



Black Creek Research

Market Insights
Omnichannel Retailing

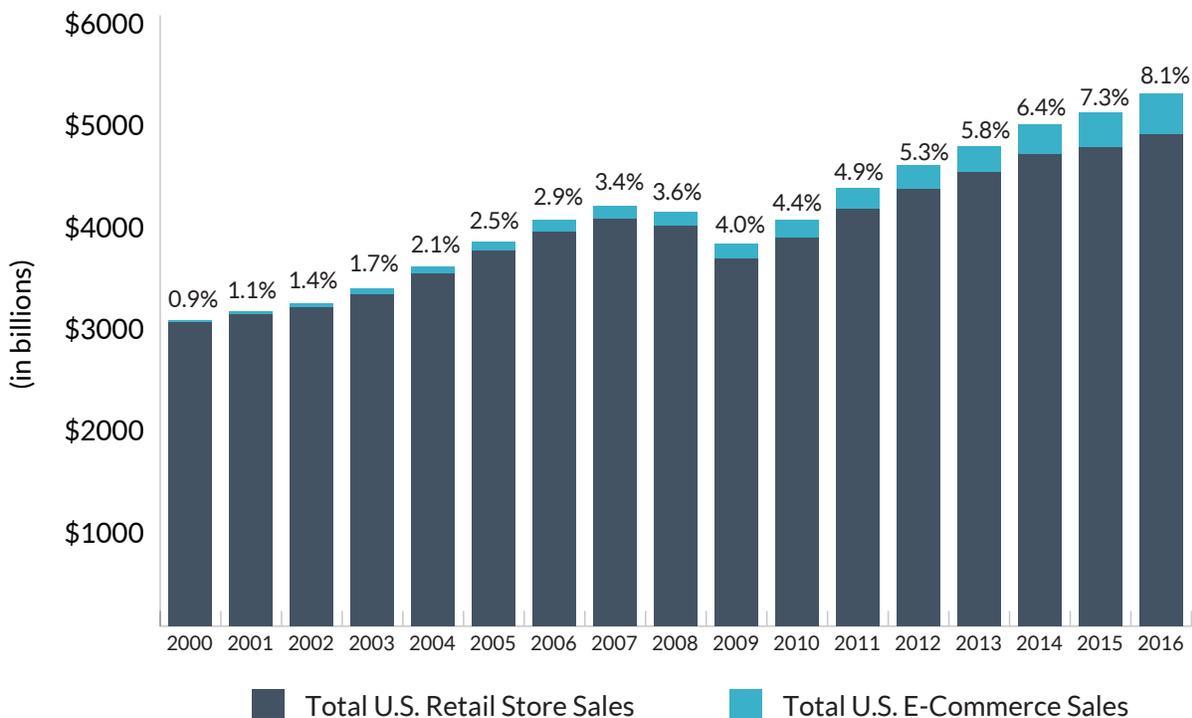
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The evolving retail war has two theaters of battle — brick and mortar and industrial — and the current environment is quickly shifting points of sale and shopping behavior that has broad implications for real estate investing. Omnichannel retailing requires changes and improvements in customer interaction, services offered and reconfiguration of supply chains. Retailers who evolve or establish a niche will succeed while those that do not will continue to lose market share and eventually go away.

E-Commerce Retailing

Despite the popular narrative and news headlines, e-commerce currently only makes up a small portion of retail sales, but is growing. E-commerce grew from less than 1% of total retail sales in the United States in 2000 to over 8% in 2016 – a compound annual growth rate of over 18%. The e-commerce trend is expected to continue, with online sales projected to increase to 25% of total retail sales in the U.S. by 2025.¹ The shift to e-commerce and omnichannel retail has many benefits for consumers, but is a stiff headwind for retailers; as the competitive price transparency, increased infrastructure and shipping costs, pressure on distribution networks, as well as the need for increased inventory close to rooftops have eroded retail margins.

Annual E-Commerce Sales as a Percentage of Total¹
2000 - 2016



Undifferentiated, highly transparent, lightweight goods purchased with a high frequency are most suitable for e-commerce sale / delivery. Grocery has been largely insulated from the e-commerce threat; online grocery sales account for less than 2% of the U.S. total. Even Amazon, the leading online retailer in the world, had been unsuccessfully trying to enter the \$700+ billion grocery space for more than 10 years. This may change with the recent announcement that Amazon has reached an agreement to purchase Whole Foods.

¹ Source: U.S. Census Bureau, Bloomberg, 2017.

Case Study – Amazon to Acquire Whole Foods

With the planned purchase of Whole Foods, Amazon has validated the physical model for grocery, and perhaps retail generally. The acquisition may dispel the “bricks versus clicks” narrative, and suggest “bricks and clicks” in an omnichannel environment is the winning formula.

Order fulfillment and delivery have proven difficult in the low-margin grocery business. The sheer number and wide distribution of U.S. households, coupled with the specialized nature of the products (e.g., refrigeration, food safety, etc.), complicates delivery in a timely and cost-effective manner. For example, according to Bloomberg, Amazon’s current online grocery offering, Amazon Fresh, experiences spoilage nearly twice the rate of a typical grocery store.² Additionally, U.S. consumers have demonstrated preference for in-store shopping and selecting their own grocery goods, particularly perishables.

While bricks and mortar locations seem necessary for grocers, Amazon’s strength in omnichannel innovation will require others to adapt their operating models to compete. The Whole Foods brand also adds credibility to allay consumer concerns of allowing others to select their perishable goods, and its wholesaler and distributor framework expands Amazon’s capabilities.

The more than 440 Whole Foods U.S. locations are concentrated in urban, affluent areas and have a large overlap with Amazon’s existing Prime customer base. Grocery delivery, the hybrid “Click and Collect,” and other enhanced convenience services, are particularly attractive in dense, high-income areas where consumers are willing to pay for the service. Amazon may also view this as more than an opportunity to grow grocery market share, but to use these locations as customer service portals, facilitating last-mile distribution, accepting returns and cross-selling other Amazon goods and services.

Real Estate Implications

The long-term significance of this combination remains unclear, but is compelling evidence that not all retail can be disintermediated by pure e-commerce. This potential acquisition is evidence that a physical presence in the market actually helps to support online sales, and of the significant industrial / warehousing footprint needed for successful same-day and two-day delivery. Existing real estate locations generally offer the best last-mile distribution system for each retailers’ target market since they are often located in proximity to the customer base. While investors should monitor this carefully, it is important to recognize Whole Foods captures less than 2% of grocery market share in the United States. Any effects to the traditional grocery model, and retail generally, will be felt first in Whole Foods’ high demographic trade areas well before they impact the majority of population in less affluent or suburban markets.



² Bloomberg, 2017

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