# Amazon-Whole Foods Is Not About to Wipe Out Supermarkets

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**Amazon will gain access to new capabilities in retail, but the challenge to traditional supermarkets will come from elsewhere.**

Much has been said since Amazon announced its **$13.7 billion bid** to buy Whole Foods on 16 June  2017. A lot of what has been said makes eminent sense. The deal allows Whole Foods to get state-of-the-art online retail technology and drive a cohesive digital strategy. It also provides it with a far greater reach than what it has with its current portfolio of physical stores. The deal enables Amazon to bring on board a business that generates higher operating margins than what it currently does (5 percent versus 3 percent), broaden its physical footprint by an additional 400 stores and develop a more compelling “touch and feel” grocery experience.

Amazon will also be able to leverage a very well-trained and loyal workforce (which is something of an outlier in the world of retail, offline as well as online) and tap into a very quality-conscious consumer base. More broadly, the tie up will help Amazon build a 360-degree perspective on consumer behaviour (online and offline) and further refine its well-oiled test-and-learn approaches to marketing and sales.

## New growth opportunities

But the reaction of Wall Street and many of the commentators in the press – that the deal heralds the death of offline retailers in the U.S. and elsewhere – is simply overblown. The pummeling that the prominent retailers' stocks received **after the announcement** does not make sense. The deal is a lot more about what it does to help Amazon strengthen its offer to its Prime segment by adding grocery capabilities, rather than a frontal assault on the mainstream offline grocers in the U.S.

It is important to keep in mind that Amazon today competes for a slice that represents about 70 percent of overall retail expenditures in the U.S. One of the key drivers of Amazon's success has been its consistent ability to show topline growth to suppliers, quarter after quarter, over the past two decades. In return, Amazon's suppliers have given it generous funding that has allowed it to invest in a whirlwind of new products and projects. To put this in perspective, Amazon generated close to $9.7 billion in free cash flow last year! To keep this tap flowing, it needs growth. However, this growth is unlikely to come from the rest of the pie – the remaining 30 percent of the U.S. overall retail expenditures – as it includes categories like automobiles and gasoline that are heavily regulated and others like alcohol and tobacco which are not high on Amazon's priority list.

## Priming Prime

This implies that the next logical step in Amazon's growth strategy is not to enter new categories in the U.S. but to increase its share of the wallet of existing customers. This is where Whole Foods comes in. The customer demographics of Whole Foods and Amazon Prime overlap significantly. Grocery remains a largely offline business even in the U.S. (online grocery's market share of U.S. overall grocery sales is still stuck at 2 percent and unlikely to change much despite **Amazon Go**). Whole Foods helps Amazon devise a compelling grocery value proposition combining online and offline for its Prime shoppers who are affluent, willing to pay for quality and convenience, and who have shown a willingness to expand their share of wallet spending with Amazon.

Even Amazon has realised that offline retail is very different from online – its physical stores, based on insights derived from how consumers browse for books online, have had **trouble generating traction**. Hence, it is not surprising that a whole host of pure online players are teeing up their offline store offers (e.g. Bonobos, Warby Parker, Kate Hudson's Fabletics to name a few). Their experience shows that offline retail generates insights/data that are simply not available from online retail. More importantly, leveraging these insights allows the development of a more compelling omni-channel experience for consumers across platforms. These differences get even starker when one compares online and offline grocery shopping. For Amazon, the Whole Foods acquisition will also allow it to create capabilities in domains that it has largely not paid attention to (e.g. buying/sourcing, curating and stocking).

## Culture shock

As we survey the froth in the public press concerning this deal, we submit that these are very early days. There could still be many potential slips between the cup and the lip. For one, there are big cultural minefields that these two companies will have to tread carefully if they merge. For instance, the two respective CEOs (Jeff Bezos and John Mackey) have very different styles of leadership and management and their **organisational cultures are markedly at odds**. Amazon is a tough place to work at – for blue-collar as well as white-collar employees. Whole Foods in contrast has succeeded in creating a workplace culture unheard of in U.S. retail – one where employees look forward to coming to work. It has one of the lowest attrition rates in a business where that number can go as high as 40 percent annually, and it has been consistently ranked over the past two decades as one of America's "Great Places to Work". Second, the merger between Carrefour and Promodès showed that even a marriage between two look-alike retailers can take years to work. For all their supposed similarities, Promodès and Carrefour realised that each had a very different way of handling activities (e.g. buying, sourcing, supplier relationship management, pricing and promotion, etc.) and that generating a common vision and approach was not easy. Lastly, there is still a very real possibility that **another bidder will appear** over the horizon with a sweeter offer for Whole Foods.

In conclusion, our view is that the hype and hoopla over the Amazon-Whole Foods deal actually obscures the real danger that offline grocers in the U.S. should worry about – the material threat from the upcoming onslaught by **Aldi and Lidl** across the country. Aldi has been quietly building up its business in the U.S. over the past decades and **announced** last month ambitious plans to open an additional 1,200 stores over the next five years (apart from remodelling its existing 1,300 stores that are mostly concentrated in the Midwest and the South).

Lidl made its entry in the U.S. a few weeks ago and **plans** on opening a total of 100 stores in the next 12 months.

These two have built very successful businesses outside their home markets and many large retailers outside Germany have paid the price for under-estimating their capabilities (e.g. retailers in the U.K.). Aldi and Lidl will have internalised the lessons from the errors Tesco made with **Fresh & Easy** in the U.S.

While it will be hard for them to really challenge Walmart in the discount retail space, other grocers should be worried about them more than by the Amazon-Whole Foods deal.

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