

Amazon Welcomes You To The New World Order: Reflections On The Whole Foods Acquisition

Jun. 18, 2017 7:30 AM ET 37 comments

by: John M. Mason

Summary

- Amazon's latest move, the acquisition of Whole Foods Markets, is confirming how information technology companies are showing that they possess the business model of the future.
- Most brick-and-mortar or manufacturing organizations think that they are progressing into the new world, but the evidence is very strong that most do not have the correct focus.
- Information technology companies have different cost structures that they can exploit and bring to the companies of the "legacy" world, even to financial institutions: these cost structures are the future.

Last fall I wrote about what was taking place in FinTech and the role that organizations like Amazon.com, Inc. (NASDAQ: AMZN) was now playing in the evolution of the financial services area. I spoke of movements taken by the company, like its venture into the payments space with Amazon Pay, was creating a tipping point for banking in the United States.

Moving into the banking arena is not easy, especially with all the rules and regulations that financial institutions face. Add to that the fact that Amazon is not a bank, or any other kind of financial services firm, and you raise even more questions about the impact that it will have on FinTech.

And, yet, to have such doubts is a result of us missing a bigger picture.

The reflections on Amazon's current acquisition of Whole Foods Market is giving us another vantage point to assess what Amazon is doing - and what major other major tech companies are doing.

Christopher Mims, in Saturday's Wall Street Journal, gives us a boarder picture of how tech companies are spreading out their wings, further and further away from their narrow

"techy" beginnings.

Mr. Mims uses Amazon as his example and begins by arguing:

"What distinguishes Amazon (from other tech companies) is that it's the company most willing to work on everyday problems."

"One way (Amazon chief Jeff Bezos) does this is by moving not just laterally-from books to consumer packaged goods-but vertically, through the supply chains that create and deliver goods. Thus, Amazon used its experience running its own websites to create Amazon Web Services, a \$14 billion-a-year business. And it's working on its own network of trucks and planes to disrupt UPS. Physical retail-still nearly 90 percent of consumer purchases as of 2016, not including car and gasoline sales-is just the latest frontier."

Mr. Mims adds, "This trajectory wasn't obvious 15 years ago." I would add that this trajectory was not obvious to most people even a little while ago.

The secret is that to Amazon:

"the fundamental technologies of the microchip, the internet, wireless connectivity, just-in-time manufacturing. Robotics, big data, etc., have made this possible."

And, Mr. Mims emphasizes:

"Those with expertise in these areas can create businesses that solve existing problems in entirely new ways, or at least more efficiently and profitably."

In other words, Mr. Bezos, and other tech leaders, think about problems in a way that is different from those in other industries. This makes all the difference. And note, by the way, a recent article in the Financial Times about how Facebook is looking at the video space in a different way.

But, the technology groups bring other advantages to the table that ordinary brick-and-mortar organizations don't possess. First of all, these technology groups tend to have zero- or low-marginal costs. This has been a highlight of the computer industry from the start, exploited to the highest degree by Microsoft and Apple.

Even if the marginal cost is not zero, it tends to be much lower than the marginal costs of brick-and-mortar companies or manufacturing companies. Furthermore, these latter companies generally exhibit marginal costs that rise relatively rapidly with scale, therefore, constraining larger companies cost-wise as they grow in size.

This extends especially to supply chain situations; a point that Mr. Mims argues Amazon is particularly adept at exploiting.

One of the things that this tech cost structure provides is almost immediate help to the cash flow situation of a company. Mark Vandeveld and Leslie Hook comment on this in another Financial Times article emphasize the role that the different company cost structures play in the successes of Amazon versus the difficulties being experienced by company like Whole Foods Market.

I have been particularly interested in the advancement of information technology into the financial services area. Like the many brick-and-mortar companies discussed above, bankers just don't seem to understand the changes that are taking place.

MIT recently held a conference on FinTech and the basic theme that ran through the conference was the "Financial Institutions Are Way Behind FinTech." Where, therefore, is the change going to come from.

I wrote some time ago:

"Brad Peterson, CTO at NASDAQ, used the Varian Rule, named after the economist Hal Varian, as an example of how innovators should look at building FinTech for the future. The Varian Rule goes something like this: observe what wealthy people are doing today, in this case, what are they doing with their money, how do they transfer money, how do they invest, and so forth.

The Varian Rule is that in ten years from today, middle-income people will be using the same tools. And, then in another ten years everybody else will be using those tools.

Part of the point of this is that the wealthy have advisors and access to things that middle income people and others do not have. A lot of what the wealthy do avoids avenues that are heavily, if at all, subject to oversight of the regulators or the examiners."

The point is that Jeff Bezos is looking at what wealthy people are doing today. Whole Foods Market is an "high-end" organization. The first Financial Times article cited above states, "Whole Foods, nicknamed 'whole check' for selling mouth-watering food at eye-watering prices..."

Mr. Bezos and Amazon plan to combine their current vehicle Amazon Fresh, a grocery delivery service that is not doing that well, with the Whole Foods chain to gain the scale it needs to gain margin and to gain scale. As Mr. Varian suggest, it plans to play off of what wealthy people want to do today. It will be building a base to spread to what "middle-income people" will want to do in the future.

