THE AMAZON ERA

IN MEAT

An in depth look at how Amazon's acquisition of Whole Foods will transform the meat supply chain

THE AMAZON'MENT OF MEAT HAS ARRIVED

In the first round of observable changes since the acquisition, Amazon lowered the price of two core meat items at Whole Foods: ground beef and chicken breasts.

This should serve as a giant flashing neon sign to the entire meat supply chain that Amazon is now in the game.

The retail food business is ~$750 billion and Jeff Bezos is not one to be content with a small piece of the pie, Amazon's $13.5 billion acquisition of Whole Foods is just the beginning. When Amazon enters a segment, the effects are felt by suppliers, competitors, and consumers. As you prepare to compete, supply, and/or partner with Amazon, let's look at the business model & ideology of Amazon and how it might influence their approach to the food sector.

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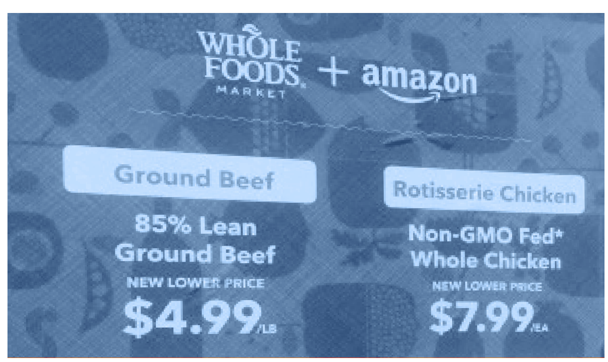
BIG IDEA

Now is the time for food retailers and meat companies to wake up and realize they are no longer competing in the old game. This is next level competition and it will require companies to build new capabilities. The way we've always done it will be the death cry of companies who choose to cling to "the way things have always been done."

In this white paper, you'll find analysis covering:

- Amazon's - the business model, ideology, & tactics used to dominate new segments
- Three steps to thrive in the Amazon era
- What meat processors should expect from this new customer
- What retailers should expect from this new competitor



DEEP DIVE INTO AMAZON

Based on Jeff Bezos' public statements, analyst coverage, and, well, just being people who are alive in 2017 and purchase things, here are 3 ways Amazon differentiates itself:

1

CUSTOMER CENTRIC.

From Amazon's humble beginnings to current lofty heights, a relentless desire to improve customer experience has been central to the Amazon ethos. Whether shipping books or bananas to a millennial in a downtown urban area or paper towels and boots to an older couple in rural America, Amazon has made shopping nearly frictionless.

2

INNOVATIVE.

Amazon Prime. Amazon Web Services. 1-Click Ordering. Amazon Fresh. 1,662 patents in 2016. Amazon will use its scale and experience rapidly deploying new products to keep the pressure on competitors.

3

ACCESS TO CAPITAL.

Amazon's market cap as of September 2017 is more than $470 billion. Shareholders love and trust Jeff Bezos and have given him wide latitude to invest for the long term. With that shareholder trust comes almost unrivaled access to capital for fueling innovation and growth. Audible. Zappos. Whole Foods.

In ***The Everything Store,*** Brad Stone chronicles Amazon's journey and shares a few telling quotes from Jeff Bezos, Amazon's founder and CEO:

> *"We'll have everyday low prices and great customer experience. We'll be Walmart and Nordstrom simultaneously."*

> *"The either/or mentality that if you're doing something good for customers it must be bad for shareholders is amateurish."*

> *"There are companies that work to figure out how to charge more and companies who work to figure out how to charge less."*

For all the insights we can glean from Amazon's past behavior, their entrance into food is already markedly different since it's started with their largest acquisition yet ($13 billion) of physical retail. They didn't buy Blue Apron or HelloFresh, they bought the Nordstrom of food. Can we reasonably expect Amazon to now Walmart'ize Whole Foods? Probably.

But Amazon doesn't just sell low priced goods, they sell an entirely different business model.

According to *The Everything Store*, here's how the evolution happened and the core principles that shape Amazon's competitive advantage(s):

1

SELECTION.
Amazon started out building the business around greater selection - you might not be able to find a book at your local bookstore, but you could find any book in the world on Amazon.com. This means that when Amazon enters a new segment, whether it is children's toys or fresh food, they have to do it big from the get-go.

2

CUSTOMER EXPERIENCE.
While improved selection contributes to a better customer experience, Amazon has continued to perfect shopping by improving purchasing decisions through product reviews, smart recommendations, and by adding convenience-focused features like subscription ordering and easy, free returns.

3

LOW PRICES.
Then Bezos bought into the idea of everyday low prices. Amazon went all in on this principle. Not only does Amazon's model enable the lowest prices, their model enables optimized pricing.

4

EXCEPTIONAL SUPPLY CHAIN.
As disruptions and inefficiencies in distribution centers (now called Fulfillment Centers) threatened Amazon's very existence, Bezos led a laser focus to the company's supply chain which led to sophisticated analytics, algorithms, and automation where possible.

The result of Amazon's revolutionary tactics is a customer centric company that's not afraid to innovate, **they're afraid not to innovate.**

In the book *The Wal-Mart Effect*, the author's thesis is that when you do business with them, you inherently take on their business model. That model includes an extreme focus on reducing costs year over year.

That same principle likely holds true with those who do business with Amazon. But their model demands even more from suppliers due to the Walmart + Nordstrom dynamic. Are you ready for that additional expectation?

