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AmazonFresh: Rekindling the Online Grocery Market

We believe that a fundamental measure of our success will be the shareholder value we create over the long term. . . . We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.

— Jeff Bezos, 1997 Letter to Shareholders

As Fishmonger Ryan Reese skillfully filleted a fresh rainbow trout at Seattle's Pike Place Market one morning in late 2012, the usual mix of tourists and locals gathered to admire his prowess. The iconic downtown market's appealing array of fresh and specialty foods drew daily crowds eager to admire its vendors' showmanship and buy their wares. But the trout wasn't for any of them. Ryan's customer was miles away on Mercer Island. Within hours AmazonFresh, the grocery subsidiary of Amazon.com, would deliver the fish, which she'd ordered online, right to her doorstep.[1]

AmazonFresh had spent five years testing and refining its business model since its launch in August 2007. The challenges were numerous; no other online grocer had yet succeeded on a national scale. Amazon typically allowed new businesses only a short time to achieve profitability before shutting down failed attempts. But CEO Jeff Bezos and his management team also made allowances for enterprises they believed would succeed in the long term. Known for being "stubborn on vision and flexible on details," Amazon was also famously resistant to Wall Street's quarterly earnings pressures.[2]

Grocery was an especially attractive sector because it was both the largest single U.S. retail category and one of the few that had not yet migrated online. (In 2012 less than 2 percent of overall U.S. grocery sales were transacted online.)[3] Furthermore, customers shopped for groceries frequently and the category was more downturn-resistant than most. Even so, when Amazon announced its intention to launch AmazonFresh, skepticism reigned. Critics questioned whether a shift to online purchases would ever happen in the grocery sector. Others asked whether Amazon could operate profitably in a notoriously low-margin business. Perhaps for these reasons, AmazonFresh had taken an uncharacteristically cautious approach; to date, it only operated in Seattle. Meanwhile, both

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traditional grocers and startup competitors were springing up around the country with their own online offerings.

While Reese busied himself wrapping the fileted trout in newspaper, Amazon was busy mapping the future of online grocery. Would there come a day when most grocery shopping was done online? If so, how would Amazon compete with established retail chains like Safeway, which was energetically opening online channels and already had a string of warehouses nationwide? Most urgently, Amazon needed to plan AmazonFresh's next step. Should the company continue refining its business model in Seattle or expand to another city? What factors should it take into account when planning its next move?

Amazon.com: A Brief History

Jeff Bezos launched Amazon.com as an online bookstore in 1994 after reading a forecast that web commerce would grow by over 2000 percent annually. Amazon.com initially offered a catalog of over 1 million titles and sold at discounts of 10–30 percent below brick-and-mortar stores' prices. The company was an instant hit. In its first week Amazon.com sold $12,000 worth of books; by the year's end, sales had surpassed $500,000.[4]

In 1998 Amazon expanded into two more retail categories, music and DVDs/videos. Over the next 14 years, Amazon systematically added a wide range of retail categories, including media, electronics, home & garden, health and beauty, sport equipment, industrial & automotive, and fashion. (See **Exhibit 1** for a timeline of the company's category expansions.) By 2012 the company had become the world's largest online retailer. Amazon also generated revenue through its Digital Content, Computing Services, and Content Production businesses. As Dave Clark, Amazon's Vice President of Worldwide Operations and Customer Service, remarked, "Anything you want on Earth, you're going to get from us."[5]

Amazon's inventory and shipping strategies evolved significantly over time. Initially, the company adopted a "sell all, carry few" approach, stocking just 2,000 book titles in its warehouse; other orders were fulfilled by book wholesalers or by publishers who shipped directly to customers. Amazon Marketplace, which enables sellers to list items on Amazon.com in exchange for a commission, is an extension of this model: it allows Amazon to offer an extremely broad selection of goods while maximizing inventory turns and minimizing working capital and capital expenditures.

