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Organic Products

Market Brief

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Report Highlights:

The UK organic market has developed significantly since FAS/London last reported on this sector in March 2000. The organic category has expanded beyond its niche market origins, moved into the mainstream and is set to break the BPS 1 billion (US\$ 1.6bn) barrier. Supermarket chains dominate retail sales of organic foods, accounting for an estimated 82 percent of sales by value. Organic product ranges now extend to a wide range of convenience and grocery items. This trend offers new opportunities for U.S. exporters, in addition to the continued demand for organic high value horticultural products from U.S. exporters.

Includes PSD changes: No
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SECTION I: SUMMARY

The retail value of the UK organic market is set to break the BPS 1 billion (US\$ 1.6 bn) barrier. This follows high growth rates in the category through the late 1990s. In 2002, the market worth was estimated at BPS 920 m (US\$ 1472m). Imports accounted for an estimated 65 percent of the organic retail value, signifying a decrease in import reliance. This was due to increased output from the domestic organic sector. The UK experienced its largest ever increase in fully organic land, from 240,000 ha to 458,600 ha, as in-conversion land qualified as fully organic.

The structure of sales by outlet type shifted significantly as the organic category expanded. Supermarket chains now dominate organic sales. This emphasizes the current importance of the organic category to the mainstream UK food market. It also illustrates the rapid expansion of organic foods beyond its niche market origins.

Fresh produce has been a key sub-sector in the growth of organic foods. Indeed, the majority of U.S. organic shipments have focused on this category. Many high value horticultural goods (salads, top fruit, citrus, exotics) are not grown domestically or in sufficient quantities to meet year-round consumer demand. Such horticultural products remain good prospects for U.S. organic suppliers.

The sub-sector that has displayed most market growth has been grocery. New product development and the entrance of conventional food manufacturers into organics have promoted the availability of organic processed foods. Increasing consumer demand for convenience will be a factor in the continued growth of organic grocery products. This should present further opportunities for U.S. shipments of organic packaged grocery items.

The food ingredients market is growing. Major food manufacturers have entered the organic category, encouraged by increasing domestic output and the increasing role of supermarkets in distribution. By contrast, the foodservice sector has generally been slow to embrace the organic phenomenon, with consistency of supply a major problem for organic cafés and restaurants.

Table 1: Summary of Key Advantages and Challenges for U.S. Exporters Targeting the UK Organic Sector

| Advantages | Challenges |
|--|---|
| Forecast UK demographic and income patterns favor the organic market, with consumers typically older and upmarket. | Category growth rates are slowing and the sector is reliant on a relatively small number of regular users. |
| UK is hugely reliant on imports to meet consumer demand for organic foodstuffs. There is particular reliance in the sub-sectors of fresh produce and cereals, where seasonality and climate restrict domestic supply potential. | Other EU member countries are preferred suppliers of organics (reduced transport costs, equivalent standards, no tariff barriers). Expansion of the EU will augment organic supply potential. |
| The U.S. is a recognized supplier of high value, organic, horticultural goods. Trends in the U.S. organic sector also mean that organic grocery goods are increasingly commonplace in U.S. retailers, and could be transferred successfully to the UK. | UK retailers under pressure from domestic supplier base and certification bodies to reduce percentage of organic food imports. In addition, UK Government supports an objective to increase UK organic market share to at least 70 percent. |
| Growing demand for organic variants of processed and convenience-style foods. This represents potential opportunities for U.S. exporters who are meeting similar demands from U.S. consumers. | Established food manufacturers are entering the organic sector and supermarket chains are seeking to condense the supplier base, prompting consolidation within the historically fragmented and small scale organic sector. |
| The UK organic category can be considered mainstream - supermarkets account for 82 percent of sales and product lines have increased significantly. | Additional financial support is available to UK arable and horticultural producers to encourage conversion to organic. |

SECTION II: REGULATIONS AND POLICY

OVERVIEW

The U.S. is not currently recognized by the EU as operating production rules and a system of inspection equivalent to those operating within the EU. However, U.S. organic products can be brought into the European Union and marketed as organic, provided prior authorization has been obtained.

