



August 2018

Amazon.com As Disruptor: How Should Food Suppliers Respond?

Ed McLaughlin, Professor

Dyson School of Applied Economics and Management, Cornell University

In 2018, e-commerce represented more than \$2 trillion in worldwide sales and almost 10% of all retail sales in the U.S. Moreover, by many estimates, e-commerce is projected to grow in the U.S by double digits, over 5 times the projected growth rate of brick and mortar retail, for at least the next 10 years. Of course, it is no secret by now that the principal driver of these explosive growth numbers is Amazon.com. Amazon now accounts for half of all U.S. e-commerce and 80% of all projected e-commerce growth. Its stock price, already among the highest on any stock exchange, has more than doubled over the period July 2017-July 2018. It is forecast by many to be only the second company to reach a market capitalization of one trillion dollars, after Apple in August 2018. For comparison, the entire U.S. economy only crossed the \$20 trillion mark in Q2 2018.

Yet for all its unprecedented growth, Amazon had been criticized by investors for having virtually no presence in the largest sector of the U.S. economy: food. That all changed in August 2017 when, after never paying more than \$1 billion dollars for a single acquisition, Amazon paid \$13.7 billion dollars for Whole Foods. The move sent shock waves throughout the food industry for both retailers and suppliers. Such unprecedented combination of a company with the “highest touch” with one with the “highest tech” was viewed alternatively as both thrilling and frightening. The day after the acquisition was announced, the combined market value of Amazon and Whole Foods grew by over \$14 billion dollars—thus essentially paying for the acquisition in the first day!—while the values of most leading competitors plunged: Kroger down by \$2.1 billion, Costco down \$5.7 billion and Walmart down \$11.3 billion.

What explains the extreme reaction? First, while U.S. e-commerce grew at a seemingly robust rate of 16% in 2017, Amazon’s growth was 29%, meaning that without Amazon, U.S. e-commerce grew at a much more pedestrian 5.6%. Amazon is THE one company driving the growth and innovation in the entire digital world. Second, Amazon possesses a palette of features and services that are so far ahead of other e-commerce players that it is unlikely competitors will be able to invest enough to catch up. Consider just one illustration: in 2017, Amazon received

10 million customer reviews—not transactions but reviews—and added more than a million new sellers (3,000 per day) from whom they will reap still more data insight. Such deep knowledge about customer preferences and behavior allows for data personalization and product customization totally out of reach of any competitor.

Third, it was widely known that despite its well-earned reputation for outstanding quality fresh departments, Whole Foods had been in serious financial trouble for years. Amazon threw it a lifeline. Many analysts expect Amazon's deft hand at technology and deep financial resources to provide for a dramatic turnaround for Whole Foods, including increases in efficiency and shopper individualization. Finally, if the above threats were not enough to provoke food industry anxiety, here is one more: Amazon does not have to make a nickel selling groceries. Amazon's goal is to drive traffic to its website and boost earnings in other much higher margin categories than food. Food retailers and food suppliers now face a competitor, or customer, which can price at any level it chooses with virtually no concern for profit. Jeff Bezos, Amazon's CEO, has a long history of selling at a loss to inflict pain on competitors—think books, media, diapers. etc.

How should food suppliers respond? A food channel that is growing at ten times the rate of conventional supermarket customers cannot be ignored. Strategies to consider:

Review current customer list. Losing a current customer in this new environment can be devastating. Redouble efforts to align with the “right” supply chain partners. Ensure that your partners—input suppliers and retail customers—share the same objectives. Transparency and customer trust take on new importance.

Sharpen pricing. Amazon purports to already to offer the lowest prices, and demands that their suppliers assist in making this a reality. However, such pricing power is also keenly felt by conventional retail competitors; as they stiffen their resolve to compete against Amazon, their margins are reduced and pressure is applied to suppliers to accept some of the loss. Simplification of the supply chain is imperative to control costs and maintain what may have to become a new, lower level of profitability.

Build compelling brand narratives. Conventional retailers need your help with differentiation like never before. As powerful as e-commerce is, much is still left to be desired when it comes to attributes valued by food shoppers: fresh, ability to smell and touch, color, brick and mortar ambiance, convenience. Food suppliers are in a unique position to develop or re-emphasize their “sustainability story (e.g., clean water, soil, chemicals, labor),” local benefits, authenticity, and innovation.

Respect discounters. Discount retail, from Walmart to dollar stores—is exploding. These are no longer channels limited to second tier labels. What's more, private label offerings—dismissed by many suppliers as cheap, low-margin alternatives-- need to be reconsidered in light of these changing financial requisites.

Beat the algorithm. When selling directly to Amazon, suppliers must be concerned with the order in which the search engine produces consumer choices. With a bewildering number of products for sale—55 million+ in 2018—Amazon employs a proprietary algorithm drawing on a complex mix of factors to produce which product pops up first in the search order. Examples *inter alia* are: price, sales volume, Prime-membership, quality of verified reviews, number of times customer has clicked and more. But suppliers can boost ranking by paying for ads on Amazon's site, providing deep discounts and paying for product reviews (although risky when

reviews come back negative) to increase credibility.

This is truly the dawning of a new economic and retail era. As they have always done, food suppliers need to monitor the changing competitive landscape and develop appropriate strategies to meet these new challenges.

“Smart Marketing” is a marketing newsletter for extension publication in local newsletters and for placement in local media. It reviews elements critical to successful marketing in the food and agricultural industry. *Please cite or acknowledge when using this material.* Past articles are available at <http://dyson.cornell.edu/outreach/smart-marketing-newsletter>.