To shorten delivery times, Amazon expanded in 1999 from two distribution centers to ten. By the end of 2012 it had 46 distribution centers scattered across the United States, most within five miles of a major city.[6] Customers received items in 3–5 days with standard shipping, but Amazon also offered two-day and next-day options to customers who enrolled in Amazon Prime for a $79 annual membership fee. Once the "addictive grip" of Prime took hold, customers tended to purchase many more items through Amazon.[7] (Prime customers spent an average of $1224 annually in 2012, compared to $505 for non-Prime customers).[8] Amazon also experimented with several other delivery models, including Amazon Lockers (shipping to a designated pickup station), Local Express Delivery (same-day delivery), and Sunday delivery. In 2013 the company hinted at eventually reducing delivery times even further by using unmanned aerial vehicles, or drones.[9]

Due to re-investments in the business, Amazon's profitability has averaged just over 3 percent from 2003 to 2012. (See **Exhibit 2** for Amazon's historical financial performance.) Some observers fretted that, as one snidely put it, Amazon appears to be "a charitable organization being run by elements of the investment community for the benefit of consumers."[10] In a 2013 interview with television journalist Charlie Rose, Bezos remarked, "I care [about profitability], but I'm willing for it to be five, six, seven years. Just that change in timeline can be a very big competitive advantage." In response Rose told the audience: "Amazon's profits are redirected to building more distribution centers. The more centers it constructs, the closer the customer and the faster the delivery. And every time a new center goes up, publishers and traditional retailers shudder."[11]

Not all of Amazon's new business initiatives have panned out. Amazon Auctions, launched as a competitor to eBay, was shuttered when it failed to gain traction. The same fate befell Endless, a competitor to the online shoe retailer Zappos (which Amazon eventually acquired).[12] Typically, Amazon gave new initiatives 12–18 months to succeed and then quietly discontinued those that didn't work. Despite the occasional misstep, Amazon had experienced dramatic growth and was widely considered a fierce retail competitor by 2012.

An Overview of the U.S. Grocery Industry

When Amazon entered the grocery category, the market was already mature and highly competitive. Groceries represented the largest single retail category, with 2010 revenue of $600 billion—a magnitude attributable to the frequency of purchases. (Consumers shopped for groceries 2.2 times per week on average.) Grocery was also resistant to downturns, though growth was somewhat slow and tended to track the growth of the overall U.S. population.

The Traditional Grocery Model

Groceries are sold in the United States through a variety of channels, including conventional supermarkets, supercenters, warehouse stores, natural/gourmet stores, limited-assortment stores, and convenience stores. (See **Exhibit 3** for a brief description of each channel.) Wal-Mart invested heavily in grocery in the late 1990s to increase store traffic, and has since become the largest U.S. grocer.

To remain profitable, grocery stores depend on a high volume of sales, efficient inventory management, and constant evaluation of products and promotions. An average grocery store in 2012 generated about $450,000 in weekly sales, cost $6 million to build and was remodeled every 6–7 years at a cost of $3 million.[13] Net income was only 1 percent for many retailers due to high COGS, labor expenses, and spoilage.[14]

Stores receive inventory from distribution centers multiple times a week; large stores receive shipments daily. Products might arrive at the store directly from the vendor, from the company's own warehouse, or from a third-party distributor. Typically, corporate-level buyers and merchandising staff decide which items to stock, discontinue, and promote. Nearly 40 percent of grocery items (meat, dairy, produce, frozen food) must be maintained at a specific temperature. Grocers and their vendors rely on increasingly sophisticated inventory-management systems to track product sales, but stock-outs and high levels of shrink[a] are still relatively common.

The Emergence and Failure of Early Online Grocers

The earliest online grocers, Webvan and HomeGrocer, emerged in the late 1990s along with other Internet startups.

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[a] *Shrink*, or loss of perishables that go bad in warehouses or are damaged in transit, is especially problematic in high-value categories like meat, fish, and fresh produce.

Launched in 1999, Webvan raised $800 million from such venture capitalists as Benchmark and Sequoia Capital. Its stated aim was to provide the quality and selection of Whole Foods, the pricing of Safeway, and the convenience of home delivery.[15] Webvan's infrastructure, built from scratch, included a highly automated distribution center complete with real-time inventory-management systems, five miles of automated conveyor belts, and carousel pods that transferred items into 10,000 individual totes daily. Pressured by its backers, Webvan adopted a 26-city expansion plan, rolled out distribution centers and vans in the Bay Area, Seattle, Chicago, and Atlanta, and signed a billion-dollar contract with Bechtel to build several state-of-the-art warehouses worth more than $30 million each.[16]

HomeGrocer.com, launched at about the same time, raised three rounds of funding from venture capitalists, including Kleiner Perkins Caufield & Byers. Amazon also invested $42.5 million, for a 35-percent stake.[17] The company offered 9,000–12,000 SKUs via a user-friendly website and promised next-day delivery during a customer-selected time window. HomeGrocer initially planned to limit its first-year operations to Seattle before expanding to other regions, but financing entailed expectations of growth. The company opened a new distribution center in a new region every few months in the runup to its IPO.