In the UK, the United Kingdom Register of Organic Food Standards (UKROFS) grants such authorizations for U.S. organic products on a case by case basis. UKROFS is the body appointed by the UK Government's Department of the Environment, Food and Rural Affairs (Defra) to control organic standards in the UK. However, UKROFS will be superseded by a new Advisory Committee on Organic Food and Farming (ACOFF) with effect from April 2003, as Defra begins to implement an Organic Action Plan. Defra will take over the UKROFS responsibilities for approving organic certifying bodies and imports. The requirements for organic products will not change as a result of the accession of this new body.

Importers can apply for an authorization to import organic products into the UK. Before authorization is given, importers must demonstrate that the products to be imported:

- were produced to rules equivalent to those laid down in Articles 6 and 7 of Council Regulation (EEC) 2092/91 (as amended); and
- were subject to inspection measures equivalent to those laid down in Articles 8 and 9 of Council Regulation (EEC) 2092/91 (as amended) and that such inspection measures will be permanently and effectively applied.

U.S. companies seeking to market organic products in the UK can apply for an import authorization from UKROFS/Defra through completing an 'OB6' application form. Guidance notes and the application form are available from :

Defra - Organic Imports Section
Area 5F, Ergon House
c/o Nobel House
17 Smith Square
London, SW1P 3JR
email: organic.imports@defra.gsi.gov.uk

They are also available online at:

<http://www.defra.gov.uk/corporate/regulat/forms/organics/ob6a.htm> and;
<http://www.defra.gov.uk/corporate/regulat/forms/organics/ob6.htm>

In addition, U.S. inspection/certification bodies have to comply with the requirements of EN45011 or its international equivalent, ISO 65 standards. EN45011 is a European Norm which contains provisions relating to the structure of inspection/certification bodies and requires, for example, that their certification decisions shall be free of influence from commercial considerations. A list of U.S. organic certification agencies that currently meet ISO 65 Standards

is available online at: <http://www.ams.usda.gov/lsg/arc/iso65.htm>

Regulation (EC) 1788/2001 is a further control to safeguard the integrity of standards of all organic imports entering the European Union. It requires that a Certificate of Inspection is provided by the U.S. certifier and accompanies organic imports for endorsement at the port of entry in the European Union prior to Customs clearance. In the UK, Port Health Authorities undertake endorsement of this Certificate and charge a set fee (circa US\$75) for each organic consignment. UKROFS recommend that importers make early contact with the Port Health Authority responsible for the port or airport through which you intend to import. Importers are required to retain the certificate for at least two years. Failure to provide a correctly completed Certificate will result in the consignment being refused Customs Clearance.

UK companies wishing to import under these arrangements must be registered with an approved UK inspection (certification) body. A full list of the UK certifiers is maintained by Defra and is available online at: <http://www.defra.gov.uk/farm/organic/approved.htm>

UKROFS standards are minimum standards as set down by the EU regulations. Individual organic associations in the UK may maintain stricter standards for their own members, and most do so.

PACKAGING & LABELING

Packaging for organic foods must conform to EU regulations with respect to materials used and labeling. UKROFS Standards for Organic Food Production state that as far as is reasonably practicable, ecologically sound materials should be used for the packaging of organically produced products.

Labeling is considered under E.C. regulation 2092/91 (Article 5). Article 5 classifies processed foods into categories depending on the proportion of organic ingredients in the product:

- organic - more than 95% organic agricultural ingredients
- partly organic - between 70% and 95% organic agricultural ingredients
- non-organic - less than 70% organic agricultural ingredients

Labeling should also include:

- certifying body stamp
- country of origin
- EU accredited registration number
- use by date
- name of product/brand
- weight (in metric)
- name and address of producer/distributor
- ingredients listing

For further information on labeling products for the UK market, see the UK Food and Agricultural Import Regulations (ref: UK2014) at:

<http://www.fas.usda.gov/scripts/attacherep/default.asp>

TARIFFS

There is no preferential access for organic products. To obtain the appropriate commodity code for your products contact:

