Amazon Fresh’s launch in the UK has created much excitement, but as an untried and untested proposition it is hard to predict its impact. In this paper we look at the Amazon Fresh operation in the US to see how it has fared and the challenges it has faced. The findings are used to provide a number of lessons and insights for the UK market.
AMAZON FRESH HAS ARRIVED!

The arrival of Amazon Fresh to the UK has long been rumored; even so, its launch has created much excitement and interest, along with a healthy dose of speculation. The conjecture is mostly around how the business will perform and, more importantly, the impact it will have on existing grocery retailers.

The predictions tend to take one of two forms: that it will struggle to compete in a highly concentrated grocery market; or, that it will thrive and in so doing pile pressure on other players.

The truth probably lies somewhere between these two extremes. However, that truth is difficult to forecast, not least because Amazon Fresh is untried and untested in the UK and no one can be completely sure of how consumers, rivals, and even Amazon itself, will react and evolve.

This paper takes a brief look at the Amazon Fresh operation in the US and uses this insight as a guide to Amazon’s likely course of action in the UK.

THE UK SERVICE AT A GLANCE

- Amazon launched its Fresh service in the UK on 10 June 2016
- The initial service covers 69 postcodes across east and central London
- The Fresh proposition offers 130,000 lines or SKUs
- The service is available to Amazon Prime Members, but only if they pay an additional £6.99 per month to become an Amazon Fresh member
- Baskets over £40 will be delivered for free; baskets under £40 will incur an additional £3.99 delivery fee
- Shoppers can select one-hour delivery slots between 7am and 11pm; same day delivery is available between 5pm and 11pm on orders placed before 1pm
THE UK IS NOT AN EASY MARKET

With virtually no volume growth in the UK grocery market, and a competitive environment that is characterized by overcapacity, it stands to reason that any new entrant is an unwelcome additional pressure. Such is the zero-sum nature of today’s food market, any sales Amazon Fresh manages to generate will come from other players.

While Amazon’s ability to generate at least a reasonable level of revenue is not in doubt, success in grocery has never just been about making sales. In order for the model to work, retailers need to sell in high enough volumes. This is especially true in online grocery where wafer thin product margins are exacerbated by the high costs of fulfilment. It is in generating sufficient volume that Amazon Fresh is most likely to find the UK market challenging.

The first issue for Amazon is that it is not entering a market in the early stages of rapid growth. Unlike in the US, where online still accounts for a miniscule 1.1% of all food and grocery spend but is growing strongly, the UK is at a more advanced evolutionary stage. Last year, some 5.7% of all UK grocery spend was made online; and while the channel continues to grow faster than physical stores, growth is much slower than it once was.

In some ways, a larger more mature market can be attractive, not least because Amazon will have a bigger pool of spend it can try to tap. However, one of the reasons the market is more advanced is because the retailers in it are sophisticated – much more so than in the US where the online offerings of the leading grocery retailers are relatively mixed, with many ignoring the channel altogether.

As such, unlike its launches in various American cities, the playing field in UK online grocery is not a clear one for Amazon. It will have to tackle, and bring down, some giant players if it is to thrive and grow.
AMAZON FRESH IN THE USA

Amazon Fresh’s most established US market is Seattle, where Amazon first launched the concept in 2007. Being an early mover helped it to win custom and arguably allowed it to become the online market leader. Today Amazon holds a 40.3% share of the online grocery market across the Seattle zip codes it delivers to, quite some way above next placed Safeway. However, that market share has been shrinking, thanks, in part, to competition from relatively new players like Instacart.

By contrast, Amazon’s entry into New York was made against a far more competitive backdrop with a number of established online players already in operation. Even though it has been trading for a relatively short time, it is notable that Amazon Fresh’s market share of the online grocery market is just 6.1% across the areas of New York to which it delivers. Its smaller rival, Instacart, which opened for business in New York around the same time has a share of 3.4%. To date, neither has had a particularly severe impact on the shares of the city’s two online grocery leaders: Fresh Direct and Peapod.

