

## AMAZON + WHOLE FOODS: A NEW PLAYER IN THE INDUSTRY<sup>1</sup>

*"Your margin is my opportunity".*  
Jeff Bezos<sup>2</sup>

### INTRODUCTION

In his office, the CEO of a leading company in the global grocery retail ranking reflected on one of the most unsettling news of recent months: *"On June 16<sup>th</sup> 2017, Amazon announced the acquisition of Whole Foods Market for 13.7 billion USD."*

Amazon was known as the *"big disrupter,"* capable of changing the industries of books, music, videos, consumer electronics, toys, and more. This acquisition launched the giant of electronic commerce into the world of brick & mortar grocery stores, until then apparently safe from this *"tsunami."* After several years and various initiatives within this industry, Amazon questioned everything the gurus of the food-chain business strategy had predicted: *"the end of the new economy?"*

During the last meeting of 2017, the members of the Board of Directors had requested him to prepare a memo with his reflections on this event, and, more importantly, to include what the next steps should be before the entrance of this *"new, agile, and aggressive actor."* *"Will the way we buy food change dramatically in the near future?"*

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<sup>1</sup> This case has been published by the Research Division of San Telmo Business School, Spain. It has been written by Professor Julio Audicana Arcas and research assistants Luis Arribas Hervas and José Andrade Nuñez as a basis for class discussion only and is not intended to illustrate any judgment on the effective or ineffective management of a specific situation.

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<sup>2</sup> Amazon's Jeff Bezos: The Ultimate Disrupter <http://fortune.com/2012/11/16/amazons-jeff-bezos-the-ultimate-disrupter/>.

## THE USA, A DYNAMIC AND HIGHLY VARIED MARKET

Household income<sup>3</sup> had grown significantly over 2015 (+5.2%) and 2016 (+4.46%), with 2015 reaching the highest growth since 1967 and slowing down in the first half of 2017. However, many consumers still bore the crisis of the last decade in mind and had modified their consumption and purchasing habits. The population in the low-income range still felt vulnerable and tried to rebalance family budgets by buying less or differently (channels, products, etc.). As a result, there was an increase in the distance between the "haves" and the "have-nots." (See Appendix: The U.S. Food Retail Market).

With over 320 million people to feed every day and the average purchasing power of a developed country, the American grocery market was the largest in the world, estimated at 800 billion USD.

Initiatives to connect with younger buyers were also common, considering that by 2020, 57% of the US population would be millennials or younger<sup>4</sup>. This population segment is familiar with the use of technology, consumes snacks "on their own," and relates better to "genuine" and local companies than to large corporations.

The main distribution channels in the food industry were retail, food service, club stores, and electronic commerce. Wal-Mart and Kroger led the retail portion, followed by Albertsons, Costco, Publix, and Ahold, and with HEB, Whole Foods, Aldi, and Trader Joe's being prominent in some geographic areas and categories. Out-of-home consumption surpassed the retail channel in 2015 for the first time, with leading operators such as Sysco, US Foodservice, PFG, GFS, and Reinhart.

After years of retail park growth, the global reach, efficient supply chains, and economies of scale of the larger chains such as Wal-Mart, Kroger, and Target, had led to a consolidation in the industry and the closure of many traditional stores in the last decade. The number of smaller stores, convenience stores, and discount stores increased at the expense of the supermarket format.

Additionally, new technologies and the entry of new competitors (European hard discounters among others) were leading to a price war that put pressure on operating margins, with an estimated average in the industry of 3.4% compared to 10.4% in all other sectors in the country.

### Trends

In 2017, the dollar share of the private labels was 17.7%, halfway between the high percentages of European countries and the lower shares found in Asian and Latin

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<sup>3</sup> <http://www.census.gov/data/tables/time-series/demo/income-poverty/historical-income-households.html>

<sup>4</sup> Generations as per Nielsen: Greatest Generation (born before 1946); Boomers (1946-1964), Gen X: 1965-1976, and Millennials (1977-1995).

American countries. There was an upward trend, mainly due to the push of Wal-Mart, Kroger, Save-A-Lot, and other smaller chains, as a reaction to the expansion plans of German hard discounters Aldi and Lidl.

In an environment of slow growth in grocery sales, it was estimated that natural and organic products retail sales had increased by 11% in 2015 in all retail channels and it was 32% higher than 5 years earlier. Moreover, it was estimated that through 2021, the retail market for natural and organic foods and beverages would grow by almost 70%<sup>5</sup>.

Compared to the growing sales of store-prepared ready-to-go food, which was up by 5% in recent years, the increased acceptance of companies offering "meal kits" was noteworthy. These companies provide packages containing ingredients and recipes at a price per person that is higher than traditional grocery shopping but lower than restaurants. There are more than 100 companies already in the market, Blue Apron, Hello Fresh, and Plated among the most prominent, with an expected market growth of 25% over the next five years.

Retailers were experiencing a technological transformation of their business models that sought not only higher profitability through productivity, but also to satisfy their customers' increasing demands. Barcodes, auto scanners, loyalty tools, coupons, fast deliveries, etc., aimed to optimize product mix, supplies, and prices.

Electronic commerce accounted for most of the sales growth of many distributors thanks to the growing use of digital devices to buy groceries. Thus, in the first quarter of 2017, electronic commerce retail sales in the US grew by 4.1% compared to the previous quarter, and by 14.7% year on year. Nevertheless, the percentage of online food purchases in the U.S. was still below 2%.

### **AMAZON, GROWING BY ADDING**

Founded by Jeff Bezos in 1994 under the name of Cadabra, Amazon.com Inc. is a U.S. cloud computing and e-commerce company that had overtaken Wal-Mart as the largest retailer in the U.S. in terms of market capitalization in 2015, with a value of 676 billion USD at the end of January 2017.

Based on the goal "*we seek to be Earth's most customer-centric company,*" Jeff Bezos' vision was, from its inception, to offer low prices, a wide selection, operate with low fixed costs, and maximum convenience for customers. (See Exhibit 1: The Virtuous Circle of Amazon).

Amazon, which started selling books online in 1995, had at the end of 2017, 300 million customers with active accounts, a turnover of more than 136 billion USD, and

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<sup>5</sup> <https://www.specialtyfood.com/news/article/report-natural-and-organic-foods-beverage-market-hits-69b/>