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Can Amazon Be the Next Apple?

By MARC LEVINSON JUNE 20, 2017

Blood is running in the retail aisle. Sears, the most iconic name in American retailing, told its investors in March that “substantial doubt exists related to the Company’s ability to continue as a going concern.” The appliance retailer HH Gregg went defunct at the end of May, and once-celebrated companies like Bebe and Limited are desperately trying to survive as online-only storefronts. The carnage has spread beyond empty shopping malls and big-box stores to the grocery trade. Last week, a poor earnings report cost Kroger, the nation’s second-largest food retailer, 19 percent of its stock market value in a matter of hours — and that was before Amazon announced its acquisition of Whole Foods Market.

So why might Amazon, the giant of online shopping, want to spend $13.4 billion on 461 brick-and-mortar stores of the sort other retailers are shedding left and right, along with a coffee roaster, 11 food distribution centers and manufacturing plants that do things like bake bread and gut fish? One obvious possibility is that Amazon could try to cut delivery times and costs by letting shoppers order online and then pick up their goods at the nearest Whole Foods. Another is that Amazon, for some reason, wants to grab a share of the low-profit grocery business, where online sales have not taken off, and see whether its technological wizardry can revolutionize food shopping.

But there may be a less obvious explanation of Amazon’s interest in Whole Foods: Perhaps it wants to be a bit more like Apple.

There’s no question that Jeff Bezos, the founder of Amazon, has built a hugely successful business. But a large part that business comes from selling the products of others. Only a tiny fraction of its retail sales — its Kindle e-reader, its Echo home control center, the audio books published by its Audible subsidiary, its Amazon Original videos — are exclusive to Amazon. The company makes money on the rest only if the prices on its website, with delivery costs added in, are below those elsewhere.

What that means is that Amazon's margins are skinny. Last year its business that provides cloud-based web services for businesses and governments, with $12 billion of revenue, brought in three times the pre-tax profit Amazon reaped from $125 billion in retail sales.

How to solve this problem? An envious glance at one of their company's best-known competitors might offer Amazon executives an answer.

In 2016, not a stellar year, Apple Inc. reported net income equal to 21 percent of sales — a ratio 12 times higher than Amazon's. A large part of Apple's profit is generated at its retail stores. Apple doesn't disclose such information, but its Apple Stores are believed to have annual sales above $5,500 per square foot. No other retailer comes close. The corresponding figure for Macy's, to take one example, is around $200.

Apple doesn't need flashy stores in expensive locations to distribute phones and computers; those can be ordered on the internet. The Apple Stores, meticulously planned from their online appointment books to the transaction processing system that emails a receipt before you've walked out the door, sell an experience, not electronics. Their purpose is to persuade customers that Apple has extraordinarily exciting products for which premium prices are entirely justified.

Whole Foods started out with a similar idea, but its approach hasn't been working well. Its customer count dropped 2.6 percent last year as shoppers rebelled against high prices for food that didn't seem worth the premium. In a phone call with investors on May 10, John Mackey, the company's chief executive, said Whole Foods was striving for "lower costs, lower prices and higher sales." That doesn't sound like the mantra of a high-end retailer.

Aside from its troubled grocery business, though, Whole Foods brings Amazon two important assets: affluent customers and locations in high-income neighborhoods. Amazon might use these assets to broaden its business in a way it cannot do online.

Online retailing allows retailers access to millions of customers, but that's not always a benefit. One of the challenges of e-commerce is that it's difficult to segment the market. Every customer has access to the same web pages. Online merchants may take advantage of information about individuals' browsing history and past purchases to offer different prices to some than to others, but there's no way to make online shopping a special experience with Apple-style margins. For that, it's still critical to bring customers in the door.

That's where Whole Foods comes in. Whole Foods's stores are sizeable, averaging nearly 40,000 square feet. Imagine Amazon carving out a fifth of that space, with separate entrances, and creating boutiques with well-trained staff and dynamic merchandising. Under the Amazon name or some newly created brand, those boutiques could sell exclusive products and services to shoppers on their way to grab a kale-and-red-currant salad for lunch or a pound of locally raised grass-fed beef for dinner, without detracting from Amazon's online business.

They could sell excitement at profit margins Amazon will never achieve from selling books and backpacks on the internet — profit margins that look a lot more like Apple's.

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