HomeGrocer went public in March 2000, one month before the Internet bubble burst. In June Webvan acquired HomeGrocer for $1.2 billion in stock, extending its reach to 13 metropolitan markets. Webvan integrated the two technology platforms and rebranded as one company, but a tumultuous transition ensued: customers abandoned the service, cash reserves dwindled, and Webvan filed for bankruptcy a year later.

Reflecting on Webvan's failure, board member Mike Moritz said that the company had "committed the cardinal sin of retail, which is to expand into a new territory—in our case several territories—before we had demonstrated success in the first market. In fact, we were busy demonstrating failure in the Bay Area market while we expanded into other regions."[18]

The Challenges of Online Grocery

After the demise of Webvan and HomeGrocer, online sales remained stubbornly flat at 1.3 percent of the U.S. grocery market. Meanwhile online grocers were facing several challenges.[19] Online grocery was characterized by long lead times—most online grocers required customers to order one day in advance—and customers had to specify delivery windows and be at home to receive delivery.[b] Some potential customers spurned online grocery shopping because they preferred to choose their own produce and enjoyed brick-and-mortar stores' appealing displays and samples. As a result, customers have been slow to embrace online grocery.

Moreover, unlike e-commerce retailers that rely on FedEx and UPS to deliver products, online grocers needed their own logistics infrastructure to keep food at appropriate temperatures. They also needed sufficient customer density in a given neighborhood to avoid sending out partially-empty delivery trucks. "Mean travel time between delivery stops is the key to success in the home delivery business," said Gary Dahl, former VP of distribution at Webvan. "Travel one block in San Francisco and you've passed 200 people, travel one block in Moraga [a Bay Area suburb] and you have passed about six people."[20] To compound the problem, customer orders tended to spike at certain times, like weekends and before major holidays; thus customized delivery trucks sat idle much of the time.

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[b] A spinoff "click-and-collect" model had emerged, allowing customers to order items online and pick them up at a store. Orders were filled by "pickers" or at dedicated warehouses and shipped to local stores. This approach reduced delivery costs and waiting time, but it also diminished the convenience of online grocery shopping.

Online grocers also lacked legitimacy, since many people had been scared off by Webvan's collapse. Online grocery became known in the industry as "the Bermuda Triangle of e-commerce—a place where investment dollars go but never return."[21] Analyst Andy Wolf of BB&T Capital Markets told an industry journalist in 2013 that "Nothing has changed from 12 years ago, the economics don't make sense."[22] Costco's CEO Craig Jelinek agreed; the company had studied online grocery delivery, he said, and could not see how any company could do it profitably.[23] Whole Foods co-CEO John Mackey concurred: "A lot of people have tried in this area and I haven't seen anybody come up with a business model that is profitable."[24]

Amazon's Entry into Grocery

It was against this backdrop that Amazon developed its online grocery offering. Amazon had offered a selection of 10,000 shelf-stable staple and gourmet items on its main website since 2005, but AmazonFresh was far more than just another category extension. Entry into perishable products required a significant change in its warehousing and distribution model, and would entail higher expectations for service and delivery. In Bezos's words:

> We'd been doing a very efficient job with our current distribution model for a wide variety of things. Diapers? Fine, no problem. Even Cheerios. But there are a bunch of products that you can't just wrap up in a cardboard box and ship them. It doesn't work for milk. It doesn't work for hamburger.[25]

Many were skeptical. Former HomeGrocer CEO Terry Drayton, whom Amazon had approached to lead the initiative, later recalled, "I saw them heading into a Webvan-type offering and knew that was a recipe for failure."[26] Even five years after the launch, some on the executive team wondered whether AmazonFresh should expand, given the changes to the existing business model that expansion would require.

The Evolution of AmazonFresh

Citing years of customer requests for a grocery offering, AmazonFresh launched in 2007 as an invitation-only beta test on Mercer Island, a wealthy Seattle suburb whose residents included Microsoft co-founder Paul Allen.[27] Mercer was geographically compact and near Amazon's headquarters. On a dedicated site separate from the Amazon.com site, a customer could browse over 100,000 grocery items, place selections in a digital "basket" and have them delivered the same day or the next day.[28] Amazon's CFO Tom Szkutak acknowledged that, as part of the beta test, the company was closely monitoring the customer experience and the economics of the business.

