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Amazon and Whole Foods, Historically Considered [Amazon-Whole Foods Symposium]

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In considering the importance of the Amazon merger with Whole Foods, some history is helpful. The relevant historical context here is not just the history of those two firms, but the longer and broader history of the grocery industry. In particular, it's helpful to see this merger as the next stage in a pattern of falling transaction costs and shifting specializations that have driven that evolutionary process. We can see how the two parties to this merger both came to prominence independently as part of that process, and how the merger is the natural next step.

At the start of the 20th century, many Americans still produced a good deal of their own food. Where the rest was purchased depended on where one lived. Small town folks had their general store while more urban folks had a variety of specialty shops to choose from. You got your meat from a butcher, your bread from a baker, fresh fruits and veggies elsewhere, and dry goods yet another place. That specialization had its advantages, but it also [imposed an increasing burden](#) on families as life got busier and more women began to enter the workforce. It required time and resources to make those multiple trips.

The [modern supermarket emerges](#) in the 1930s as a one-stop shop for many of the things that previously were purchased separately. The advent of car culture enabled firms to locate outside of downtown areas where parking was easier and land was cheaper. Smaller inventions like the shopping cart enabled people to navigate larger stores and buy more goods, which in turn aligned with the lower average costs associated with greater size. It took modern technologies such as reliable refrigeration, new techniques for freezing food, and advances in transportation to make the supermarket feasible. By the 1960s and 70s, true supermarkets were ubiquitous, though they were still small, dim, and lacking in variety compared to the food palaces of the 21st century.

Continued [marginal improvements](#) in technology and transportation enabled the supermarkets of the 70s to become the much larger and more luxurious versions that appeared by the turn of the 21st century. Since then, transportation technology has not improved that much, but communication and other forms of technology have, which brings us to one of the two players in our story: Amazon. Amazon's rise has been fueled by the combination of increased computing power, the Internet, and the falling cost of consumer computing technology, especially smartphones. All of these factors have enabled Amazon to

assemble its own inventories, tap into those of other sellers, and bring them all to consumers cheaply and quickly. Also not to be overlooked is the marketing genius of “Prime,” which convinced consumers to essentially pay their shipping costs up front, removing the pain of positive shipping costs on the margin. Amazon also built on the advances of other large-scale retailers like Walmart in the decade or two before. The irony now is that many of them are trying to match the Amazon experience of not having to go into a physical store by offering delivery to your car for orders placed online. And more mega-markets are offering pick-up or home delivery as an option as well.

On the grocery side, a different trend was [emerging](#). Even as large mega-markets were becoming more popular, consumers with more resources and more concerns about where their food came from and its overall quality were willing to pay more for a more upscale and ethically concerned shopping experience. The growth of markets like Whole Foods, Fresh Market, and Fresh Thyme made clear there was a demand for smaller, higher quality stores that focused on fresh produce, meats, and fish as well as upscale prepared food. What all of these stores gave up to go smaller was the selection of dry goods that had come to characterize the mega-markets. This strategy made sense because of firms like Walmart and Target, which had dramatically dropped the consumer cost of those goods, not to mention the wholesale clubs like Costco. The experience that was once associated with the mega-market opportunity to get everything was being fragmented by the combination of upscale grocery stores and low-cost big boxes, with the latter’s entry into the grocery market duly noted.

So as [Amazon’s growth](#) in the delivery of non-perishable goods increased, more consumers were purchasing items previously bought in a supermarket or a big box store through Amazon. The big advantage is delivery, and that is just another step in recognizing the increasing value of people’s time that began the move to supermarkets in the first place. We’ve gone from not having the time to make multiple stops for shopping to not wanting to either get out of our car or even leave the house to do so. Given Amazon’s growth in the delivery of non-perishables, the idea of merging with a grocery store that specialized in providing high-quality fresh perishables was not hard to fathom. And a year ago that came to fruition with the merger with Whole Foods.

The merger points to what the future of the grocery industry might well look like, which in some ways looks like a return to the past. I think that we will see the hollowing out of the center of the supermarket. All of the non-perishables, whether food items like breakfast cereal or household goods like toilet paper, will slowly disappear, with consumers purchasing them at cheaper big-box stores, or through delivery services like Amazon. The grocery experience will become more focused on the periphery of the store: produce, meats, dairy, frozen foods, and prepared foods. The high-quality of those goods will make the grocery store seem something like a return to the past, with specialized butchers and bakers and the like, but now all under one roof to minimize the transportation costs. These all remain more or less experience goods that many consumers want to be able to see or touch or smell before they purchase, making them harder to sell through delivery, especially when one considers the additional shipping costs involved with keeping them fresh.

In these ways, the Amazon-Whole Foods merger is both the predictable outcome of the history of the grocery store and a pointer for where it is headed in the future. Already we are beginning to see some interesting economic benefits coming from the synergies involved. One of the more noticeable ones is that many Whole Foods are now offering two hour delivery. As noted earlier, many of the traditional grocery chains are now offering delivery, so it makes sense that the merged firm would combine the distinctive upscale selection at Whole Foods with Amazon's delivery capacity. To the degree consumers have a great deal of trust in the Amazon brand name when it comes to delivery, this looks like a smart move for Amazon and a win for consumers.

Another early move is to offer in-store discounts for Amazon Prime members. In essence what Amazon has done here is to use Prime membership as the equivalent of a grocery loyalty card. You get the discounts applied by scanning the Whole Foods app at the register after you have linked that app to your Amazon account. In the same way that traditional grocery store loyalty cards enable firms to have enormous data on your purchasing patterns and to then customize coupons for you, Amazon already had a lot of data on Prime members and can easily extend the same customization you get when you login to Amazon to customers who also shop at Whole Foods. Economically, the Prime discounts are, like coupons, a form of price discrimination that hopes to pull Prime members into Whole Foods who see it as a close enough substitute for their normal grocery store. Given Whole Foods' well-earned reputation as more expensive than traditional grocery stores, the Prime discounts might be enough to pull people away from something like Kroger and into Whole Foods more often.

With Amazon's enormous database and the logistics that it can bring to delivery, I suspect that we are shortly going to see all kinds of ways in which the grocery shopping experience at Whole Foods will become extraordinarily customized in the same way the shopping experience at Amazon already is. It will also be interesting to see if Whole Foods doesn't move to a membership model based on having Prime.

Viewed from the [long history of the evolution of the grocery store](#), the Amazon-Whole Foods merger made sense as the start of the next stage of that historical process. The combination of increased wealth that is driving the demand for upscale grocery stores, and the corresponding increase in the value of people's time that is driving the demand for one-stop shopping and various forms of pick-up and delivery, makes clear the potential benefits of this merger. Amazon was already beginning to make a mark in the sale and delivery of the non-perishables and dry goods that upscale groceries tend to have less of. Acquiring Whole Foods gives it a way to expand that into perishables in a very sensible way. We are only beginning to see the synergies that this combination will produce. Its long-term effect on the structure of the grocery business will be significant and highly beneficial for consumers.

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