

# Going Organic: The Profits and Pitfalls

Organic foods are increasingly popular and command premium prices. But it isn't an easy switch for farmers, and that tightens the supply chain

By Pallavi Gogoi

Six months ago, Sheryl O'Loughlin, the chief executive of Clif Bar Inc., had a tough problem to crack. The head of operations at the Berkeley (Calif.)-based maker of energy and nutrition bars had just informed her that the company's source of organic almonds had dried up. Having gone through the difficult and time-consuming process of getting her Clif and Luna health bars certified as organic barely two years, O'Loughlin wasn't about to go back. She needed to get her hands on some organic almonds, even if that meant paying top dollar.

The search took weeks, but Clif Bar, which logged \$100 million in sales last year, eventually located a grower in Spain. Looking back, O'Loughlin calls the almond crunch "a huge wake-up call."

She's not the only one getting a rude awakening. Organic has become big business in the U.S., with consumers willing to pay as much as a 50% premium to buy products that are grown without the use of toxic and chemical pesticides and fertilizers, which must meet strict U.S. Agriculture Dept. regulations to carry the organic label.

Organic products are still a small segment of the market -- accounting for just 2.5% of all retail food sales in the U.S. -- but one that's growing rapidly. Organics rang up nearly \$14 billion in sales in 2005, a 30% increase from the previous year, according to the Organic Trade Assn. (see BW Online, 2/10/06, "Is Whole Foods Still a Natural?").

**ON THE VERGE.** But along with the double-digit growth rates, supply shortages of everything from organic oats to organic milk are beginning to crop up. Experts are warning that what is now an intermittent problem could escalate into a full-blown crisis, since more and more supermarkets are fast expanding their organic aisles. Even the world's largest retailer, Wal-Mart (WMT), recently unveiled plans to double its offering of organics (see BW Online, 3/29/06, "Wal-Mart's Organic Offensive").

"Pick any organic product, industry-wide, whether its milk, meats, or grains, and you'll see that either we're already in a supply shortage or we could fast find ourselves in a shortage," says Marty Mesh, executive director of Florida Organic Growers, a Gainesville-based organization

that provides certification to organic food growers globally.

These days, it isn't uncommon to see signs in even the biggest supermarkets, like Kroger (KR) and Publix, that read: "Organic Milk Sold Out." That's because consumption of organic milk nationwide is growing at rate of 26% a year, while supply is growing at a mere 15%, says Theresa Marquez, chief marketing executive for Organic Valley Cooperative in La Farge, Wisc.

**TOUGH TRANSITION.** That imbalance is putting the squeeze on companies such as Horizon Organic, a division of Dean Foods (DF) that recorded \$273 million in sales in 2005, a 37% increase on 2004. "We have been able to fill only 70% of orders," says Horizon Senior Brand Manager Caragh McLaughlin.

To alleviate the problem, the Broomfield (Colo.)-based company kicked off a program four months ago to help dairy farmers go organic. Under the program, farmers get help buying organic feed, and advice from an in-house veterinarian. "It's a challenging transition," says Marquez. "Cows get sick, and farmers can't give them antibiotics. And they have to buy expensive organic feed, since

their pastures also have to be transitioned out of the pesticides they have used."

The tough conversion process is one reason the U.S. is experiencing organic shortages. It takes a minimum of three years for grain and citrus farmers who are making the transition from typical farming practices to rid the soil and their plants of synthetic fertilizers and harmful chemical pesticides. And that has to happen before their produce can be certified organic.

### **LONG-TERM PARTNERS.**

The detox often leads to lower yields -- a big reason many growers are reluctant to make the switch. In Florida, barely 1% of the state's oranges and grapefruit are farmed organically, even though the price of organic orange juice is often more than double that of regular. "Oftentimes, yields fall 30% when citrus farmers convert out of the conventional farming style and stop using the synthetic ingredients," says Wade Groetsch, president and COO at Blue Lake Citrus, a citrus-juice processor in Winter Haven, Fla.

To ease the burden on his suppliers during the transition, Groetsch offers long-term contracts that cover the years when farmers cannot send their lower yield oranges and tangerines into the organic market. It's a strategy that makes good business sense: While Blue Lake's overall sales have been growing at a steady clip of 10% to 15% in the past decade, those at

the company's organics division, which produces the Noble Organics brand of juice sold through Wal-Mart and Publix supermarkets, have doubled in just the last year.

One successful organic convert is Matt McLean, a citrus grower in Clermont, Fla. McLean began farming organic citrus in 1999 on barely five acres and is today one of Florida's largest organic growers, with 1,000 acres. His operation supplies fresh oranges and the Uncle Matt's brand of organic orange juice to stores ranging from Whole Foods (WFMI) to Kroger. In his first years of organic farming, McLean had to export 50% his juice to Europe because there wasn't enough demand in the U.S., but today he sells 95% of his production stateside. "I'm turning away orders because I don't have enough organic groves," he says. (For an interview with McLean, see "Sowing Success Through Organic.")

**FLEXIBLE FARMING.** With the continuing growth of organic supermarkets such as Whole Foods and Wild Oats (OATS) -- not to mention increased organic offerings from giants like Wal-Mart -- the strains on suppliers aren't likely to ease anytime soon. "We're seeing demand growing at a rapid 40% pace," says Andy Berliner, owner of Amy's Kitchen. Berliner says that's double the rate of recent years. Revenues at the Santa Rosa, (Calif.)-based company, which makes organic frozen foods such as pizza, pasta dishes, and Indian

and Mexican meals, topped \$125 million last year. Berliner, who's in the process of building a new processing plant in Medford, Ore., says he has built a loyal network of farmers over the last decade, so he hasn't seen any shortage of raw ingredients yet.

Clif Bar is also working more closely with suppliers to avoid a repeat of the almond emergency. "The list of short-supply ingredients is increasing, whether it be apricots, cherries, or other berries," says O'Loughlin. One of the company's peanut suppliers is in the middle of a crop rotation, which is necessary in organic farming to keep the soil fertile. So he isn't planting any nuts this year, but Clif Bar has already pledged to buy the 500,000 pounds of organic oats he's growing instead. One thing Clif Bar has experienced no shortage of since it went organic in 2003 is customers: Sales, which had been fairly flat for a number of years before the switch, have jumped 35% since the organic move. No wonder O'Loughlin would rather scour the globe for organic almonds than settle for just any old nut.

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