Initially AmazonFresh's value proposition emphasized "a great selection and great prices and a really convenient experience," though some observers questioned the price claim.[29] Delivery was complimentary, and Amazon often provided free samples with orders to promote goodwill. The company also partnered with local merchants to sell their products, notably fish from Seattle's Pike Place Market. Inclusion of local products was motivated by a nationwide shift in affluent customers' preferences towards sourcing food locally and supporting local merchants. Freshness, another important value, was conveyed by the name "AmazonFresh" and by the company's bright-green delivery trucks and bags.

Amazon experimented with several delivery options, including next-day delivery during a one-hour delivery window. Customers who used this popular option had to order by 10 a.m. on one day and be at home the next day during the delivery window. Alternatively, the "sleep tight" service enabled customers to order later in the day and have their groceries left in a temperature-controlled tote on their doorstep during the night.[30] Alongside home delivery, AmazonFresh opened retail locations in Seattle suburbs where customers could pick up groceries ordered through the site.

These initial tests prompted several major changes. AmazonFresh began promoting convenience over price: the tagline "Convenience, Delivered" was added to marketing materials in 2009. As it gained scale, AmazonFresh also shortened delivery times substantially and began offering same-day delivery. The service area expanded 1–2 zip codes at a time, and customers were sometimes invited to vote on where to expand next. The company also extended its product offerings to include SKUs from the Amazon.com site and began to offer delivery from restaurants. Meanwhile the underutilized pickup option was discontinued.

Customer feedback also prompted modest changes. Drivers were instructed to drive slowly and to turn off the engine and headlights during early-morning deliveries to address noise complaints.[31] Packaging was streamlined to mitigate environmental impact, and customers were notified of deliveries via email and text to discourage theft.

Operations

Suppliers Unlike some of its competitors, AmazonFresh maintained its own warehouse for nationally supplied items like produce, enabling tight control over quality. But it also contracted with local retailers and suppliers of prepared foods: restaurants, ethnic supermarkets, bakeries, and specialty meat and seafood stores.[32] Participating suppliers gained exposure and expanded their customer bases while avoiding costly investments in delivery. AmazonFresh negotiated deep discounts and a cut of suppliers' revenues in exchange for handling payment, fulfillment, and delivery**.**

Distribution centers Because groceries are perishable, AmazonFresh needed distribution centers with refrigeration and freezer capabilities. It opted to purchase an existing distribution center from Safeway rather than converting one of its own warehouses or building a new facility; but layout changes still had to be made. In a traditional grocery warehouse, pallets of products are received at one set of docks, stored along aisles, and repacked at a second set of docks on the other side of the warehouse for delivery to stores. Because AmazonFresh was assembling individual orders, more floor space had to be dedicated to breaking down pallets and picking and packing orders. Space also had to be set aside for the packaging used in deliveries (cooling packs and tote bags).

Scheduling and routing Assembled orders were loaded onto AmazonFresh's refrigerated delivery trucks, which represented Amazon's first experience owning and operating its own delivery fleet. The company had briefly considered using a third-party provider, but quickly recognized its inability to meet Amazon's needs. Routes were designed to minimize the total distance traveled and maximize the fullness of the truck—a daunting logistics problem, given that the number of possible routes for even a small fleet of delivery trucks on any given day "tops the number of atoms in the known universe."[33] To help allocate deliveries evenly, customers were given a set of timeslots to choose from. Occasionally a time slot would become unavailable if a truck was already full, travel time was too long, or order density in a given area was too sparse.

Delivery Customers received their groceries in crates, which the drivers carried to the kitchen. For customers who chose doorstep delivery, groceries were packed in reusable totes and insulated coolers that maintained proper temperatures for two hours after the scheduled delivery window; customers placed used totes and coolers outside for pickup during their next delivery. Gel-Packs were initially used to keep products cold, but AmazonFresh switched to frozen bottles of water and dry ice to simplify return logistics and minimize costs.[34] For both kitchen delivery and doorstep delivery, drivers scanned a Quick Response code on each crate or tote bag to increase order accuracy.[35] Customers could request a no-questions-asked refund if an item was missing or damaged during delivery.

The Website and Integration with Amazon.com

When first launched, the AmazonFresh website was relatively sparse (see **Exhibit 4a**). The site operated separately from Amazon.com (though credit-card information was integrated between the two sites). Early on, the Fresh site lacked the reviews and customized suggestions that Amazon.com is known for; it provided none of the recipes, nutrition pointers, and similar features offered by competing online grocers.[36] It did, however, post detailed descriptions of produce, including information about its quality, ripeness, and appearance.

