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IR/PS CSR Case 07-03

# Whole Foods Market®:

An Industry Leader?

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## I. Introduction

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The phenomenon that is Whole Foods Market® began in Austin, Texas in 1980 with the opening of the chain's first location. The original store was founded when John Mackey, the current CEO, and his girlfriend Rene Lawson merged their store, SaferWay, with Clarksville Natural Grocery, owned by Mark Skiles and Craig Weller. Like every good success story, the origins of the company are modest and rooted in legendary details: the company's website describes how the twenty-something couple chose to live in their first store after losing their apartment, using the hose attachment for the store's Hobart dishwasher to shower. At the time the first Whole Foods opened, there were less than ten natural foods supermarkets in existence in the country.<sup>1</sup> In 1984, the retailer began expansion outside of Austin, and now, with nearly 40,000 employees and almost 200 locations in North America and the United Kingdom, Whole Foods Market is the largest supermarket retailer of natural and organic foods and products in the world.

The comfortable and attractive stores are designed to invite customers into the full experience of shopping at Whole Foods and in many respects, the chain's success has been built upon savvy marketing and an attention to detail and purpose. It strives to create a place in the community and a brand within the marketplace which is recognizable to a large market. To this end, the company has developed several of its own company brands, such as its Allegro Coffee, Whole Catch, Whole Creamery, and 365 Everyday Value label. Its growth has been steady and the recent purchase of its largest rival, Wild Oats Market, Inc, in February 2007 will add over 100 stores to its coverage.<sup>2</sup>

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<sup>1</sup> According to the Whole Foods Market website. <http://www.wholefoodsmarket.com/company/history.html>.

<sup>2</sup> Moore, Angela. "Whole Foods to acquire rival Wild Oats". *MarketWatch*. (22 February 2007). <http://www.marketwatch.com/news/story/whole-foods-acquire-rival-wild/story.aspx?guid=%7B7068D3A7-6BF0-4CC9-B3C2-674B394953F0%7D>.

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As a self-proclaimed industry leader in the natural foods market, Whole Foods prides itself on its dedication and commitment to quality standards which set the bar for the rest of the industry and create demand for healthy, sustainably-derived products on a large scale. Furthermore, in addition to promoting the value of whole foods and products, the company's philosophy is based upon a value-system which supports socially responsible corporate performance by itself and its vendors. What are these standards and how does the company guarantee that these standards are being achieved? What would inspire confidence in the market that Whole Foods is indeed meeting its goals?

This paper is intended as a case study of Whole Foods as a socially responsible corporate actor and examines the ways in which the company ensures the successful provision of its quality standards and leadership claims. Rather than rely on independent, outside regulations and standards, Whole Foods promises social responsibility through a strict control over the quality of its brand. The company claims that its standards are higher than those regulated by existing bodies and that it is therefore positioned to provide leadership to the industry. Yet, this allows the company to remain outside of a regulated monitoring process. So, what internal processes and incentives determine whether its self-monitoring practices are stringent enough to back up their claims of industry leadership? Can internal monitoring provide a solid foundation for socially responsible practices?

The case study is structured into four sections. The first section details the company's values and philosophy as it relates to socially responsible practices, including a general reference to the standards for its grocery products. The second section focuses more specifically upon the grocery standards portion of its "Whole Philosophy" and goes on to describe in greater detail the meat quality and animal welfare audit process. Because Whole Foods is currently developing a

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labeling system for its meat products, their internal compliance-monitoring audit provides a useful example of the processes the company uses to regulate itself. Third, I attempt to evaluate the success of this internal monitoring process by looking at the stringency of the audit and the incentives of the actors involved in the process, as well as the viability of alternatives. The paper concludes by suggesting the greater implications of the Whole Foods case for the monitoring processes in socially responsible corporations.

## **II. The Whole Philosophy**

The company's vision involves several goals in its effort to provide socially responsible products. As a corporate retailer, Whole Foods promises customer satisfaction and the creation of wealth for its stakeholders. While these elements of its value proposition could arguably be considered socially responsible behavior, other "harder" goals include the provision of a rewarding work environment, a dedication to communities and the environment, and a commitment to the provision of high quality organic products. Because the company's reputation as a responsible retailer is based around the truth of these claims, it is important to first see if and how Whole Foods meets these general promises.