Her Majesty's Customs & Excise, Tariff Classification Helpline

Tel: +44 1702 366077

Fax: +44 1702 367342

It is possible to obtain a verbal ruling over the telephone or a written legally binding ruling called a Binding Tariff Information (BTI). This will provide assurances that you have the correct tariff classification for your product. More information on how to apply for BTI is available online at:

<http://www.hmce.gov.uk/business/importing/classifying/binding.htm>

Tariff classification and rates are available online through the European Union's TARIC database: http://europa.eu.int/comm/taxation_customs/dds/en/tarhome.htm

SECTION III: CONSUMPTION AND MARKET SECTORS

A). CONSUMPTION

Organic consumers are older and wealthier than the norm. They tend to be from the ABC1 socio-economic groups, have higher levels of disposable income and there is a clear bias towards older (aged 50-70) consumers. Inherent in this consumer profile are several characteristics, such as

- strong enthusiasm for meal preparation
- belief that organic products improve the quality and taste of a meal
- an abundance of time to shop and prepare foods
- high levels of health consciousness
- concerns over food safety

In addition to the affluent and older consumers, parents with young children have developed into a key target market for organic products. Organic baby food has seen phenomenal growth, as parents translate their concerns over food safety to their retail behavior when buying for children. Approaching 50 percent of all baby food sales are organic, such has been the growth in the sector. This compares to the approximate 2 percent share represented by organics in the total food market.

Changing demographic trends should assist continued growth in the organic sector. With the population forecast to benefit from increased disposable income levels and greater life expectancies, the number of people in the organic sector's key demographic is forecast to increase.

A basic segmentation of organic consumers is into loyal or regular users and occasional users. The market is very dependent on a relatively small number of regular consumers. Less than 9 percent of homes in the UK account for almost 64 percent of the total sales value of organic foods. However, the proportion of regular consumers has increased over the last 3 years as the core consumer base expanded. By contrast, over 80 percent of UK households purchase organic products less than once a month or not at all. Even acknowledging that there is a proportion of consumers that will never buy organic, the potential gains from transforming occasional and trial buyers into regular purchasers remain huge. However, recent market intelligence from market research company Taylor Nelson Sofres (TNS) indicates the size of this challenge. For the first time, the percentage of households buying organic at least once over a one year period has dropped, falling to 77.7 percent in the year to 5 Jan 2003 (from 80 percent in the year to 6 Jan 2002).

B). MARKET SECTORS

1. RETAIL FOODS.

Market Entry Strategy

As observed in Section II, UK importers of organic foodstuffs from outside of the European Union must be registered with a UK certification body. Indeed, when applying for an import authorization from Defra, the UK importer's details must be included on the application form.

Therefore, the most common and rudimentary entry method utilized by U.S. exporters is to work directly with an existing importer of organic foodstuffs. The significant volume of organic imports necessary to meet UK consumer demand means that many organic companies do have experience developing international trading relationships.

The company functioning as the UK importer will already have linkages in the organic supply chain, which is an obvious advantage to the U.S. exporter. The UK importer may be a food manufacturer that will utilize the import in further processing or perhaps a large-scale domestic grower that is looking to guarantee year round supply for supermarket customers. More likely, the importer will fulfill the role of a wholesaler/distributor, and will supply organic products directly to the retail and foodservice sectors for sale to consumers.

USDA/FAS London maintains a database of existing UK importers of organic products from the U.S. - please contact Post to find out more about these companies and the produce sectors in which they operate.

Distribution

Chart 1: Retail Value of the UK Organic Sector and Market Growth Rate, 1998-2002 (source: Soil Association)