If Amazon has had a slightly tougher time gaining ground in New York, a city where competition in online grocery is but a pale imitation of that in the UK and where few of the main US grocers like Kroger have a presence, its British launch is likely to prove to be something of a hard slog.

Despite some reasonable shares of the online space, the overall small scale of Amazon’s US operation is also noteworthy. Unlike in many other categories it sells, Amazon’s national share of total food and grocery spend barely registers. Even in Seattle, where it dominates the online market, its total share of all food and grocery spend is a meagre 1.2%; in New York the same figure is 0.2%. Although such shares generate a reasonable number of dollars, they do not give Amazon anywhere near the purchasing power or economies of scale of the leading grocery players. Attaining a solid share will be even more of a struggle in the UK where the market is more concentrated and competitive.

US CITIES WHERE AMAZON FRESH OPERATES AND LAUNCH DATE

- Seattle (August 2007)
- Los Angeles (June 2013)
- San Francisco (December 2013)
- San Diego (July 2014)
- New York City (October 2014)
- Philadelphia (November 2014)
AMAZON FRESH USA, KEY MARKETS IN NUMBERS

Market share of Amazon Fresh for both online grocery spend and overall grocery spend within key cities, all figures are for calendar year 2015; shares relate to zip codes to which Amazon Fresh delivers within each city

Source: Conlumino market share tracker and Conlumino calculations

Amazon Fresh, Seattle
- Share of all online grocery spend: 40.3%
- Share of all grocery spend: 1.2%

Amazon Fresh, Los Angeles
- Share of all online grocery spend: 30.4%
- Share of all grocery spend: 0.6%

Amazon Fresh, New York
- Share of all online grocery spend: 6.1%
- Share of all grocery spend: 0.2%
THE ISSUE OF PROFITABILITY

While it does not release detailed figures, based on the scale of its operation and the total value of sales, it is inconceivable that Amazon Fresh in the US is fully profitable. This is one of the reasons Amazon has experimented with delivery options, recently increasing the cost of the Fresh service. Essentially, it is attempting to weed out infrequent and low value users in favor of higher spending shoppers. The problem, of course, is that many consumers balk at paying, and, as such, Amazon simply ends up restricting the share of the market it can secure.

Arguably, making the financials work is not just a problem for Amazon. It affects all online grocers and is one of the reasons why the US has seen so many failures, one of the most high profile being Webvan – partly out of which Amazon’s grocery operation was born. However, in UK grocery, even with their present difficulties the big four grocers are able to offset weak online performance by the more robust financials of their stores. Moreover they can bolster productivity by using existing store and logistics networks to fulfil online orders. Amazon has no such advantage and, notwithstanding its recent better financials, while Amazon has deep pockets low profitability will likely discourage it from ramping up a loss-making operation too far and too fast.

All of these issues inevitably create speculation that the move into grocery is simply a way for Amazon to boost Prime membership or to drive sales in other areas. In its purest sense this is unlikely, given that it is an expensive and risky route to growth. However, there is no doubt that the expansion of Fresh brings additional benefits – including the creation and growth of a more integral logistics platform – that make entering the battleground of a very tough market more rational and worthwhile than would otherwise be the case.

Whether it is financially successful or not, the launch of Amazon Fresh in the UK will most certainly add pressure to an already challenged market. It will likely make the big grocers reassess their online propositions (at least in the areas where Amazon operates) to ensure that they are delivering, literally and metaphorically, on things like delivery slots, delivery times, and substitution rates. In this way Amazon will continue to do one of the things it excels at: keeping competitors on their toes.
CUSTOMER ACQUISITION IS THE CHALLENGE

Even in the US, where online grocery is more embryonic, Amazon Fresh’s key challenge is acquiring new customers. When the service first launched in the Seattle suburb of Mercer Island back in 2007, Amazon had a clearer run at building up a base of customers in a market that was not that crowded with competitors. However, today the online grocery landscape is different and Amazon is having to, at least in part, build its business by persuading some customers to switch from other online players. In a more developed online grocery market like New York, this is challenging when only 4.2% of existing online food shoppers say they’d be willing or fairly willing to switch over to Amazon. As developed as it is, the New York online grocery market is nowhere near as advanced as the UK where the issue of customer switching is also likely to be an issue.