The company tries to provide a rewarding work environment by offering its Team Members (employees) competitive wages, paid trainings, transparency and access to all its financial books, including its annual individual compensation report, and discounted stocks for purchase. Whole Foods also pays 100% of the employee benefits package, which includes flexible options such as a debit card-based personal wellness account. Since 1998, Fortune has

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consistently listed the company in the top 100 of its list of Best Companies to Work For, and ranked it number five overall in 2007.<sup>3</sup>

Community relations at the local and international level are supported in several ways. The company periodically holds CommUnity Giving Days, or 5% days, where the local stores donate 5% of net sales to a local or regional organization. This is part of the corporate promise to donate at least 5% of total net sales to charities. The company has also donated food to food banks and promotes environmental stewardship by utilizing local composting facilities.<sup>4</sup> Internationally, the company sponsors the Whole Planet Foundation, partnering with established groups such as the Grameen Trust and ProMujer, to make grants and loans to people in countries from which Whole Foods buys products.<sup>5</sup>

Whole Foods seems to be doing more than just paying lip service to the values that qualify it as a socially responsible company. It has taken definitive steps toward meeting the standards it claims to uphold and has been recognized by the market for successful elements of its overall value proposition. While this case study looks specifically at the product standards and the company's internal compliance monitoring, the brand that Whole Foods wants to create, the brand that can demand higher prices in its stores, hinges on trust that these other promises are kept. Does this commitment translate to trust for the quality of the products it sells in its stores? What are the standards and processes in place to ensure quality for those items?

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<sup>3</sup> See: [http://money.cnn.com/magazines/fortune/bestcompanies/2007/full\\_list/](http://money.cnn.com/magazines/fortune/bestcompanies/2007/full_list/)

<sup>4</sup> "Whole Foods Market - Addressing Issues of Hunger and Waste" *Metro* (15 March 2007). <http://www.metro-region.org/article.cfm?articleid=1393>

<sup>5</sup> See: <http://www.wholeplanetfoundation.org/partners/index.html>

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### **III. Standards and Compliance Monitoring**

#### *A. Product Standards*

Whole Foods supports natural and organic products because it believes that these foods and body care products are the most nutritious, pure, and/or flavorful items a consumer can purchase. The quality standard is based upon a high valuation of organic farming and the company proudly highlights this commitment by its participation on the National Organics Standard Board, the only retail representative on the board. It also took action in 2003, when Congress sought to weaken the standards on organics.<sup>6</sup> Recently, a debate between John Mackey and best-selling author Michael Pollan, who extols the value of locally-produced goods over organically-grown ones, has encouraged the company to realign its production methods to incorporate this value.<sup>7</sup> While the company has made moves toward greater usage of local products, it has historically been focused on organics, and the use of natural ingredients and production methods.

Standards for the grocery items are focused on “high quality at a reasonable price” and quality is defined in terms of freshness, appearance, nutrition, and taste. Food quality standards include a huge list of unacceptable ingredients, including such things as bleached flour, aspartame, calcium peroxide, artificial colors/flavors—a total of over 80 items. The Whole Body™ bodycare product standards are slightly less stringent, but the website claims that buyers “encourage” their vendors to use plant-based, naturally-derived ingredients that are petroleum-free and light on the preservatives. They also claim to only sell products that are not tested on

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<sup>6</sup> Moore, Suzanne. “Political game of chicken: Whole Foods pressuring Congress to change provision.” *Environmental Working Group* (9 April 2003).  
[http://www.ewg.org:16080/news/story.php?print\\_version=1&id=1619](http://www.ewg.org:16080/news/story.php?print_version=1&id=1619)

<sup>7</sup> See John Mackey’s Blog on the Whole Foods Market website for more information about the spirited discussion on this topic. [http://www.wholefoods.com/blogs/jm/archives/2006/06/detailed\\_reply.html](http://www.wholefoods.com/blogs/jm/archives/2006/06/detailed_reply.html)

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animals. Monitoring compliance for these standards is dependent upon DSHEA (Dietary Supplement Health & Education Act of 1994), FTC Truth in Labeling laws, and all associated FDA regulations, including standards for organics. Thus, the standards enforced are based on governmental monitoring. For FDA-safe products that Whole Foods deems unacceptable, labeling provides the signal for its internal auditors to catch items that do not meet standards.