But, this is not the only area that others are moving into the banking area. As I have recently suggested "Watch Hedge Funds." They are looking for cutting edge ideas and they are not as heavily regulated as most other financial institutions are. A specific example here is that of WorldQuant. Another place to look for banking services that are quite extensive and quite fluid, look to TDAmeritrade, an affiliate of TD Bank, which is coming from Canada.

Two points to close out: first, evidence is building that tech organizations like Amazon are driving innovation and one means of this is through acquisition, something that was not imagined very long ago; and second, the non-tech companies are going to have to pivot and change their business models, or, they are going to become "legacy" - even those that are highly regulated.

Disclosure: I/we have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours.

I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

Comments (37)

Gary J

Amazon is disrupting yet another market segment. They, us and all of the stakeholders get to become the winners.

18 Jun 2017, 07:49 AM

Who Dat?

And we know what happened to the Roman Empire...

This acquisition will consume Bezos because now he's moving away from his niche. Classic MBA101 case study.

18 Jun 2017, 08:27 AM

15044572

That just means you don't understand what their core business is.

Their core business is satisfying their customer needs.

Your comment sounds exactly like what someone would have said the moment they offered more than just books so long ago.

18 Jun 2017, 08:56 AM

Not-So-Fast

With logic Amazon would have never launched AWS; \$14b

18 Jun 2017, 09:25 AM

june1234

Shot of wheat grass and a hormone free grass fed steak to go with your Prime movie?

18 Jun 2017, 07:52 AM

ahimsaka

pay cash when you shop and they can't track you.

18 Jun 2017, 08:05 AM

15044572

Oh yea, because facial recognition technology doesn't exist at all.

18 Jun 2017, 08:23 AM

Gary J

cash misses out on Chase Amazon Visa 5% back.

18 Jun 2017, 08:36 AM

Reel Ken, Contributor

And I don't want to be tracked, WHY????

18 Jun 2017, 09:17 AM

JR2251

My view is that AMZN could have struck a long time supply agreement as opposed to outright purchase. That would also truly benefit both companies. If AMZN was looking for delivery location it should have bought UPS and not WFM.

18 Jun 2017, 08:06 AM

15044572

That doesn't make sense. UPS is not designed to handle perishables. If they bought UPS for Grocery items, each and every UPS location would require a tremendous amount of capital for construction.

Each Whole Foods location is purpose built for food.

18 Jun 2017, 08:26 AM

JR2251

I was talking about getting delivery location for non grocery items. For grocery items could have had long term supply agreement with WFM

18 Jun 2017, 08:50 AM

15044572

That still doesn't make sense. If both could have benefited than Amazon could benefit more by buying Whole Foods and keeping it all for itself.

18 Jun 2017, 08:57 AM

WinGreen

Although everyone thinks this is "groundbreaking", people have been expecting this for a while. The other issue is that AMZN is priced at insane levels based on cash flow, P/E, P/B, etc., etc. I wouldn't buy AMZN here.

Now if we have a significant correction, I might "bite".

18 Jun 2017, 08:18 AM

dpeterson5620

WinGreen is right. Strong company but stock price is much too inflated.

18 Jun 2017, 08:28 AM

Ike Antstanditt

Planning is one thing, breaking ground is another. AMZN broke ground Friday, and it was groundbreaking.

18 Jun 2017, 08:55 AM

konlearn

Oh? Really you won't buy, yet you might be correct and then again you might be wrong, we shall see, if you haven't read the number book of all time, you should, then you'll find out why Amazon is where it is at today.

18 Jun 2017, 08:57 AM

markrhodes89511

Awesome comment I was thinking exactly the same thing!

18 Jun 2017, 09:38 AM

markrhodes89511

Not in my humble opinion, sorry, I didn't think it was such a big deal.

18 Jun 2017, 09:41 AM

JR2251

Konlearn, let's face it. Nothing justifies a PE of 186. Bubble waiting to burst.

18 Jun 2017, 09:45 AM

BAHAMAS1

AMZN, through Mr. Bezos, is simply planning and EXECUTING JUST RIGHT

for now and the Future.

Long AMZN

18 Jun 2017, 08:28 AM

Gilbi

If this goes on you will soon have no more retail stores. Imagine big cities with only offices and no more stores !
What a bright and boring future !

18 Jun 2017, 08:31 AM

Gilbi

And Amazon will soon deliver your cooked meal including waiters to the comfort of your home , so you will

not have to interact with anybody. Isn't that exciting ?

18 Jun 2017, 08:35 AM

15044572

None of that is the vision of Amazon. If it was they wouldn't be interested in buy Whole Foods in the first place. Amazon wants efficiency and the profit from impulse buys that happen in person when people are shopping.

Second, that's not a boring future, just a boring imagination on your part. You can't imagine anything else we would put the parking lots to use for? Parks, gardens, nature reserves in cities?

The only thing boring here is your imagination.