Percentage of existing online grocery shoppers, by city, who say they’d be willing or fairly willing to switch from their existing service to Amazon Fresh

Source: Conlumino customer survey (April/May 2016)
ESTABLISHED PLAYERS CAN BE TOUGH COMPETITORS

While the 4.2% of New York online grocery shoppers who are willing to switch to Amazon Fresh may seem low, the situation is even more challenging than it first appears. This is mainly because customers of the more established players, which tend to have larger market shares, are the least willing to switch to Amazon. In New York customers of Fresh Direct and Peapod – the two largest online grocers in the city by sales value – are less willing than average to switch to Amazon. Notably, customers of newer startup Instacart are the least likely to switch to Amazon – mainly because they like the flexibility of the service in terms of the range of grocers Instacart partners with and its non-subscription model.
WHAT STOPS SWITCHING TO AMAZON FRESH?

There are a variety of reasons why existing online grocery shoppers won’t switch over to Amazon Fresh. The most significant is the cost of the service – mentioned by almost three-quarters of non-switchers. Similar to the UK model, since October 2015 Amazon Fresh has required a special $299 a year membership fee to use the service.

Concerns over cost also influence 61% of non-switchers who say they feel they would not use the service enough to justify the annual membership fee.

The hassle involved in switching preferences and details is also an important consideration, especially in a market like New York where consumers may have been using alternative services for many years.

The difficulties of differentiating are also evident with over half saying they see no point in switching to Amazon Fresh as it does not offer anything (in service and product terms) that they can’t get from their existing provider. Just under half say that they don’t think Amazon is any cheaper than their current online grocer.

Reasons given for not switching by those who are unwilling to move to Amazon Fresh from their existing online grocer; all cities
Source: Conlumino customer survey (April/May 2016)

<table>
<thead>
<tr>
<th>Reason</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Am deterred by high cost of membership</td>
<td>73.8</td>
</tr>
<tr>
<td>Too much hassle to transfer preferences/details</td>
<td>62.0</td>
</tr>
<tr>
<td>Would not use it enough to justify the cost of membership</td>
<td>61.4</td>
</tr>
<tr>
<td>Doesn’t offer anything I can’t get from my current service</td>
<td>53.9</td>
</tr>
<tr>
<td>Don’t think Amazon is any cheaper overall</td>
<td>48.2</td>
</tr>
<tr>
<td>Not sure how the Amazon service works</td>
<td>37.9</td>
</tr>
<tr>
<td>Does not stock brands/products I like</td>
<td>35.2</td>
</tr>
<tr>
<td>Don’t think Amazon products are any cheaper</td>
<td>33.8</td>
</tr>
<tr>
<td>Do not consider Amazon a proper grocer</td>
<td>29.4</td>
</tr>
<tr>
<td>The service seems too restrictive</td>
<td>22.7</td>
</tr>
<tr>
<td>Don’t use online enough to justify switching</td>
<td>19.4</td>
</tr>
<tr>
<td>Have heard poor things about Amazon Fresh</td>
<td>6.2</td>
</tr>
<tr>
<td>Dislike Amazon or the Amazon brand</td>
<td>2.1</td>
</tr>
</tbody>
</table>
AMAZON HAS MORE SUCCESS IN ATTRACTING NON-ONLINE SHOPPERS

Given that the US market is less developed than the UK in terms of online food it stands to reason that there is a bigger population of shoppers who don’t currently buy groceries online. When these people are asked which service or retailer they would be most likely to use if they started to shop regularly for food online, Amazon is the top mentioned player in all markets. Even in Philadelphia where the Fresh service is more embryonic and restricted to core parts of the city, Amazon gets the most mentions although it fails to attain a majority. The familiarity with Amazon and the fact that general Amazon Prime membership is common are important reasons for Amazon’s potential success with non-online food shoppers.