Like the quality assurance on the grocery and body care products, the company's meat quality and animal welfare standards are intended to allow customers the freedom to shop in the store with an assurance of a basic level of quality. In general, Whole Foods guarantees its customers that all of the meat it sells is free of hormones and antibiotics, and that no animal byproducts (other than milk) are ever fed to the animals. Some of the literature also makes mention of a basic level of "humane treatment" of animals, although during the time of this case study, marketing materials with these claims were removed from the stores and the website was changed to reflect an ongoing process toward this end.

So, in addition to these meat quality issues, the company is currently developing more stringent standards in regards to the welfare of the animals brought to slaughter. As a recently converted vegan, John Mackey has directed Whole Foods in the creation of an "Animal Compassionate" label which far exceeds the standards of the USDA, and which they claim also exceeds some of the animal welfare labels already in existence. The label will be a species-specific approach and is planned to be launched in late 2007. The scheme involves a five-tier system and offers higher payment to vendors as they move up the stringency tiers.<sup>8</sup> Details about the standards are hard to come by, as they represent proprietary information the company will

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<sup>8</sup> My research benefited immensely from several interviews with Marissa Guggiana, a marketer and distributor of lamb in Northern California. She recently completed the Whole Foods audit process and provided a wealth of information. Details of the on-site audit are courtesy of her, unless otherwise noted.



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use to gain an advantage over its competitors. However, information provided by the website and personal interviews is summarized below:

1. **Benchmark level**—reflects Whole Foods Market's current meat & poultry standards. No antibiotics, no hormones, no animal by-products.
2. **Traceability to farms**
3. **Pasture based farming**—only very limited time in barns.
4. **Animal Compassionate standard**—no castration, no tail docking.
5. **Animal Compassionate Gold standard**—natural weaning, four-hour proximity to the slaughter facility.

Currently, Whole Foods only guarantees the most basic level of its meat quality standards (with some fuzzy mention of animal welfare, such as pasture-raised stock). The standards which it touts as important for the humane treatment of animals are more stringent and are subjected to self-reporting by vendors, internal audits, and what the company claims is an independent, 3<sup>rd</sup> party audit. The company relies on standards developed by Dr. Temple Grandin, a professor of animal science, who is widely considered as the leading expert on farm animal welfare and facility design for livestock. Dr. Grandin's research influenced the standards at the USDA in terms of animal handling and care, specifically the practice of stunning, and her recommendations were incorporated into the American Meat Institute's Good Management Practices (GMPs) in 1997.<sup>9</sup> The GMPs are used widely, although voluntarily, by numerous meat

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<sup>9</sup> "Voluntary Initiatives in the Meat Industry" From the National Cattlemen's Beef Association. <http://www.beef.org/ncbaanimalwelfare.aspx>.

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handlers. Grandin's standards provide the basis for the animal welfare commitment, but it is unclear to what extent and what specific elements of the more stringent tiers are a product of her expertise.

*B. Audit Process*<sup>10</sup>

The audit for meat quality and animal welfare is based on a three-step process. The process is the same for all tiers on the quality level system, and currently, no producers are operating at the fourth or fifth tiers.

Step One If potential vendors confirm that they meet the basic criteria that Whole Foods requires in a screening with the regional meat coordinator, they are then required to submit annual verification statements about their handling practices, medical practices, environmental sustainability practices, facility design, and type of feed. This affidavit is required for each species the vendor sells to Whole Foods and the vendor agrees to update Whole Foods with any changes made to its own farm plan or production system.

Step Two Along with this self-reporting measure, an internal audit is conducted by a Whole Foods corporate employee. This process used to be conducted by the national team, but is now done through the regional meat coordinator in the area.<sup>11</sup> This process involves an on-site facility inspection of the ranches or farms and seeks to verify that the information provided in the affidavits is valid. Such Quality Assurance audits are done annually.