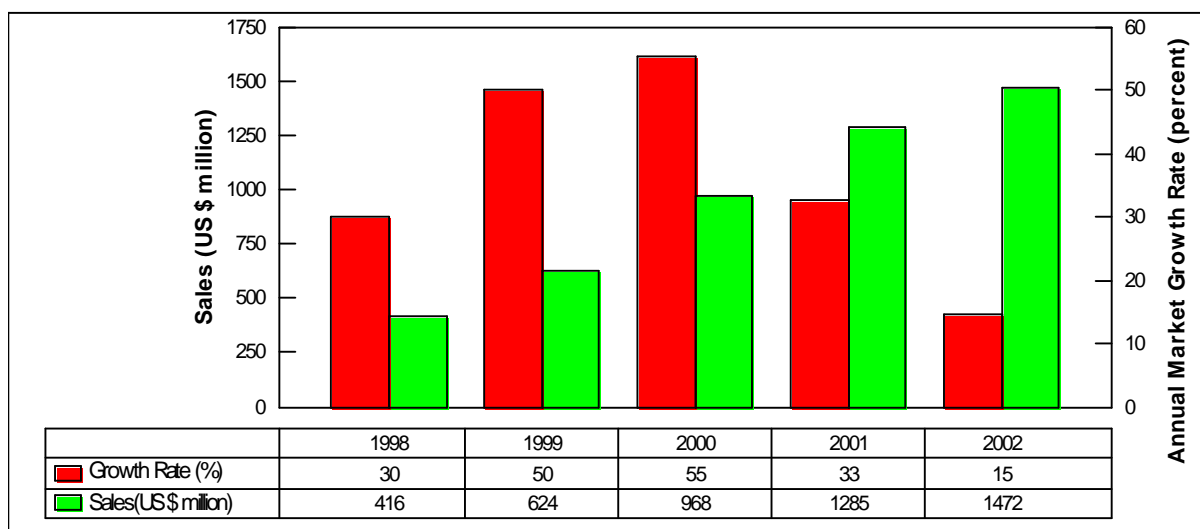


Chart 1 illustrates the dramatic expansion that the total organic category achieved as it expanded beyond its niche market roots and grew into a market worth an estimated BPS 920 million (US\$ 1,472 m) in 2002. The chart also shows that market growth rates have slowed considerably, but organics still outperformed the low growth rates witnessed in total food sales and maintained its position as one of the fastest growing categories at the retail level. However, more recent data from TNS estimates that organic market growth in the year to 5 January, 2003 has slowed further to an estimated 8 percent per annum. Despite this slowdown, organic sales at the retail level in the UK are set to break the BPS 1 billion barrier (US\$ 1.6 bn).

The UK food retail market is dominated by a small number of multiple retailers. These

supermarket chains now account for an estimated 82 percent of organic sales at the retail level, on a par with their share of total food sales. This constitutes a significant strengthening of their position, with market share of the retail organic market increasing from around 60 percent just five years ago. With the growing dominance of the multiple retailers, the market shares of independent food retailers, health food stores, and direct sales methods (box schemes, market stalls, farm shops) have been eroded. But this is against a backdrop of a category which has shown significant growth. Therefore, although share is diminishing, the value of sales through these outlets has actually increased. In 2001/02, the Soil Association estimated annual retail sales through direct outlets at BPS 73m (US\$ 120m), an increase of 3 percent. Sales through independent retailers showed similar slow growth rates, increasing to BPS 92 m (US\$ 147m). These specialist outlets remain important to UK producers, facilitating the establishment of localized supply chains for small-scale producers. Additionally, specialist retailers can offer a one-stop organic shop for loyal/regular consumers.

Some retailers, such as Sainsbury's, Tesco and Waitrose, have stocked organic lines since the 1980's, but all of the leading supermarket chains have increased their organic presence in recent years. The number of organic product lines has grown significantly in most stores. Increases in the global supplier base have meant a general increase in the availability of organic staples (fruit, vegetables and meats), while new product development and the entrance of multi-national companies at the food manufacturing level have yielded organic variants of many popular conventional foods.