<table>
<thead>
<tr>
<th>Percentage of shoppers who don’t currently buy food online who say they'd be most likely to use Amazon Fresh if they decided to regularly buy groceries online, by city</th>
</tr>
</thead>
<tbody>
<tr>
<td>City</td>
</tr>
<tr>
<td>Seattle</td>
</tr>
<tr>
<td>San Francisco</td>
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<tr>
<td>New York</td>
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<tr>
<td>Los Angeles</td>
</tr>
<tr>
<td>San Diego</td>
</tr>
<tr>
<td>Philadelphia</td>
</tr>
</tbody>
</table>

Source: Conlumino customer survey (April/May 2016)
WHY WOULD YOU USE AMAZON FRESH?

When asked why they would be most likely to use Amazon Fresh if they shopped for groceries online, non-internet shoppers for food gave a variety of reasons. Foremost among these were the fact that they were familiar with the Amazon brand name, had used Amazon for other things and were comfortable using it. Well over a third already had Prime membership and cited this as a reason for being most likely to use Fresh.

The specifics of the service, which along with competitor specifics were briefly shown to survey participants, also proved to be attractive to a smaller, but still significant, number of potential shoppers.

Understanding this data in the context of the UK is interesting. Firstly, grocery shopper penetration is far higher in the UK than in the US so the pool of potential non-online consumers is smaller. Secondly, familiarity with existing online players is much greater as the space is dominated by big grocers which consumers regularly use for physical shopping. This is often not the case in the US, especially in cities like New York where major grocers do not have a strong online presence.

<table>
<thead>
<tr>
<th>Reason</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Am familiar with the Amazon name / brand</td>
<td>78.5</td>
</tr>
<tr>
<td>Amazon is a brand I trust and am comfortable using</td>
<td>71.0</td>
</tr>
<tr>
<td>Am already using Amazon for other things</td>
<td>63.3</td>
</tr>
<tr>
<td>Already have a general Amazon Prime membership</td>
<td>39.4</td>
</tr>
<tr>
<td>Think Amazon Fresh is competitive on price</td>
<td>35.8</td>
</tr>
<tr>
<td>Have had good experiences with Amazon in the past</td>
<td>35.6</td>
</tr>
<tr>
<td>Know friends/relations who use Amazon Fresh and like it</td>
<td>30.1</td>
</tr>
<tr>
<td>Like the product choice available</td>
<td>25.4</td>
</tr>
<tr>
<td>Like the delivery slots and flexibility available</td>
<td>20.2</td>
</tr>
<tr>
<td>Trust Amazon to deliver on time and get my order right</td>
<td>19.6</td>
</tr>
<tr>
<td>Am happy to pay an annual subscription for ‘free’ delivery</td>
<td>15.4</td>
</tr>
<tr>
<td>Am simply more aware of Amazon than other suppliers</td>
<td>13.2</td>
</tr>
<tr>
<td>Don’t trust other suppliers very much</td>
<td>10.2</td>
</tr>
</tbody>
</table>
AMAZON’S FUTURE EXPANSION IN THE USA

To date, Amazon Fresh’s expansion in the US has been significant but fairly modest. Indeed, we believe that the number of cities and households being served are less than the retailer initially planned by this stage in its development.

There are a number of reasons for this more cautious pace of development.

Firstly, as far as Amazon is concerned this is still something of an experiment which it is trialing, testing and tweaking – in other words the concept is not yet totally proven in terms of its financial success or its optimal configuration. This especially so given the different shopping dynamics across the various cities in which Amazon Fresh has launched.

Secondly, the financials and return on investment are nowhere near strong enough to roll this out further and faster. Indeed, we believe that Amazon Fresh is still loss-making on an operational level. This both constrains Amazon’s willingness and ability to roll out the service at speed.

