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Amazon Moves Offline

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On Friday, 16 June, in a game-changing and widely unanticipated move, Amazon announced its acquisition of Whole Foods Market, for USD 13.4bn (valued at USD 42/share). In this short note, we highlight some initial thoughts on the implications of this deal, focusing on the likely impact on food companies.

Grocery is ripe for Amazon disruption

Since its inception as an online bookstore in 1994, Amazon has disrupted most retailing sectors, becoming the preferred option for consumers to purchase anything—from books to apparel to electronics, or anything else in between and beyond.

However, grocery—with its high frequency of purchases—has been the one retail sector that remains highly attractive, but so far elusive. Amazon has been selling food online for 18 years, and—despite establishing a number of platforms, including AmazonFresh—reported food and beverage sales through its sites were USD 8.7bn in 2016: only slightly over 1% of the USD 700bn grocery market.

The acquisition of Whole Foods takes Amazon's objective of becoming a top 5 grocery retailer by 2025 much closer, allowing it to grab an important share of the premium market in one swoop. The Whole Foods platform provides Amazon with a number of previously missing key elements to take on WalMart (25% grocery market share in the US) and Kroger (10%), including: decades of experience in selling food, a physical presence closer to loyal and affluent consumers, and a successful private label brand.

Food retail expertise. As the number-one e-commerce player, Amazon's online technological know-how and supply chain savvy can't be disputed... but selling food is a different game to books and electronics. Whole Foods gives Amazon a deeper understanding of the offline world of food, of sourcing and curating, as well as managing perishable products and cold supply chains. Figuring out fresh food is a necessary skill set for Amazon in order to take on long-time food retailers such as WalMart, Kroger, or Costco.

Store footprint. For all of the talk surrounding retailing moving online, the deal also confirms Amazon's recognition that not everything has to be online and that—in the case of food—bricks-and-mortar shopping still has, at the industry level, a bright, but evolving future. Amazon has already given us a glimpse of its vision of the future of food retailing by way of its Amazon Go store concept in Seattle. The Whole Foods purchase gives Amazon the opportunity to apply its 'grab-and-go' learnings from these test stores into Whole Food's 460 prime locations. In return, Amazon now has access to the shopping habits of affluent, loyal, trend-setting foodies, as well as invaluable insights into the experiential nature of food shopping, interacting more directly and personally with customers—something that Whole Foods excels at.

A private-label brand. Whole Foods Markets also comes with the successful 365 private-label brand, an important category in food (16% of food sales in the US are private label), in which competition is heating up, especially with Lidl's arrival into the US the year. As with groceries in general, Amazon has made previous attempts at private label, without much success. In contrast, Whole Foods' 365 brand represents about one-quarter of total sales for the company. In order for Amazon to be successful in retail, it certainly has to become a strong and innovative player in private label: Whole Foods' existing private-label savvy (skills, knowledge, infrastructure, brand value, supply chain, manufacturing arrangements, etc.) will prove invaluable.

A friendlier takeover

After almost two years of same-store sales declines, along with management and board-level upheaval, the acquisition is a welcome chance for Whole Foods to increase its value proposition. Groceries are playing with a variety of online formats, but so far, no one has cracked the code to online food sales.

More than one retailer will be jealous of Whole Foods' access to Amazon's technology, automation, and algorithms. The expectation is that Amazon will support the company in restoring its dominance in the organic and natural space—both on- and offline—and no longer have to rely on third parties such as Instacart.

There also appears to be alignment in the values of the two founders: the acquisition integrates two truly disruptive companies, with common missions of "bringing the highest quality, experience, convenience, and innovation to our customers", as stated by John Mackey, Whole Foods Market co-founder and CEO.

Will big food be excluded from the party?

While the acquisition is a major threat to other retailers who are facing increased competition from new entrants such as Lidl, along with new direct-to-consumer players such as Blue Apron and Freshly, the implications for the larger food CPGs are a little more complicated.

Don't panic. In the short term, we believe this deal will have little immediate impact on established food companies, for the simple reason that virtually all of their products (apart from their natural and organic lines, such as Annie's Homegrown in the case of General Mills) are already excluded from Whole Foods. (It is not unfair to categorise Whole Foods as targeting the high-income and aspirational shopper, whereas most CPG company portfolios are still largely targeted towards the mass market.)

Stepping up. However, with online and organic sales as two of the fastest-growing segments in food, Big Food cannot afford to be left behind. Many CPGs have already begun this process, either by way of direct acquisitions (such as Hershey's purchase of Krave and Danone's buying of WhiteWave) or through their corporate VC arms. (Almost all CPGs currently have a VC platform set up to look for and invest in emerging and interesting brands.) We expect this deal to hasten CPGs' move into natural and organics, speeding up the rate of acquisitions in order to secure shelf space at Whole Foods and on Amazon.

Discounting Whole Foods. But if Amazon steers Whole Foods away from its 'whole-paycheck' image (the company recently offered up a discounted Prime subscription service to the 40m+ adults on food stamps) and/or successfully sells Whole Foods products online, then Big Food faces the threat of losing even more market share.

Taking control. The rapid growth of online food sales, coupled with the fact that CPGs are already being squeezed off the shelves of traditional supermarkets (see RaboResearch F&A's Talking Points June 2017), raises the question of what can they do to improve their bargaining position and procure better access to consumers. One obvious area which some CPG companies are already exploring are direct-to-consumer (DTC) options, even at the risk of being delisted by supermarkets. Almost ironically, Amazon recently extended an olive branch to CPG companies, inviting them to a conference on using its platform to sell directly to consumers, bypassing the supermarket.

Emerging brands: friend or foe?

For the small and emerging brands that have so successfully taken market share from established players over the past five years, this deal offers some opportunities, along with posing some threats. For the longest time, getting distribution at Whole Foods was always the holy grail for these companies and a key milestone in achieving credibility in the marketplace. But increasingly, there are so many other distribution possibilities, as organic and natural foods move beyond natural food retailers and into the mainstream. And this has contributed to the erosion of Whole Foods' competitive advantage, which has culminated in this deal.

Having said this, with 'Whole Foods' now meaning 'Amazon', the price for getting in might be raised once more—preferred featuring on its online platform, providing higher volume opportunities—but the cost might also increase, with margins likely to come down, as Amazon is likely to be stricter on prices.

Imprint

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Banking for Food