Over time, Amazon made improvements to the site to increase its usability and appeal (**Exhibit 4b**). Customers could track past purchases and automatically add favorite items. The site began to feature recipes (e.g., seasonal recipes and "Easy Family Favorites") and to make it easy for customers to add a recipe's ingredients to their carts. A Coupons section allowed customers to clip coupons electronically for both grocery and non-grocery items. Amazon developed a mobile app that enabled customers to scan barcodes on products purchased anywhere and add them to their online shopping basket on Amazon.

Most noteworthy was enhanced integration with Amazon.com, increasing the number of Amazon.com items (such as books and electronics) that Fresh subscribers could order from 100,000 to 500,000. These items were delivered with customers' grocery orders the same day or next day. Amazon had honed a sophisticated picking-and-packing process to ship out products in less than 2.5 hours after a customer clicked "Place your order," but many routines had to change if eggs and books were to appear in the same tote on a customer's doorstep.[37]

The Management Team

Recognizing the unique challenges of online grocery, Amazon tapped seasoned executives with experience in both e-commerce and retail operations to lead AmazonFresh.

Amazon's Senior Vice President of Consumables, Doug Herrington (HBS '92), oversaw AmazonFresh as well as Amazon's health & personal care, gourmet food, beauty, and baby businesses.[38] A former consultant, Herrington had been VP of Marketing at Webvan and CEO of a digital content company.

Mark Mastandrea, Director of Delivery Experience at AmazonFresh, was an MIT-trained engineer with supply-chain and e-commerce experience. A former Director of Distribution for Webvan, he had held executive positions at eBay and Weight Watchers.[39] Mastandrea joined Fresh from Kiva Systems (acquired by Amazon for $775 million), a provider of robots for materials handling.

Peter Ham served as Director of Software Development at Amazon. After earning computer-science degrees at Stanford, he had built large-scale software systems for food retailers. Ham had previously been the system architect for Ocado Ltd., a large U.K.-based online grocery retailer, and VP of Order Fulfillment at Webvan.

Economics

While continuing to enhance convenience, AmazonFresh also strove to improve the underlying economics. Rather than maintaining its usual low-pricing approach, Amazon aimed to make its prices comparable to those a customer might find at a grocery store. (See **Exhibit 5** for a side-by-side price comparison.)[40] "It's not like they're pricing things to win market share, which usually is Amazon's M.O.," analyst Sucharita Mulpuru pointed out.[41] Tom Furphy, former head of consumables at Amazon, agreed: "They serve a less price conscious and time-starved customer. They want people to feel good about the prices, but it's about convenience rather than the lowest prices."[42]

The minimum order size was increased to $30 and a $5 delivery fee was charged for orders of $30–$75 unless the customer subscribed to AmazonPrime. The Big Radish program waived the delivery fee (but not the minimum order size) for customers who spent more than $400 each month at AmazonFresh.[43] Besides defraying delivery costs, the Big Radish program encouraged customers to do most or all of their grocery shopping at AmazonFresh.

AmazonFresh negotiated promotion budgets with major suppliers and began advertising branded products on its trucks and website as an additional source of revenue. Amazon also pioneered data analytic technologies for automatic replenishment and upgraded its software systems. Bezos seemed optimistic: "If we can be smart enough, i.e., have the right technology, the right software systems, machine-learning tools to position inventory in all the right places, . . . it [means] lower costs, less fuel burned, and faster delivery."[44]

Such improvements notwithstanding, some observers questioned whether AmazonFresh would ever be a profitable stand-alone business. Some even speculated that it might have been intended all along as a kind of Trojan horse, designed to pave the way for same-day delivery of all of Amazon's products. After all, getting an item "right here, right now" was one of brick-and-mortar stores' last advantages over online retailers. By expanding AmazonFresh, Amazon.com could improve the economics of same-day delivery for all its products and build out the infrastructure necessary for speedy same-day delivery. In short, Amazon could achieve "total retail domination."[45]

Competition

Over the course of the five years that AmazonFresh experimented in Seattle, several competitors had emerged. Traditional retailers like Safeway, Wal-Mart, and Stop & Shop probably posed the greatest threat. Safeway was the second-largest supermarket chain in North America, with stores throughout the western and central United States; in 2001 the company began offering online ordering and delivery services as a response to Webvan. An online order was transmitted to the customer's nearest Safeway, where pickers filled the order in-store. Orders were then placed on trucks for delivery. Safeway maintained this practice in some areas and opened dedicated warehouses in others. Prices were higher than at other online grocers, but the company had the scale to expand quickly.