Thirdly, while there are many locations in which Amazon Fresh could work in the US, most of these are cities – which somewhat restricts where Amazon can open. Seattle was chosen first because it is Amazon’s home city, but subsequent locations were selected for their population density, high average spend on food, high penetration of existing Amazon shoppers, and a strong concentration of medium to high income professionals.

The latter point is interesting as we do not believe, as it is currently configured, Amazon Fresh could work successfully outside of big cities. The quantum of deliveries, the lower population densities, and the high distances between drop-offs, would all act against the financials and produce too great a level of losses.

All of this suggests that while Amazon Fresh will continue to grow in the US, that immediate growth will be focused on increasing penetration in existing cities – especially newer locations like New York – and in a select number of additional cities like Boston, Phoenix, Dallas, Chicago and Houston.
AMAZON FRESH’S NEXT STEPS IN THE USA

As it is currently configured, the Amazon Fresh service in the US isn’t profitably able to service non-urban areas – including the sprawling suburbs surrounding large cities. This severely restricts Amazon Fresh’s potential market and means the company is unable to expand the service as it might like. As such, we believe that Amazon is likely to trial a physical pick-up point for grocery shopping. Indeed, there is speculation that the first of these will be in Sunnyvale, California where, last year, plans were submitted to the city council for the development of a site at 777 Sunnyvale-Saratoga Road. While Amazon has not been conclusively identified as the company behind the development, there is strong evidence to indicate its involvement.

LET’S GET PHYSICAL: AMAZON’S POTENTIAL MOVE INTO GROCERY PICK-UP

• The picture opposite is a rendering of the grocery pickup concept as submitted to the City of Sunnyvale Council

• It is an 11,600 square foot facility with up to 8 pickup lanes for cars

• Most of the building would be warehouse space, but there could be some retail

• Customers would pre-order groceries and be given a specific window of their choosing for pickup
LEARNING THE LESSONS FOR THE UK

Amazon Fresh’s experience in the US provides a number of lessons and learning points for the UK.

• The first thing to note is that as far as the grocery market as a whole is concerned, Amazon Fresh has only been moderately successful within the US. Even in its most established market, Seattle, it only attains a 1.2% share of total grocery spend. In newer markets like New York this share is a paltry 0.2%. As such, we believe claims that Amazon will take a share upwards of 3% of the total UK market (on and offline) to be overblown.

• That said, Amazon Fresh is more successful online with a 40% share in Seattle where it first started. This level of penetration is unlikely in the UK where Amazon, rather than having the advantage of being a first mover, is a late-comer to the scene. We believe that even a share of 6.1% of online grocery, which Amazon Fresh manages to attain in New York, is unlikely in the areas Amazon serves in the UK – mostly because the UK market is more mature and competitive than it is in the US.

• Getting existing customers to switch to Amazon Fresh has been a key issue in the US, especially in markets with more established competition. In New York, potential switching rates are low. In our view, the UK will also present such a challenge. However, we sound two notes of caution for existing UK players. First, unlike the US the UK market is already concentrated and the general trend is one of fragmentation; this could play into Amazon’s hands. Second, as a more developed online market UK consumers are generally more experimental and willing to try new propositions.

• Pricing in the US, while competitive, is not ultra-low and is more on a par with other players. This does not seem to be the case in the UK where Amazon Fresh has taken a more aggressive stance. Part of this is down to the fact that the UK market is more competitive per se, but it also suggests that Amazon will work hard to encourage switching and to entice shoppers over to its service. This is a danger as evidence from the US suggests that once switched and using Amazon, shoppers are fairly loyal to the service.
LEARNING THE LESSONS FOR THE UK

• In the US, Amazon Fresh’s annual subscription fee has proved to be a point of resistance in terms of signing up shoppers. We also believe this will be the case in the UK, especially among infrequent online consumers. The free trial period may help to mitigate this, but we think Amazon will struggle to widen its appeal. Part of this is deliberate, so that it can focus on higher value grocery consumers, but it will nevertheless restrict market share growth.