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<sup>10</sup> A description of the audit process will necessarily reflect the transition period which characterizes the current situation. Therefore, some of the processes are actually occurring, while others are being developed along the way, in an as-yet-incomplete method. I will try to be as clear as possible in distinguishing the difference, although in some cases, the best information reflects this overlap of word and deed.

<sup>11</sup> Some of the information about the audit process and the 3<sup>rd</sup> party auditors was provided by the regional meat coordinator of the Northern California division, Dan Neueberg.

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*Step Three* The last stage of the monitoring process involves an audit of the animal welfare practices on the ranch, based on the standards described above, as well as an evaluation of the slaughter houses, based on the GMPs and the health and safety standards required by the USDA. Whole Foods calls this part of the process an independent, 3<sup>rd</sup> party assessment. The name of the audit company is not listed on the website or any literature, but a regional meat coordinator interviewed for the case study said that Steritech performs the audits.

#### **IV. Evaluation of the Self-Monitoring Process**

Steritech Group, Inc. performs the audits of both the in-store grocery quality standards as well as the last step of the meat quality and animal welfare standards considered here. The company bills itself as the “leading provider of specialized brand protection services.”<sup>12</sup> Founded in 1986 as a commercial pest elimination company, it now serves agricultural, government, food service, health care, and supermarket industries to provide food safety, quality assurance, and pest prevention. It has 40 corporate office employees in its headquarters in Charlotte, North Carolina (no number for total employees is given) and serves 20,000 clients in 24 different countries. The website claims to offer independent audits, but says that these audits are “educational and consultative” and can be customized by the client. The company does display institutional capacity with the completion of GMP and vendor certification audits.

One of the strongest elements of the process would be the 3<sup>rd</sup> party audit, which would offer the most stringent (external) monitoring of the system and provide the most confidence in the truth of the claims Whole Foods makes. However, while the literature refers to the auditing company as independent, the group acts more as a second party assessor. Therefore, the

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<sup>12</sup> Information about the company taken from its website <http://www.steritech.com/site/home.cfm>

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evaluation of the process involves the characteristics of this group, its relationship to Whole Foods, and the incentives each has in enforcing the quality standards.

*A. Independence*

The level of independence that this company displays seems questionable. One discussion with a meat coordinator seemed to indicate that the auditors and their results are separate from the knowledge of the internal staff. In other words, this coordinator knew little about the process or the company itself and simply received a scored report of the potential vendors that resulted from the audit. His knowledge of the monitoring was gleaned from discussions with the vendors themselves and he did not have direct contact with the auditors. However, Steritech gets the standards that it enforces from Whole Foods itself, acting as an agent of the company. Moreover, as the company's website highlights, the process is based on feedback and is understood to be a consultative process. Because of these facts, Steritech cannot be considered an independent third party, but acts as a second party evaluator with only a basic level of independence.

*B. Thoroughness*

A major strength of the process is a high level of thoroughness. The audits may take several days, and the representative spends several hours per ranch to evaluate that the procedures are met. One distributor said she felt that audit process was extremely thorough. She described that the auditor first interviewed her, using a questionnaire form and asking further questions where needed, then walked around the ranch to examine the animal's pens, asking questions about how the animals are moved and how often. The auditor also checks the animals and determines how the rancher keeps the tagged animals (ones who have been treated with antibiotics for example) separate from the other animals intended for sale to Whole Foods.

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Finally, the auditor inspects the barns and the grounds to see if they meet the standards. The auditor did this for each of the ranches from which the distributor sold product.

*C. Violations*

The issue of violations and sanctions is tied in to the level of independence that Steritech has from Whole Foods. The distributor was unaware of what would happen if she did not pass the audit and felt that few would fail this level, since so much background screening is done to ensure that the farms are compliant with the standards. She felt there were some violations which would automatically result in failure, but that there were a range of things that could be worked on. The meat coordinator echoed this point and said that in the past, vendors are immediately prevented from selling to Whole Foods if they did not pass inspection, but that recent practices allowed for vendors to work on the problems indicated in the audit. It seems that once vendors pass the initial inspection, there is less of a concern about failing future audits. The distributor, for example, did not have specific fears about harsh penalties for failure, so this can not be seen as a strong disincentive to guard against mistakes.