More recently, Wal-Mart announced its own grocery-delivery service in 2011, Wal-Mart To Go, modeled on its subsidiary Asda, the largest UK online grocery-delivery service. Like AmazonFresh, Wal-Mart To Go offered a full array of fresh, frozen, and dry packaged items, as well as other items from Walmart.com. It also offered an option for customers to order online and pick up their orders in-store, a convenience for those who needed items sooner. A "ship-from-store" model leveraging Wal-Mart's physical stores as mini distribution hubs is rumored to be in the works.[46] Online orders could be routed to customers in a store's vicinity, shortening delivery time and reducing costs via shorter routes and fewer markdowns. As of 2014 Wal-Mart To Go operated only in San Jose and San Francisco, but the company was considering expansion.

The online grocery pioneer Peapod, owned by Royal Ahold, serves 24 markets with next-day delivery via Stop & Shop and Giant Food stores. In 2011 Peapod launched virtual grocery stores at commuter-rail stations, where customers could order groceries by scanning a virtual display while waiting for their trains. Peapod claims to be one of the few profitable online grocery businesses in the United States.[47]

Aside from these traditional competitors, Google and eBay were mulling same-day delivery and a few digital grocery startups were experimenting with various business models. One of the newest was Instacart, launched in 2012. In preference to owning inventory and building warehouses and distribution infrastructure, Instacart utilized a "crowd-sourced" model: freelance drivers assembled orders and delivered them directly.[48] Customers could select from an array of local stores, including Safeway, Whole Foods, and Costco. Pricing varied, but most deliveries cost $3.99 for a $10 minimum order; customers could also pay a $99 annual fee for free delivery. Founded by a former Amazon engineer, Instacart was backed by Sequoia Capital. "We all held hands and prayed," joked Mike Moritz about his firm's decision to invest in another online grocery startup.[49] The company was only present in a few markets, but had recently announced plans to expand to eight more cities in two years.

Next Steps: Scaling Up Freshness?

AmazonFresh executives were pleased with the company's performance in Seattle over its first several years, but nagging questions remained. The most critical was expansion. A methodical approach had ironed out kinks in the business model, but it was still far from perfect. More troublingly, AmazonFresh faced increased scrutiny from investors and competitive pressure from traditional retailers and online grocery startups. Two options appeared to be most realistic:

Continue to refine the business model By early 2013, AmazonFresh served most of Seattle and was approaching profitability. But margins were still relatively low, and penetration of Seattle households was estimated at only 5 percent. With a few operational improvements the company might be able to extend the same-day delivery deadline to later in the day; it could also make a more concerted effort to increase customer retention and repeat ordering. A switch to a yearly delivery fee (like Instacart's and those of Costco and other club grocery stores) might encourage customers to use the service more frequently to "get their money's worth." That approach might slow acquisition of new customers, but could lead to higher profitability down the road. Assuming that Amazon pursued this option, which aspects of the model would need attention and what tests could be run?

Expand to a second test city The second option was to introduce AmazonFresh's current business model into a second (or even third) test city. Doing so would enable the company to distinguish aspects of the model that were market-specific from those that were transferable across markets. Like the successful controlled tests that Amazon had run with its core website, a second market could promote experimentation, enabling Amazon to roll out changes in one market but not the other to evaluate their impact on the business. To pursue this option, the company would have to choose an appropriate follow-on city carefully. Ideally a second test city would offer a suitable grocery warehouse near the city center to lease; building a new one could easily take a year and require a large capital outlay. Two cities seemed especially suitable: Los Angeles and New York. Compared to Seattle, L.A. was large and traffic-congested; it also had many affluent consumers with limited online grocery options. New York was much denser than L.A. and Seattle, and grocery shopping there tended to be a chore, but several online grocers were already operating in New York. Also, its distance from Seattle would make operations there harder to manage and monitor. Assuming that Amazon pursued this option, which would make a better second test city? Which factors should guide AmazonFresh's expansion strategy more generally?

As AmazonFresh weighed these options, Bezos' comments at the 2011 shareholders meeting were still fresh in people's minds:

> The customer experience is good. We're still tinkering with the business to try and make the economics acceptable. So it's an expensive service to provide, a similar kind of operation to what HomeGrocer did 10 years ago, what Webvan did 10 years ago. We like the idea of it, but we have a high bar of what we expect in terms of the business economics for something like AmazonFresh.[50]

Was the time right to expand?