• Young, urban professionals have been key to Amazon’s success in the US as have, to a lesser extent, busy professional families. These are also likely to prove to be lucrative segments in the UK – especially those who currently use Amazon for existing products and who have Prime Membership. However, unlike the US, we do not believe Amazon Fresh will drive up online shopper numbers significantly, mostly because penetration and usage is already high.

• The choice of London is deliberate as it fits Amazon Fresh’s ideal market of a population dense location with a large number of affluent, high spending shoppers. As has been the case in the US, we expect Amazon to extend the service to other areas of London and then beyond into other big, concentrated cities. While we do not expect Amazon to extend beyond cities initially, the more crowded and dense nature of the UK makes it easier to tackle suburban areas than is the case in the US.

• Amazon Fresh should not be seen in isolation; Amazon has no desire to own the grocery space per se. In the US it is part of a wider strategy to scale-up Amazon’s own logistics operation and to extend its reach and penetration among consumers. Food gives it the ability to do this and, while still loss making on a stand-alone level, helps to boost Amazon’s sales and profitability in other categories. This is likely to be the approach and rationale in the UK where Amazon wants to grow its total share of wallet. Arguably this could prove to be a secondary threat to UK grocers because of the high proportion of non-food they sell – an issue that is less relevant for US grocers.
LEARNING THE LESSONS FOR THE UK

• A further point about Fresh is that it is also a cash generative part of Amazon’s business and one that can be used to fuel expansion in other areas. Unlike the shareholders of other retail businesses, expectations around Amazon’s profitability are relatively low; it is accepted that Amazon will funnel cash and profits into business expansion. In the US this has created a marked contrast between Amazon and other players like Walmart, which has often struggled to justify investment in its online operations. Given the profit pressures on UK grocers this is likely to be a similar problem in the UK.

• As much as Amazon Fresh may struggle to build a high level of market share we believe that it still has the potential to be highly disruptive and to damage the profitability of some players which, because of low margins, is very sensitive to even small shifts in volumes. With high property costs and higher levels of investment in financially weak online operations we believe that UK grocers are more exposed to pain of small volume shifts Amazon Fresh may cause, than is the case for US grocers.

• Further disruption will come from Amazon Fresh’s service levels. Amazon has helped raised the bar in the US where, subject to availability, same day delivery is now fairly common. Over the medium term we believe that Amazon Fresh will also raise this bar in the UK and that other grocers will become more competitive on delivery—something that may not be helpful to margins.

• Amazon Fresh is a more collaborative retailer, partnering with local stores and third party grocers. In this regard Amazon is fairly agnostic about brands and competitors. This is a model it will follow in the UK and, as a result, over the longer term we could see this strategy being adopted by more mainstream grocers.

• Although we do not believe Amazon Fresh currently has any concrete plans to open grocery fulfillment centers in the UK, we believe this is part of the longer term agenda. As in the US, these are likely to be focused on grocery to drive volume, but are also likely to offer the possibility of picking up other goods ordered from Amazon.
METHODOLOGY AND FURTHER DETAILS

Research methodology
Consumer research in this document is based on an online survey conducted in April and May 2016. This had a sample size of 3,150 online grocery shoppers split across the 6 cities (New York, Los Angeles, Seattle, San Francisco, San Diego, and Philadelphia). A brief poll was undertaken among 3,074 non-online grocery shoppers across the same 6 cities. All market shares and financial information are drawn from Conlumino’s internal models and calculations.

About us
Conlumino is a retail research agency and consulting firm. We provide analysis and intelligence on all aspects of retailing and consumer behavior to help our clients make better business decisions. Our insight is used across many different sectors, and we count the leading global retailers, banks, investors, and property firms among our clients.

Next steps
Want further insight on Amazon Fresh or related retail and FMCG topics? We have a wealth of analysis and knowledge to help answer your questions and solve your problems. This includes consumer research, financial analysis, market forecasts, competitor analysis, pricing research, product and range insights, and category analysis. Your account director will be happy to discuss your requirements.