Whole Foods Is Innovating in the Wrong Direction

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Whole Foods Market WFM +0.33% (NASDAQ: WFM) plans to start a new store format to appeal to the "millennial generation." Co-CEO John Mackey describes the yet-to-be-named concept as a "streamlined, hip, cool, technology-oriented store that has lower capital, perhaps a little less labor cost and lower prices." Most of the coverage of the announcement has expressed concerns that value-oriented stores will cannibalize existing Whole Foods stores and damage value perceptions of the brand.

This is certainly a valid concern, given the failed attempts of other companies to extend down-market. But it overlooks the more important issue with this new development — it's addressing the wrong problem. The prices at Whole Foods may keep some younger customers away, but many just don't find traditional grocery shopping relevant or appealing anymore. To appeal to different customers, Whole Foods needs to innovate in a different direction.

(Credit: wholefoodsmarket.com)

According to data from the U.S. Census Bureau,, monthly sales at restaurants exceeded grocery stores sales last year for the first time on record. While this trend was spurred in part by lower gas prices and rising income levels, it also reflects prevailing changes in consumer tastes and behaviors. Twenty-five to 34 year-olds are more interested than their older counterparts in buying "food away from home," according to research from Morgan Stanley MS -1%. Barkley, a Kansas City-based advertising agency, and BCG reported that in-store delis are more important to Millennials than to older customers. A study by King Retail Solutions found more consumers, particularly younger ones, are buying their groceries at big box stores.

All of this research points to kind of new store Whole Foods should be developing — one that differentiates based on **convenience**, **access**, and **immediacy**.

Delivery should be a key component of the store offering. Not only should it offer one- or two-hour delivery of grocery items the way Amazon Fresh and Instacart , but meal kits and prepared meals should also be delivered. Upstarts like Blue Apron (meal kits) and Munchery (chef-cooked meals) are growing in popularity with customers and investors alike. If Whole Foods wants to meet evolving customers' needs for groceries, it should make the trip the store optional.

It should focus on its prepared foods offering. Prepared foods has already become a significant part of the company's sales and stores' square footage; it only makes sense to increase it in order to appeal to customers who want freshly prepared foods but don't want to do the fresh preparation. Designing a new concept around prepared foods while improving value perceptions and maintaining margins will require Whole Foods to pursue innovation in different areas — partnerships with suppliers and local restaurants, assortment management (perhaps rotating offerings more frequently and creatively to provide increased variety without increased overhead), and pricing strategy (possibly deviating from a single price per pound for all food bars). This approach may be more difficult than simply offering lower-priced alternatives, but it would provide more sustainable differentiation, and therefore ultimately more profitability.

The new format should also emphasize branded food service. Stores targeted to younger customers would be ripe territory for a fast-casual restaurant concept. And since, restaurants and bars already exist in some Whole Foods — for example, its Pasadena store is home to 110 & Bellevue, a full-service restaurant named for its cross streets — creating a new restaurant concept(s) would be a natural extension. Including a fast-casual restaurant would make the new stores a dining-out destination as well as a one-stop shop for grocery shoppers, thus enabling Whole Foods to capture more food occasions.

Many are calling Whole Foods' decision to start a new concept a mistake; I disagree. The company definitely needs to evolve its offering — but developing a value-based concept may move the brand downward.

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