It is commonplace for the leading retailers to stock over 1,000 organic product lines and the retail sector has undoubtedly been at the fore in developing organic foods beyond its niche market origins. Some leading performances and initiatives stand out:

- Waitrose significantly overperforms in the organic sector. Despite a low overall share of the total food retail market, an estimated 6.5 percent of Waitrose food sales are organic, resulting in a 10 percent share of the total organic market in the UK. The upmarket retailer benefits from a consumer base that closely matches the organic consumer demographic and has been an advocate of UK organics.
- Sainsbury's expanded their organic range to over 1,300 product lines, generating an estimated sales value of BPS 235 million (US\$ 376m) in 2002. Sainsbury's launched their Organic Partnership scheme in 2001, where they work with organic suppliers to develop the organic range. This includes a commitment to source British organics wherever possible.
- Following a threefold increase in the number of customers buying organics through 2001, Tesco announced a target of achieving organic sales of BPS 1 billion (US\$ 1.6 bn) by 2006. Tesco, the UK's leading multiple retailer, has started adding more information to its organic labels to help inform consumers of the differences between organic and conventional. This is part of a education process to help support its long term strategy.
- Marks and Spencer completely relaunched their organic offering in 2001, increasing the product range and re-branding organics under its 'O' label.

Despite the obvious successes, there have been setbacks for the multiple retailers in organic foods. For example, Waitrose was conducting price promotions on organics in fall 2002, as a

tactic for driving the sector forward. More recently, Sainsbury cut back their organic range, to focus on their most profitable lines. And with the slowdown in total organic sales, there are even grounds to question the probability of Tesco achieving the ambitious target for its organic sales within the original time frame. But perhaps the most documented of the setbacks on organic food expansion was the case of frozen food specialists, Iceland.

Although only a small player in the food retail market, Iceland planned to convert a significant proportion of its frozen food range to organic, and committed to maintaining conventional prices. At one stage, Iceland was reported to be purchasing up to 40 percent of the world's organic vegetable supply. But Iceland's customer base and product focus were ill-suited to the organic market: the customer profile tended towards low-income earners, while organic consumers initially showed a marked preference for fresh organic foods over highly processed products. This organic initiative pre-empted disappointing sales and ultimately lead to a fundamental review of business strategy.

The multiple retailer sector is analyzed in detail in the UK Retail Food Sector Report (ref: UK0046). The report contains an overview of the structure of the food retail market and profiles the major multiples and the convenience sector. It is available online at:

<http://www.fas.usda.gov/scriptsw/attacherep/default.asp>

Product Range

Chart 2: Organic Expenditure Share by Sub-sector in Year to January 5, 2003 (source: Taylor Nelson Sofres Superpanel)

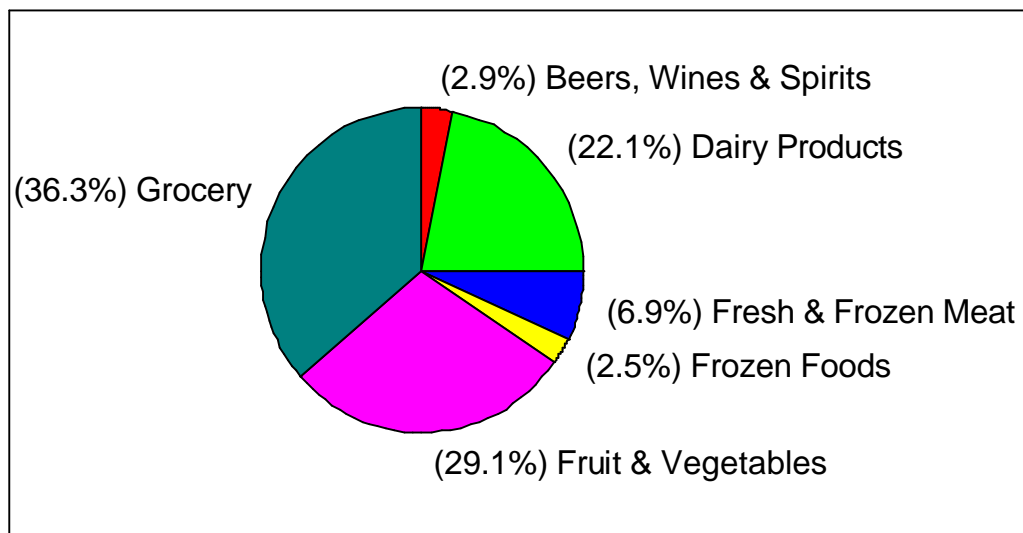


Chart 2 illustrates the current retail expenditure on the organic category by sub-sector. Historically, fruit and vegetables have been the largest sub-sector in the organic food market, with the UK largely reliant on Europe to meet demand. However, the organic category is still relatively young and characterized by change. The growth in total organic sales has prompted a shift away from the traditional focus of the category on food fundamentals, such as fruits, vegetables, meats, dairy products and cereals. Although such sectors have been key in the evolution of the organic sector and continue to grow in terms of retail expenditure, these products

are experiencing an erosion of their market share as the range of organic foods expands.

