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Amazon May Face Biggest Challenge With a Brick-and-Mortar Grocery Expansion

E-Commerce Titan Confronts Walmart, Other Obstacles in Highly Fragmented Industry



Amazon is reportedly looking to grow its physical grocery space well beyond its Whole Foods Market chain. Photo: CoStar

In many industries where Amazon decides to compete, the online retailer is a category conqueror -- but that may prove a harder feat with fresh foods. The Seattle-based e-commerce titan could be facing a major challenge if it decides to open new brick-and-mortar stores in a hyper-competitive, low-margin grocery industry that is already dominated by its largest rival, Walmart.

Recent news that Amazon may be considering creating a new physical grocery chain sent shockwaves through the retail world. The company

already serves the upscale market with its Whole Foods chain and the online delivery market with its food-delivery service Amazon Fresh, but it hasn't gained a significant foothold in the larger grocery market yet. While another chain of stores may help reach that goal, breaking into one of the largest sectors of the American economy could take considerable time and resources, say executives familiar with the grocery industry.

“After they’ve been so dominant in e-commerce, Amazon is realizing that they need to have boots on the ground,” said Steve Avoyer, president of San Diego-based brokerage Flocke & Avoyer Commercial Real Estate, which handles leasing, sales and management at more than 100 Southern California retail centers.

“Everyone I know would love to have an Amazon in their center, but right now we really don’t know what this is going to be,” said Avoyer, whose firm has pitched locations for various experimental concepts previously announced by the e-commerce company, such as its cashier-less convenience chain Amazon Go.

Citing unnamed sources familiar with the situation, the Wall Street Journal reported Amazon plans to open dozens of grocery stores in major U.S. cities, apart from its existing Whole Foods Market chain. The first would reportedly open in Los Angeles later this year, with talks underway for other locations in San Francisco, Seattle, Chicago, Philadelphia and Washington, D.C., though no specific locations have been announced or confirmed.

Amazon doesn't comment on “rumors or speculation,” a spokeswoman for the company said when contacted by CoStar News.

It's unclear what exactly is planned nationally for the reported new Amazon grocery format. The company hasn't disclosed how big the stores will be, what they will carry, and how they might be integrated with the e-commerce giant's other products and online services.

While all types of brick-and-mortar retailers have come to fear Amazon and its willingness to spend furiously to grow its scale, the extremely fragmented and low-margin grocery industry has long remained a weak spot compared with other segments the e-commerce titan has conquered. Multiple nationwide consumer surveys over the years have confirmed that's largely because there are many items that shoppers still prefer to buy in-store, such as meats, fresh produce and temperature-sensitive goods like ice cream.

Walmart, with its thousands of physical stores, led all grocery contenders with 26 percent of the \$800 billion U.S. grocery market in 2017, including in-store and online sales, compared with 1.6 percent for Whole Foods, which has about 500 locations, according to research firm Statista.

Analysts have noted that Amazon will likely need to build out its physical presence much more in order to capture significant sales of groceries, the vast majority of which are still made in-store by shoppers. While growing rapidly, online grocery purchases are still on track to reach just 6.3 percent of overall U.S. grocery sales by the end of 2019, consulting firm Brick Meets Click recently projected.

Avoyer said Amazon certainly has the resources to keep experimenting, and he would not be surprised to see the company buy other chains to add to the Whole Foods Market, which it acquired in 2017.

Fragmented Industry

Much of Amazon's sense of urgency to build out its physical footprint in groceries could stem from progress now being made by competitors, especially Walmart, in building online sales, primarily those pickups of items ordered ahead through retailers' own websites and mobile apps.

Walmart, the world's largest retailer and by far the nation's largest seller of groceries, continues to bolster its position in online [grocery ordering for pickup](#) at its physical stores. The company in recent years has de-emphasized new store openings and is now focused on beefing up its infrastructure geared to online ordering of goods for pickup and, further down the line, more direct deliveries to customers' homes.

Amazon remains king in terms of its share of online U.S. grocery orders – 12.5 percent or \$2 billion in 2017 -- though Walmart is catching up and took 11.1 percent of those online sales that year, according to Deutsche Bank.

Final numbers for 2018 have not been tallied. But in an October 2018 research note, Deutsche Bank analyst Paul Trussell said Walmart was in position to surpass Amazon in online grocery sales by the end of that year, with 1,000 more Walmart stores expected to be set up for online orders and pickups.

“Further, we believe Walmart could reach 17 percent online grocery market share by 2025,” Trussell said.

One indicator of the U.S. grocery sector's fragmentation, which could be a big challenge for Amazon in bolstering its brick-and-mortar presence, is that the top 10 sellers -- a list that also includes Kroger, Albertsons, Target and Trader Joe's, all trailing far behind Walmart in market share -- controlled a total of just over 57 percent of all U.S. grocery sales as of 2017, Statista reported.

That leaves nearly 43 percent of the market now being carved up among numerous other types of stores selling groceries, including warehouse clubs, gourmet markets, no-frills discount chains, produce and organic specialists, convenience stores, drugstores, ethnic markets and multiple other local and regional operators with significant space footprints.

For many consumers, getting fresh groceries from one of the many existing neighborhood food-selling locations remains faster than the fastest of the industry's current online pickup or delivery offerings.

Los Angeles-based real estate consultant Michael Shustek said it appears Amazon, by moving beyond Whole Foods for physical expansion, is looking to diversify the range of potential locations to serve grocery buyers -- going beyond, for example, the mostly upscale audience served by Whole Foods to reach other demographic groups in locations where it might be less expensive to set up shop.

He said Los Angeles is being talked about as the first location for a new Amazon grocery format because of its large population, diverse demographics and car-centric culture that still leans heavily toward in-store grocery shopping -- an indicator that San Diego and other Southern California cities could also be on its long-term radar for future tests of brick-and-mortar stores.

Beyond that, Amazon has the cash war chest -- \$40 billion in reserve according to industry reports -- to continue experimenting, expanding and otherwise taking on the considerable forces mounted against it in the grocery sector. Its track record in other retail segments will likely keep investors on board for what could be a long haul.

"Amazon is disruptive, and they have the balance sheet to disrupt groceries," said Shustek, who is also chief executive of Parking REIT Inc. and formerly led brokerage firm Vestin Group Inc. "Usually when somebody disrupts groceries, it's the consumers who win -- it's going to be good for you and me."