Exhibit 1 Timeline of select Amazon retail-category extensions

Year	Month	Milestone
1995	July	Amazon.com sells first book, *Computer Models of the Fundamental Mechanisms of Thought*
1998	June	Opens Music Store
1998	November	Opens DVD/Video Store
1999	July	Opens Consumer Electronics, and Toys & Games Stores
1999	November	Opens Home Improvement, Software, Video Games and Gift Ideas Stores
2000	May	Opens Kitchen Store
2000	October	Opens Camera & Photo Store
2000	November	Launches Marketplace
2002	September	Opens Office Products Store
2002	November	Opens Apparel & Accessories Store
2003	September	Opens Sports & Outdoor Store
2003	November	Opens Gourmet Food Store
2003	December	Opens Health & Personal Care Store
2004	April	Opens Jewelry Store
2004	October	Launches Beauty Store
2004	November	Launches Amazon Theater
2005	May	Introduces Amazon Wedding
2006	June	Launches Emergency Preparedness Store for Hurricane Season
2006	June	Launches New Toy and Baby Stores with Largest Selection Ever
2006	July	Launches Grocery Store
2006	September	Launches WebStore and Fulfillment by Amazon for Small and Medium-Sized Businesses
2008	June	Launches Office Supplies Store
2008	September	Launches Motorcycle & ATV Store
2008	September	Opens New TV Show Stores
2009	April	Launches Xbox LIVE Store
2009	July	Launches Outdoor Recreation Store
2010	May	Launches Amazon WebStore
2010	June	Launches Wheels Store

Source: Amazon.com, Inc., "History & Timeline," http://phx.corporate-ir.net/phoenix.zhtml?c=176060&p=irol-corporateTimeline, accessed February 2014.

Exhibit 2 Amazon Financial Metrics

	Revenue ($ millions)	Net income ($ millions)	Net income (%)
1995	1	-0.3	-60%
1996	16	-6	-38%
1997	148	-31	-21%
1998	610	-125	-20%
1999	1,640	-719	-44%
2000	2,762	-864	-31%
2001	3,122	-412	-13%
2002	3,933	64	2%
2003	5,264	270	5%
2004	6,921	440	6%
2005	8,490	432	5%
2006	10,711	389	4%
2007	14,835	655	4%
2008	19,166	842	4%
2009	24,509	902	4%
2010	34,204	1152	3%
2011	48,077	631	1%
2012	61,093	-39	0%

Source: Amazon.com Inc. 10-K filings (1998-2012), U.S. Securities and Exchange Commission, accessed February 2014.

Exhibit 3 Overview of Retail Grocery Channels

Conventional supermarkets. Traditional supermarkets like Safeway and Kroger provide a full line of groceries, carry over 100,000 SKUs and sometimes offer a service deli, a bakery, and/or a pharmacy. Conventional supermarkets sold ~$370 billion in grocery in 2010.

Supercenters. Supercenters are a more recent entrant into the grocery industry. Their vast grocery and non-grocery selections allow consumers to do virtually all of their shopping in a single location. Major players include Wal-Mart and Target. Supercenters accounted for ~$149 billion in food sales in 2010.

Warehouse stores. Warehouse stores and wholesale clubs like Costco and BJ's eliminate frills and concentrate on price appeal through bulk sales. Customers typically pay an annual membership fee. Increasingly, these stores offer additional services like a travel agency, optometry services, and credit cards to boost revenue.

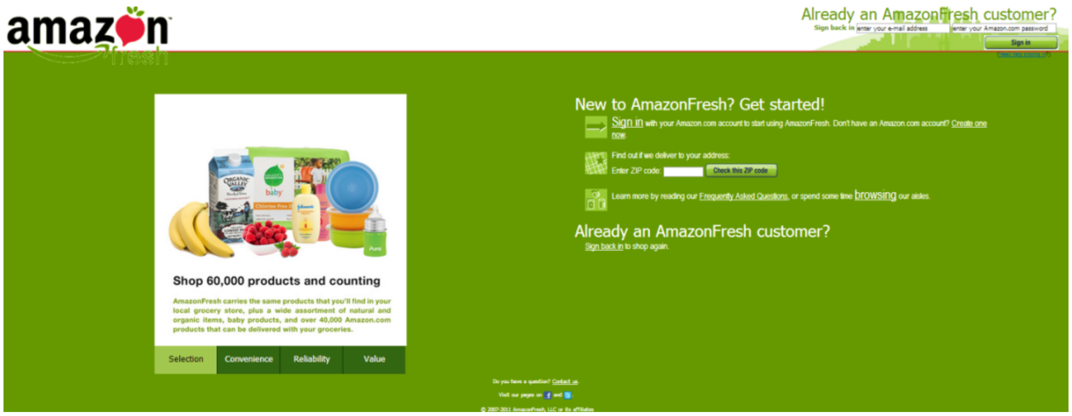
Natural/gourmet stores. Natural and gourmet stores like Whole Foods and Wegmans's emphasize perishables and cater to distinct preferences, including ethnic, organic, and natural foods. This category grew quickly in the early 2000s, and continues to be a growth category.

