitors in the industry. In 2006, Mackey recognized that it "never pays to underestimate any competitor," but had not seen many impacts in the industry from these potential new entrants (Gray, 2006). Ten years later, the battle for organic food market share has truly intensified, and the competitive pressure is likely to increase in the future (GuruFocus, 2016).

Strategic Issue(s)

From a SWOT analysis perspective, the main strategic issue faced by Whole Foods is effectively a former opportunity that first transformed into a major strength, and more recently, into a threat. When Mackey opened Whole Foods' doors in 1980, he saw the opportunity to capitalize on the natural and organic movement in America. As people became more interested and committed to an organic-food lifestyle, the company experienced growth. The overall social trend of being more health-conscious and aware of food ingredients turned into a major strength for Whole Foods. Soon, more organizations identified this social force as an opportunity and began to enter the industry. At this point, the natural and organic movement had proved itself not to be a fad; according to Mackey, the organic movement "is a value system, a belief system… penetrating into the mainstream" (Gray, 2006). Consumers made it clear that they *want* to pursue organic foods, and a myriad of competitors, such as HEB, Wegmans, Publix, and Costco have joined the industry, recognizing its opportunity (GuruFocus, 2016).

Many of these competitors have quickly become successful in the industry, and according to Goldman Sachs' analysts, Whole Foods has "lost share in its core natural and organic business" to a "competitive barrage" from major players such as Costco, Sprouts Farmers Market, and Kroger (McGrath, 2016). These competitors have created various forms of competitive advantage – for example, Costco has become the most attractive price option for consumers, while Kroger prides itself on offering convenience. The saturation of competitive players has contributed to a geographic problem for Whole Foods, as "54% have at least one Kroger within five miles, 75% have at least one Trader Joes within five miles, and 84% have a Costco within ten miles" (McGrath, 2016). Consumers are likely to not travel large distances to go to Whole Foods when a viable alternative could be closer, and the company has attempted to establish a customer loyalty and rewards program in order to curtail this geographic issue (Haddon, 2016).

As these competitors force more pressure onto Whole Foods, the company has been faced with falling market share over the last few years, and a consistent decline in net income. While newer players see massive growth, such as Kroger experiencing a 50% increase in sales from 2013 to 2015, Whole Foods has seemingly stalled, unable to catch up to the higher pace of competitive pricing. The company's net margins have decreased over the last few years, with overall profit declining five percent in 2016. Some corresponding quarterly profits fell more dramatically – for example, from 154 million in Q3 of 2015 to 120 million in Q3 of 2016 (Haddon, 2016). As a response, Whole Foods has launched various initiatives, both customer-facing and business-facing. From an internal angle, the company has reduced selling, general, and administrative expenses in an attempt to improve margins (GuruFocus, 2016). Furthermore, it eliminated two thousand employee positions in 2015 (two percent of its overall workforce) in order to reduce costs and potentially provide price discounts to its customers (Haddon, 2016). From an externally focused perspective, Whole Foods has recently attempted to broaden its market by opening smaller stores called "365 by Whole Foods Market," which aim to offer consumers cheaper options, especially in major cities. The initial feedback from the general public appears to be positive, and it will be important for the company to analyze the financial status of these stores as they become more established (McGrath, 2016).

While declining market share and increased competition appear to be the main issues faced by Whole Foods, the company will also have to be aware of other problems that have recently appeared. In the last year, United States health regulators have given Whole Foods warnings regarding food safety in multiple states, and this has led to negative publicity for the firm (Haddon, 2016). Furthermore, the organic food industry appears to be affected by economic forces at the moment, with declining food prices (deflation) potentially exacerbating the company's slowdown (Haddon, 2016). Moving forward, Whole Foods should carefully monitor both of these issues.

Theories & Analysis

When analyzing Whole Foods' position from a Porter's Five Forces perspective, as described above, **competitors** are the most problematic force. This rivalry with the industry has truly become intense, and Whole Foods must adapt to the new landscape through various strategic defenses. The bargaining power of **buyers** is another dangerous force that is working in conjunction with industry rivalry – as customers realize that Whole Foods' competitors offer the same organic products, but in a more cost-effective or convenient manner, they are likely to switch to a different firm. At the moment, there do not seem to be high switching costs involved in the industry, so consumers are able to move to competitors with ease. Whole Foods' aforementioned pilot loyalty program could be a potential method to minimize buyer power – by establishing a rewards program, customers would theoretically be less willing to leave Whole Foods. However, this program could have been established too late – do enough customers perceive Whole Foods as an organization to which they want to be loyal? With the combined forces of industry rivalry and the bargaining power of buyers, Whole Foods will have to potentially restructure its retail pricing. While initial attempts are being made through the establishment of the 365 stores, only time will tell if the discounted alternatives will control these forces effectively.

On the other hand, Whole Foods has strategically positioned itself in a manner that reduces the bargaining power of **suppliers** to a very minimal, if non-existent, amount. Throughout its history, the company has emphasized an "empowered, decentralized culture," where individual stores have autonomy and can customize the product mix based on local demand, trends, and suppliers (Gray, 2006). Each Whole Foods store has a plethora of unique products chosen by team leaders, and these products can come from local, regional, national, or international suppliers (MarketLine, 2016). In addition, they have even established partnerships with various food production facilities, including those that produce cheese, condiments, and coffee (MarketLine, 2016). Because of this diverse supplier dynamic, it appears that Whole Foods would be able to effectively control where they receive their products, and there would not be much risk that these suppliers could vertically integrate.