*D. Transparency*

Another problem with this monitoring process, and of internal compliance monitoring in general, is the lack of transparency. As noted, Whole Foods does not provide the name of its independent auditor to the general customer, so it is difficult for customers to determine whether it can trust this party. It is unclear why Whole Foods would not provide this information, especially in light of its general good record of transparency. In any case, customers must rely on trust for the brand and the word given by the Whole Foods company that the auditor is acceptable. Furthermore, the Steritech group provides no information about its clients' success on the audits they perform, so a customer can not visit a website and see how many violations

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that Whole Foods vendors had or what is being done to remedy an issue. In fact, Steritech does not even list the names of its clients for customers to determine whether they believe that this group is representative of what they consider to be characterized as “high quality”. The relationship between these two companies precludes any level of transparency, because Steritech has an incentive to protect the proprietary information about its client.

*E. Accreditation*

Finally, Steritech is not an accredited institution. While the company may be recognized in the corporate world (although even this is difficult to determine without knowing which companies use its services), it does not prove the quality of its auditing services with the approval of an independent accrediting body.

*F. Economic Incentives*

One meat distributor said that it was her understanding that as vendors move up the tier system, they will receive more money for this meat. The meat coordinator was unsure about how this new process would work once the standards and label were in place, and could not corroborate this information, but if this were true, one might have more confidence that Whole Foods was truly committed to promoting the value of animal welfare in society. Of course, Whole Foods may believe that they are able to sell this higher quality product for a higher price, and cover the cost it incurs in developing the higher standard. However, the demand for these products is not well-known since no product with exactly these qualities is on the market, which of course will be the basis of the next step in Whole Foods’ marketing program. If the company fails to create, or capture (as the case may be), the demand for products with higher costs, it will be footing the bill for its socially responsible standards rather than its customer. In this sense, the

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company is able to use its branding and first-mover advantage to push the industry standard higher, even if it involves an initial cost.

Yet, there is also an economic incentive for Steritech to keep Whole Foods as a client<sup>13</sup>, which muddles the issue of independence and could compromise the stringency the auditor places on the monitoring process. Steritech does have incentive to be rigid, so that it can provide good “brand protection service” to its client, but only as rigid as defined by Whole Foods. Without specific regulation governing such things as tail cropping of farm animals, there is no shadow of the law that would result in a lawsuit against either Steritech or Whole Foods if such things were done incorrectly or not at all. So, if Whole Foods is happy with its quality levels, Steritech is too, and vice versa.

One important economic incentive in this question of corporate responsibility is the one which ranchers and distributors receive. Because Whole Foods pays above market value for the meat that it buys, meat producers have an incentive to meet the standards it requires. Of course, the producers could cheat the system and try to fake meeting the higher standards, but the involved process does discourage this, so only serious producers are likely to enter into it. Also, the cost of the third party certification that Whole Foods requires is actually paid by the distributor/vendor, so unless the rancher believes that he will pass the audit (and attain the higher price for his meat), it would be expensive to take the risk.

*G. Alternatives*

There are some alternatives that exist for animal welfare practices in meat production, including the Certified Humane label and the Free Farmed label. Both of these labels are certified by auditors accredited by the USDA’s voluntary, user-fee, audit-based programs. The

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<sup>13</sup> While Whole Foods does not pay Steritech directly, it does require its vendors to use the company, therefore, Steritech earns money from the audits of almost all of the Whole Foods vendors.

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standards are competitive in terms of stringency, although the Animal Compassionate standards under development by Whole Foods are just slightly more so, and come down to a difference in the areas of tail docking and castration.<sup>14</sup> What is interesting is the fact that Whole Foods, because it does not yet have the Animal Compassionate label on its food is not regulated by any of the labeling laws that would open it up to lawsuits or action by the government. Therefore, until the labeling process is complete the company can tout its strict standards and quality assurances without fearing action against it for untruthful claims.