18 Jun 2017, 09:00 AM

jaydennis88

yes it is, humans are horrible.

18 Jun 2017, 09:08 AM

BobOnSIRI

I had that realization years ago when Border's Books closed. My family used to go to Borders almost every Sunday after brunch and peruse/read over a cup of coffee. Then Amazon put them out of business and put an end to our pleasant Sunday ritual. Life became a little more boring. :-(

18 Jun 2017, 09:53 AM

Micrite1

So when are the feds going to step in and start screaming monopoly and hall Amazon to court? If they keep damaging other firms and eventually drive them out of business and become the last one standing seems like a monopoly to me.

18 Jun 2017, 08:34 AM

15044572

Where is Amazon the last one standing? There are still Barnes and Nobles, the first business Amazon went after.

18 Jun 2017, 09:01 AM

nothamilton

Part of the point of this is that the wealthy have advisors and access to things that middle income people and

others do not have.

Incorrect. Financial advisers are available now and have been for a number of years to middle-income folks. They just don't use them. I have no idea what "things" the author is referring to.

A lot of what the wealthy do avoids avenues that are heavily, if at all, subject to oversight of the regulators or the examiners."

Another vague and ambiguous statement by the contributor.

The point is that Jeff Bezos is looking at what wealthy people are doing today. Whole Foods Market is an "high-end" organization. The first Financial Times article cited above states, "Whole Foods, nicknamed 'whole check' for selling mouth-watering food at eye-watering prices..."

Last time I checked wealthy people still had to eat whether they or their staff purchased groceries. Second, I bet they prefer to select ripe fruit and vegetables and not over or under ripened ones that an anonymous clerk may slip into the bag. I have shopped at Whole Foods a few times and the food was not mouth-watering any more than other stores (Wegman's , Kroger, Safeway,) but a lot of it was over-priced. Hence only a few times (10-20) in twenty years. P.S. I also never heard the nick-name "whole check."

18 Jun 2017, 08:54 AM

Michael Rogus, Contributor

Author makes a good point. But how to change a legacy culture and pivot? Might be impossible on a large scale.

18 Jun 2017, 09:13 AM

Buyandhold 2012

The new world order?

Amazon?

I have always wondered why they named the company Amazon. Think about it. The Amazon is not exactly a major tourist attraction like Paris. The weather in the Amazon is not that nice. And the Amazon has a lot things that can kill you or injure you like those fish that bite.

I just hope Amazon does not make changes at Whole Foods that would bother me. I like paper bags, not plastic. I never use the self-service line. And I prefer to pay with cash.

18 Jun 2017, 09:17 AM

Benjamin Frost

My price target for Amazon is \$10.

18 Jun 2017, 09:21 AM

StockBouncer

Hard to see how the two can really be merged. Seems disjointed in regard to what Bezos has in mind for Whole

Foods. Like someone said WF is a high end...high priced market segment for those who can pay up for organics. The home delivery model has never been able to get a foot hold and various companies have tried to make a go of it and failed over time. The best I can see here is that Bezos will consider the brick and mortar stores as some distro centers.

18 Jun 2017, 09:27 AM

baker1929

With all due respect Amazon wants to buy a exclusive market segment. It is hardly the world dominator in the food market space. What this business model ultimately looks like is yet to be seen by proof of concept.

18 Jun 2017, 09:28 AM

moatfrog

Bring on the nay sayers. We need 'em to bring on to us unimaginable investment profits. That was rather smug, but it flies in the faces of the many who, with their insecurity, just don't get it -- including the author.

18 Jun 2017, 09:34 AM

markrhodes89511

AMZN and WMT will both be strong and both will thrive for years to come. AMZN will not kill retail and WMT will not stop AMZN. I just wish AMZN would lower their ridiculously high price so I could buy some shares. I also wish AMZN would start paying dividends.

18 Jun 2017, 09:52 AM

gebick99

Another master stroke from planet Amazon.

Groceries are about frequency. What does one shop for the most often? Groceries. Amazon wants people on their site every day. Buying things constantly, repeatedly, and even automatically. Groceries turbo charge that process. It matters not what the specific margins are on groceries because the increased frequency of customer interaction means AMZN will see dramatically more add on and cross sell business from their customer base. You are on the site more often, you order more broadly, AMZN captures more of the customer wallet. So simple and yet so brilliant.

WFM is a wonderful platform for AMZN to make groceries a much larger piece of the customer experience on AMZN. Every store immediately becomes a distribution center. And WFM has PREMIUM locations in close proximity to the most desired customers. This is a sales AND supply chain bonanza for AMZN. It's a goldmine for the AMZN delivery model and platform.

The long-term prospects for AMZN just got substantially better as the path to capture greater market share just became more obvious. Investors will figure this out and continue to value the company highly as they see the

opportunities expand. That is what market valuations are about, the long-term earning POWER of a business, NOT what current earnings are. And AMZN's earning power just became broader and deeper.

The path to a trillion dollar market cap just got clearer. All aboard.

18 Jun 2017, 09:55 AM