Looking into the future, Whole Foods will have to be aware of the long-term threat of **new entrants** in the industry. Recently, Walmart has started to emerge as a potential new competitor in the organic industry, and as such a massive retailer known for low prices, it will be important to see how its entry changes the industry dynamic. Another emerging threat is that of international grocers arriving in the United States. According to analysts from Deutsche Bank, the German companies Aldi and Lidl are beginning to expand in the United States, with the former planning to open 500 new stores in the next two years, and the latter one hundred (Peterson, 2016). Both of these firms offer low prices – even cheaper than Walmart and Kroger – and have recently begun expanding the natural and organic options found in their stores, thus potentially threatening Whole Foods' already weakening market share (Peterson, 2016). There also appears to be a future threat from Amazon, which has attempted to expand its online marketplace into many different industries (GuruFocus, 2016). If Amazon can revolutionize the grocery realm with online shopping, that could potentially disrupt the model established by Whole Foods. At this time, the threat of **substitutes** is effectively non-existent, as organic foods do not have many viable alternatives. Unless consumers were to rapidly move back to non-organic foods, Whole Foods' focus should be on competitors instead.

While analyzing the external environment, Whole Foods will have to primarily understand the economic, social, and environmental forces that surround its industry. From an economic perspective, the firm will have to monitor the overall price of food for potential inflationary or deflationary pressures. Both economic pathways have positive and negative effects – if food prices continue to deflate, there might be more customers willing to buy organic products, but would there be enough to offset the decline in price? Alternatively, if food prices were to increase, would customers flee? According to Mackey, Whole Foods has previously relied on the "overall culture becoming wealthier," thus allowing them to purchase higher quality, organic foods that tend to be more expensive (Gray, 2006). If macroeconomic conditions worsened, how quickly would Americans remove organic food from their personal consumption expenditures? From a social perspective, Whole Foods will have to analyze whether the “value system” of organic purchases will remain prevalent in society, or if there will be a shift back towards artificially produced goods. At this time, it appears that Whole Foods expects the organic movement to continue, and this is substantiated by the increase in competitors in the industry. Finally, from an environmental perspective, Whole Foods will have to be aware of various factors that surround its food sources, including extreme weather factors, climate change, and pollution. With the decentralized culture of Whole Foods, each store will have to be cognizant of what is happening nearby, and could theoretically be more susceptible to local environmental issues.

Ultimately, Whole Foods is in a very intriguing strategic location. While social trends would suggest that Whole Foods should be experiencing success, increased competition has truly disrupted the firm’s progress over the last ten to fifteen years. When viewed through the lens of Jim Collins’ theories and warning signs, Whole Foods appears to represent the profile of an institution that “looks strong on the outside, but on the inside [is] dangerously on the cusp of a precipitous fall” (Collins, 2009). In understanding the history of Whole Foods, it is plausible that the company has already progressed through the first two stages, “hubris born of success” and “undisciplined pursuit of more.” The corporation has experienced success in the past, and attempted to expand in a rapid fashion. Between 2006 and 2016, the number of Whole Foods stores rose from 189 to 462 (MarketLine, 2016) – could this be seen as overreaching? In the last few years, warning signs have continued to mount in Whole Foods’ financial statements, as previously discussed. However, other external results have remained strong enough for management to “discount negative data and amplify positive data,” which is a potential sign of the third stage, denial of risk and peril (Collins, 2009). In 2006, Mackey did not seem overtly concerned with the emergence of competitors, and this mindset is still around in 2016. If Whole Foods is indeed at the third stage of Collins’ quintet, then it will need to be more proactive in the near future to avoid irreversible damage.

References

Collins, J. (2009, May). How the Mighty Fall - A Primer on the Warning Signs. *Businessweek*. Retrieved November 19, 2016, from http://www.jimcollins.com/books/how-the-mighty-fall.html

Gray, S. (2006, December 04). Natural Competitor. *The Wall Street Journal*. Retrieved November 19, 2016, from http://www.wsj.com/articles/SB116519862144439661

GuruFocus. (2016, November 6). Whole Foods: A Year to Forget. *Forbes*. Retrieved November 18, 2016, from http://www.forbes.com/sites/gurufocus/2016/11/07/whole-foods-a-year-to-forget/#6dcfc9cc7aed

Haddon, H. (2016, July 27). Whole Foods Profit Falls; Sales Slip. The Wall Street Journal. Retrieved November 18, 2016, from http://www.wsj.com/articles/whole-foods-profit-falls-sales-slip-1469656674

MarketLine. (2016, September 7). Whole Foods Market Inc. Retrieved November 18, 2016, from http://0-advantage.marketline.com.shulsso.sacredheart.edu/Product/Download?pid=BD72666B-7DBD-4CB9-A94F-4FDC7997ECA7&role=MainDeliverable&mimetype=application/pdf

McGrath, Maggie (2016, July). Why Wellness Going Mainstream Is Bad News For Whole Foods. *Forbes*. Retrieved November 18, 2016 from http://www.forbes.com/sites/maggiemcgrath/2016/07/27/why-wellness-going-mainstream-is-bad-news-for-whole-foods/#4f3f04493105

Peterson, H. (2016, April 04). Aldi, Lidl threaten Whole Foods' business. *Business Insider, Inc*. Retrieved November 20, 2016, from http://www.businessinsider.com/aldi-and-lidl-threaten-whole-foods-business-2016-4