**V. Conclusion**

So, is Whole Foods able to claim that it is the leader in terms of innovative quality standards which push the industry to perform in a more socially responsible way? This case study illustrates the implementation of a sound process by a major corporation in an effort to support its quality standards and those values it wants to promote. I think the thoroughness of the audit process and the fact that Whole Foods is financially willing and able to support vendors that want to participate in a market which supports more sustainable and humane practices does inspire confidence in its brand. The distributor I interviewed felt that in comparison to competitors like Certified Humane (CH), Whole Foods can provide immediate benefit; she had the application for the CH label, but since it cost her money to apply, she preferred to sell to Whole Foods. Also, the company can even create buy-in of those ranchers who do not necessarily support the values of the brand, but appreciate the greater economic incentives Whole Foods can offer.

I think the monitoring process examined here *could* be sound, but greater transparency would be needed to truly determine how stringent the standards are and how successful the

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<sup>14</sup> Martin, Andrew. "Meat Labels Hope to Lure the Sensitive Carnivore" *New York Times* (24 October 2006).



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company is in meeting them. Internal monitoring structures which Whole Foods uses to ensure its brand reduces the burden on consumers who are freed from having to read labels because they “know” what to expect when they shop there. However, this freedom comes at the cost of transparency, and while the company would like to have us believe that its monitor is an independent 3<sup>rd</sup> party, this is not really the case. Without knowing the name of its monitor, a customer must trust in the Whole Foods brand. The quality of the brand, of course, is assured by the monitor, so the process is very cyclical. In the case of Whole Foods, its brand is also cultivated by the other socially responsible actions it undertakes, like the labor practices mentioned earlier. These create value that is transferred to its other products, even when transparent information is not available to assess levels of quality on these other products.

The process is also lacking an acceptable accrediting body. Perhaps if Whole Foods is truly dedicated to the value of animal welfare, it should utilize the fee-based accrediting services that the USDA offers in addition to its own more stringent standards. This may put more pressure on the industry standards and could push the governmental regulating bodies which could enforce them. Once the labels are in place, the shadow of the law will provide a level of regulation which will also make the process more trustworthy. For now, I am not convinced that its claims about pushing the industry for stricter standards in the area of animal welfare is not simply a tactic to get first mover advantage and develop a market niche which could draw greater profits.

In terms of innovation, Whole Foods is certainly a leader in the retail supermarket industry in deciding to develop these standards, which can have a broad impact because of the company’s broad scope. But its marketing language seems to indicate that it is the only body supporting such standards, when in fact other retailers offer products with quality labels as well.

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Customers may believe this intimation and stop looking for products in other stores.

Furthermore, the label that Whole Foods will develop will only be valuable to the company and can't be used to allow other retailers to gain economically. Therefore, the company may be making gains at the expense of smaller retailers. It would be disingenuous, then, to state that the Animal Compassionate standard was more valuable than the economic profit the company receives for pursuing it. Then again, corporate practices which are socially responsible must be sustainable for the company in the long run, and it seems that Whole Foods has perfected the usage of branding to support the standards and values it touts.

**VI. Discussion Questions**

1. How should a company demonstrate its commitment to being a responsible retailer? Should it be via philanthropy? Or demonstrating responsibility over its supply chain? In what ways does Whole Foods delivers on its commitment to being a responsible retailer? In what ways does it not?

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2. Whole Foods adopts government standards and the National Organics Standard Board for its food and body care products, while it works with environmentalists and academics to establish standards for its meat products. Should Whole Foods focus on using governmental standards in the future? Or should it continue to work with environmentalists? Which strategy would most benefit Whole Foods? Which strategy would consumers most like to see?
3. Do you think Whole Foods is an “innovator” in food and product quality standards? Do you think its Animal Compassionate standard will prevail in the industry over other standards? What are the pros and cons with having contending standards within an industry?
4. How much confidence do you have in Steritech Group and its auditing process? What measures should Steritech Group and/or Whole Foods adopt to strengthen their credibility?
5. How has your perspective about Whole Foods changed (or not changed) after reading this case study? As a consumer, have you ever purchased anything from Whole Foods that suffered from product quality?

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