TNS data indicates that the Grocery sector is now the leading sub-sector in organics. As the organic category matured, organic variants of a range of grocery staples appeared. Examples of expanding product lines include breads, biscuits, cereals, soft drinks, baby foods and prepared/chilled foods. Between 1999 and 2002, all of these sectors showed three digit growth rates. The rising availability of organic packaged grocery goods is indicative of the growing diversity of the category as a whole.

As in the conventional food market, meeting consumer demand for convenience is increasingly a feature of organic food products, be it snacks or home meal replacement opportunities. Suppliers are keen to maintain the high quality of new products in order to support the category as a whole. The influence of the multiple retailers and the entrance of established food manufacturers into organics mean continued new product development is to be expected. Activity will likely focus on convenience and luxury food items. This reflects both the upmarket profile of organic consumers and the increasing saturation of basic organic foodstuffs.

Pricing

Organic products generally command a price premium in retail outlets, reflecting the higher costs of production. However, the increasing dominance of supermarkets in the organic food sector has prompted concern over the longevity of price premiums. Some organic lines are under pressure to meet the every day low pricing offers that currently characterize the UK food retail sector. Organic suppliers and certification bodies have both questioned such pricing initiatives. They highlight that fact that without acknowledging the higher production costs faced by organic farming systems, supermarkets are effectively risking the sustainability of their supplier base. Food retailers have investigated different pricing strategies for organic foods. For example, Sainsbury's dropped prices of selected organic products to the same level as conventional lines. Following a negligible impact on sales performance, the original pricing levels were reinstated.

It is well known that a key challenge for organics is to increase the consumer base. A seemingly straightforward way of attracting more consumers is to drop prices, a view apparently corroborated by the various consumer surveys which tend to indicate that a significant proportion of customers would buy organic if products were less expensive. However, the Sainsbury's example above, in addition to the experiences of Iceland, highlights that price is not necessarily the sole key to expanding the organic consumer base.

Similar variation has occurred over placement of organic products in-store. The dilemma on where to place this fledgling sector has been very real for the supermarket chains. Placement varies between chains and has also changed over time. Some have moved away from dedicated organic sections to display organic variants alongside conventional produce, effectively presenting organics as a high quality product and giving the consumer the opportunity to upgrade to organic. Others have sought to group organics in one section, where strong branding and key messages can be communicated to the loyal users.

Import Reliance

It is commonly quoted that despite the obvious success of the organic category, up to 80 percent

of the products sold are imports. The rate of organic conversion of agricultural systems in the UK did not keep pace with the rise in demand for organic products, leading to greater import reliance. However, the 2002 Soil Association Annual Report indicates that the reliance on imports is diminishing, with an estimated 65 percent of organics imported in 2001/02 as domestic suppliers come on line following conversion (In April 2002, fully organic land in the UK was recorded at 458,600 ha, with a further 260,000 ha in the process of conversion. This is a 91 percent increase in the fully organic land area recorded in April 2001.).

UK retailers remain under pressure from domestic producers and certification bodies to buy locally sourced produce. Sainsbury has been among the retailers aiming to reduce their import reliance, setting a target of importing just 45 percent of their organic products by the end of 2004. In addition, DEFRA, through its Action Plan for Organic Farming, introduced an objective to increase UK organic market share to at least 70 percent. There are a number of food sectors where UK producers have been able to increase market share, notably dairy, meat and eggs. This largely reflects the structure of the UK organic farm sector; 92.5 percent of the fully organic area is grassland. Other sectors, such as cereals and horticulture, remain heavily reliant on imports, although efforts continue to be made to prompt increased domestic organic production. Indeed, Defra's Action plan to develop organic food and farming in England contains special provision for increased financial support to arable and top fruit growers.