Limited-assortment stores. Limited-assortment stores like Trader Joe's and Fresh N' Easy provide a limited selection of SKUs at a lower price point, and often carry a wider assortment of private-label goods. They are typically characterized by above-average gross margins and smaller store footprints.

Other. Groceries are also carried by convenience stores, dollar stores, drugstores, and gas stations.

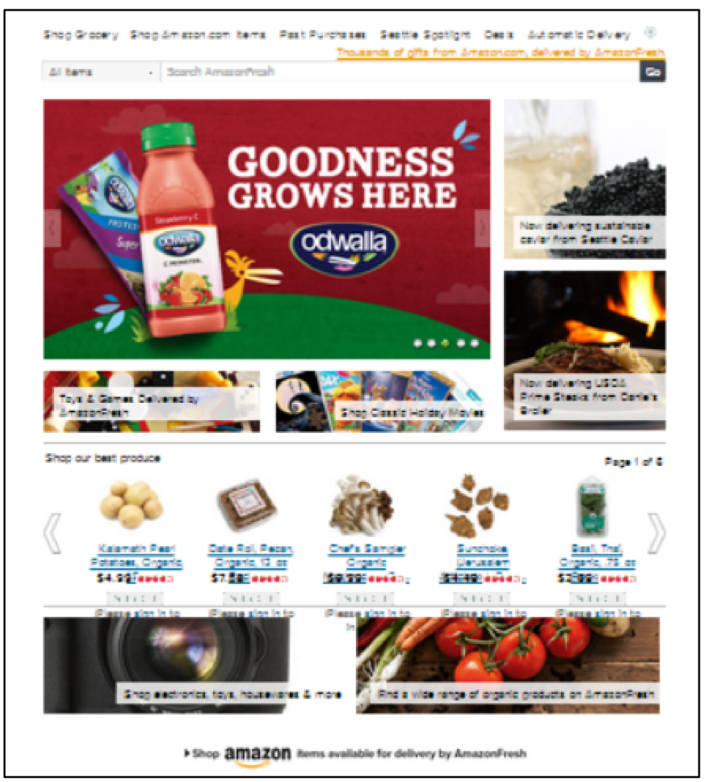
Source: Casewriter. Food Marketing Institute, "Supermarket Facts," http://www.fmi.org/research-resources/supermarket-facts, accessed February 2014. The Reinvestment Fund, "Understanding the Grocery Industry," http://www.cdfifund.gov/what_we_do/resources/Understanding%20Grocery%20Industry_for%20fund_102411.pdf, accessed February 2014.

Exhibit 4a The AmazonFresh website at launch, 2007



Source: Internet Archive, "WayBack Machine AmazonFresh," http://web.archive.org/web/20110209153311/https://fresh.amazon.com/Welcome, accessed March 2014.

Exhibit 4b The AmazonFresh website, 2012



Source: Internet Archive, "WayBack Machine AmazonFresh," http://web.archive.org/web/20121221152823/http://fresh.amazon.com , accessed March 2014.

Exhibit 5 Price Comparison, AmazonFresh vs. Safeway in 2013

	Amazon Fresh	Safeway
Skirt steak (1 pound)	$ 8.99	$ 6.05
Frozen spinach	$ 1.28	$ 1.19
Clover 2 percent milk (gallon)	$ 3.99	$ 4.19
Honeycrisp apple	$ 1.49	$ 1.26
Organic eggs	$ 3.99	$ 4.99
Bananas	$ 1.49	$ 2.18
Cilantro	$ 0.99	$ 0.50
Organic baby carrots	$ 1.49	$ 1.99
Baked beans	$ 2.99	$ 2.99
2 Hass avocados	$ 2.50	$ 2.50
Shredded mozzarella	$ 2.69	$ 3.99
Tip	$ 4.00	$ -
Subtotal	$ 35.89	$ 31.83
Delivery	$ 5.99	$ -
Total	$ 41.88	$ 31.83

Source: Sharon Profis, "AmazonFresh vs. supermarket: A hands-on shopping test," CNET.com, December 17 2013. http://www.cnet.com/news/amazonfresh-vs-supermarket-a-hands-on-shopping-test/, accessed March 2014.

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