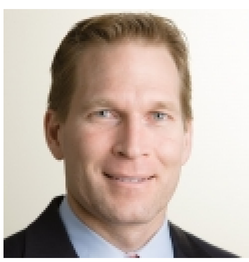
Entrepreneur

The Winners and Losers in Amazon's Whole Foods Deal

Consumers win. But other grocery stores? Not so much.

Image credit: Whole Foods Market



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When Amazon opened its first brick-and-mortar store in 2015 on the campus of Purdue University in Indiana and then in December announced its first Amazon Go check-out free convenience store in Seattle, people wondered what on earth the online retailing giant was doing experimenting in the physical world it disrupted in the first place.

Now, Amazon’s $13.7 billion purchase of Whole Foods Market tells us that the Seattle company wants a big slice of the $674-billion U.S. grocery market (and while Whole Foods' revenue, approximately $16 billion in 2016, is but a fraction of the entire grocery market, Amazon’s price setting status in the American retail landscape will cause reverberations throughout the grocery econsystem). The deal is the largest manifestation yet of the omni-channel, or in this case, “clicks-to-bricks” trend, in which online retailers seek to optimize the customer experience by augmenting a strong online presence with physical retail stores. In this case, Amazon is dramatically changing the grocery landscape for all those involved (consumers, vendors, distributors, competitors and related companies).

It’s easy to imagine that Amazon Chief Executive Jeff Bezos’ obsession with single focus, ruthless efficiency will be brought to bear on the firm’s grocery technology. This, after all, is the company that uses machine learning and algorithms to know what you want before you do. As Narvar CEO Amit Sharma wrote in the *Harvard Business Review*, “Retailers need to think more like tech companies, using artificial intelligence and machine learning not just to predict how to stock stores and staff shifts but also to dynamically recommend products and set prices that appeal to individual consumers.” Amazon’s Whole Foods deal will make that a reality.

In addition, fitting with its broader strategy, the acquisition will help Amazon’s further penetration of the millennial generation. Amazon and Whole Foods are tailor made for the millennial cohort -- aged from 18 to 35 and now the single-largest generation in America. It’s a generation that was raised online that embraces the healthy food trend and they're already dynamic residents of the organic/natural food space where Whole Foods has a decades-old nationwide brand. A survey by the Organic Trade Association found that more than half of parents who buy organic food regularly are millennials, compared to a little more than a third of Gen Xers and 14 percent of baby boomers.

With its private label line 365 Everyday Value, its antibiotic- and hormone-free meats, and its priority on animal welfare, Whole Foods is popular among millennials who have a strong social conscience and like to purchase socially responsible products. Furthermore, Whole Food’s smaller store format, called 365, is specifically targeted at millennials, reflecting their preference for smaller stores in urban environments that incorporate technology.

The deal also likely provides a logistics and distribution strategy play for Amazon. Whole Foods gives Amazon a network of 450 stores in 42 states, which can effectively become mini-distribution centers for groceries and potentially other retail items as well. Since 2007, Amazon has learned about the grocery business through its Amazon Fresh grocery delivery unit. By acquiring Whole Foods, millennials can now blend two shopping habits -- seeing and touching products at a local store and conveniently ordering online. It may be that your dried kale with sesame will soon be delivered by drone from that local store.

So, who are the winners and losers?

The big winner in the deal is the American consumer. Amazon is known for offering hyper-competitive prices, so groceries, and organic food in particular, may become more affordable. Ordering groceries that will be quickly delivered will also become a whole lot easier, especially for homes that are using other Amazon products such as Echo. Soon, you will just have to say you want some cage-free eggs and a bottle of kombucha to make it a reality.

Companies that are major suppliers to Whole Foods -- which has struggled lately as everyone from Kroger to Walmart has added organic foods to meet growing demand -- may be big winners or huge losers. Amazon will crunch mountains of data to draw conclusions about what's working, what should be kicked to the curb and what fits its broader strategy. For example, suppliers to Amazon's growing number of private label brands may benefit as these products may now be placed at Whole Foods. Among the growing list of brands Amazon owns that could sell at the grocery stores are Mama Bear organic baby food and Happy Belly, which sells such things as nuts, granola, eggs and coffee. Over and above the general margin pressure that all vendors will face, as Amazon pushes its own brands at stores, traditional consumer packaged goods (CPG) companies currently selling at Whole Foods may suffer.

Perhaps the biggest losers are other grocery stores, be they national chains or local, one-off neighborhood stores. This is the moment Amazon stops dabbling in the groceries segment and gets competitive. In the past, when Amazon has sought to win a new business, whether that's books or clothing, it's driven prices lower. Grocers, from Safeway and Kroger to Walmart and Target, will have to withstand increased price pressure and will have to redouble efforts to evaluate, adapt and enhance their digital and delivery offerings too. Lastly, home food delivery services, which have multiplied in recent years, may find their models under siege.

Finally, this move may be part of an even larger strategy at Amazon that could create even more winners and losers down the line. After all, it's hard to imagine that this is the last traditional retail industry that Amazon will disrupt. Companies working in everything from home improvement to drug stores should sit up and take notice.

Craig Lawson is a founder and managing director of middle market investment bank MHT Partners. He has over 20 years of sell-side and buy-side financial experience, including dedicated public and private company M&A.