U.S. organic products that have been successful in the UK market tend to complement rather than substitute UK organic products. Mainly, the shipments are composed of organic products that just cannot be produced in the UK. Alternatively, U.S. supplies make up seasonal shortfalls in domestic production and help ensure year round availability of critical organic lines on retailer shelves. The technical problems of growing high quality horticultural crops in the UK climate at competitive prices, coupled with year-round consumer demand means that import reliance will continue to be a feature of the UK organic market.

2. FOOD INGREDIENTS

Market Summary

The rising availability of organically-grown raw ingredients in the UK has stimulated new product development and attracted new companies into the organic processing sector. The organic meat and dairy sectors have benefitted from increased domestic production. However, seasonal peaks in production have created excess supply, diminishing the price premium available for organics, and in some cases leading producers to sell into conventional markets. That said, improvements in supply chain management and communications between retailers and producers should limit such examples of oversupply in the future.

Reflecting the growth in the value of the organic sector, the number of businesses licensed to process organic foods increased, numbering almost 2,000 in 2002. But consolidation is increasingly a characteristic of the organic sector, as processors seek economies of scale and as multiple retailers condense their supplier base. The Soil Association estimated the 2002 market value at the processor level at BPS 721 m (US\$ 1,154 m), a rise of 18 percent on 2001 data.

Traditionally, the organic supply base has been dominated by relatively small, specialist organic

companies. With the growing worth of the organic sector, a number of large food manufacturers have now entered the market, including Unilever, Nestle, Mars and Heinz. Acquisition of an existing organic supplier has been the preferred method of entry. This allows continuation of the brand name and maintenance of perceived independence, if considered strategically advantageous. Conversely, the appearance of organic variants of major brand names acts as an effective method of attracting occasional or non-users to the category.

3. FOODSERVICE SECTOR

Market Summary

The growth of the organic category in retail markets has not been matched in the foodservice sector. Early expectations of the rapid spread of organic HRI outlets has been countered by supply constraints. Businesses have found it difficult to guarantee supplies of certified organic foodstuffs, which has significant implications regarding menu options. Also, a key barrier to expansion is how to verify claims made by foodservice outlets over their organic offerings. They do not have to be registered with any of the Defra approved certification bodies and enforcement is the responsibility of local trading standards officials.

Wholly organic restaurants and cafes are still limited in number and most are concentrated in London. They are often incorporated into independent health or organic food retail outlets. For example, independent organic retailers Planet Organic and Fresh & Wild both have foodservice fixtures allied to their retail stores.

Despite the slow growth of organic foodservice specialists, outlets are increasingly offering one or two organic options to customers. Sodexo Alliance, a leading foodservice specialist, is just one of the companies now offering an organic range to customers. In addition, McDonald's attracted media attention when it announced plans to stock organic milk in UK fast food outlets. The chain expects to retail more than 5.6 million bottles of certified organic milk by the end of 2003, and could also extend its organic offering to include desserts.

SECTION IV: PROMOTIONAL ACTIVITIES

April 6-7 Natural Products Europe, Olympia, London
Contact: Full Moon Communications Ltd, Mr. Chris Down
Tel: 011 44 1903 817305 Fax: 011 44 1903 817318
E-mail: cdown@naturalproducts.co.uk Website: www.naturalproducts.co.uk

Natural Products Europe is the UK's biggest trade show event for the natural and organic products industry. In addition, organics is an increasing feature at the UK's leading food industry exhibitions. Both Food and Drink Expo (next show - March 2004) and the International Food & Drink Exhibition (March 2005), have growing numbers of organic exhibitors and feature dedicated zones. For more details about UK trade show opportunities for U.S. companies, contact USDA/FAS London.

The organic industry does have specialist publications, providing opportunities for U.S. companies to target the UK trade through advertisements and new product updates. Also, developments in the organic category are regularly included in mainstream food industry publications.

SECTION V: POST CONTACT AND FURTHER INFORMATION

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