Amazon is a data driven company. A lot of companies say that, but few take a disciplined approach to driving decisions based off robust analytics. Two examples of this principle in action at Amazon:

CASE STUDY #1

Fulfillment Centers

Amazon realized the airline pricing model to distinguish business and pleasure travelers in a way that maximized profit. Seat utilization could be applied in a similar way to drive efficiencies in Fulfillment Centers and increase sales per customer. The mechanism evolved into Amazon Prime, but the iteration prior to Amazon Prime served as a data based way to segment customers for free shipping based on their time sensitivity and willingness to pay. The short-term outcome was a decrease in shipping costs and the additional long term outcome was an increase in sales per customer. Each iteration was driven by looking at the data from Fulfillment Centers and customer behavior in a holistic way that led to innovation, decreased costs, and increased revenues.

CASE STUDY #2

Product Optimization

Early in the life of Amazon, an entire team was dedicated to recommending certain products. These Editorial Sales were based on the employee's intuition of how likely a person was to buy a kayak if they bought a life vest, for example. Then data happened. Specifically an algorithm was built to personalize the product recommendations each shopper sees when visiting the website. The idea was to show products an individual shopper was statistically more likely to purchase. Even once this algorithm was built, however, the transition from the Editorial Sales team to the new algorithm was not overnight. Bezos first ran a robust test to compare the two mechanisms in order to identify the method that maximized additional sales. The algorithmic approach won the day through cold, hard evidence and the result was a lower cost way to increase sales and customer satisfaction.

Imagine the very possible scenario in which Amazon is updating prices in real time throughout the day based on various combinations of purchases while Joe the Pork Category Manager for a competitor retailer is using historical rules of thumb to set prices that will be static for the rest of the day, or worse, the next week and is setting promotions based on the same annual calendar they have used every year. Which company would you bet on in that scenario?

This begs the question, what will happen when Amazon brings that level of analytical rigor to an industry where very few companies use sophisticated analytics? Where pricing decisions across the supply chain are made based off intuition and rules of thumb rather than data?

3 STEPS TO THRIVE IN THE AMAZON ERA

If you've been in the meat industry for even a second, you've likely heard the phrase "I've done it this way for 20+ years." Companies that allow this sentiment to flourish put themselves at great risk to struggle mightily in the Amazon era.

How can you resist the temptation to continue business as usual, embrace the Amazon era, and position your business to thrive?

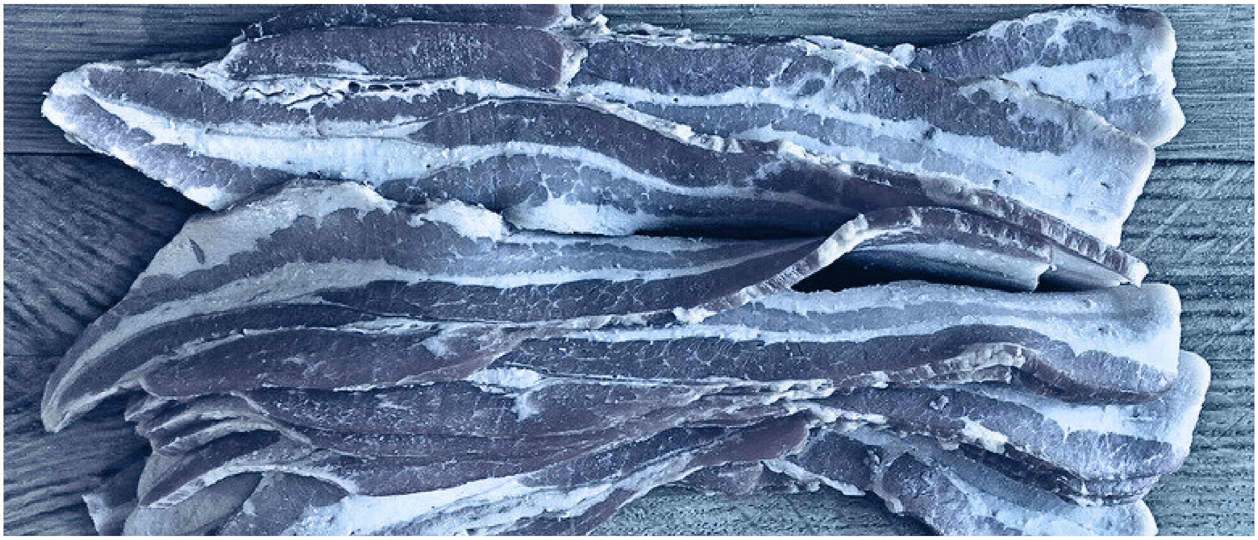
1. **Check your assumptions.** Are the assumptions you hold about competitors, customers, or consumers that drive your company's behaviors still true or do they need to be updated?
2. Rethink decision-making processes. Are decisions made in your organization in a disciplined manner tied to objective data or someone's gut?
3. Modernize your tools. Bezos has an army of data scientists driving inefficiencies out of Fulfillment Centers and optimizing each consumer's shopping experience. Maybe that isn't necessary for you, but how will you leverage rigorous analytics to make dynamic, optimized decisions?

MEAT PROCESSORS: WHAT CHANGES TO THE VALUE CHAIN SHOULD I EXPECT?

1. **RISK TRANSFER/REDUCTION.**
One of the standard risks of selling into the retail channel is that processors assume all volume risk. The retailer and processor agree on a price (formula or fixed) and an estimated volume. But the processor assumes the risk if the retailer does not sell all the anticipated volume, resulting in an operational disaster of picking up some cases at a store and trying to find a home for a perishable product which usually means selling it at a significant discount. I think we can all agree this isn't optimal.... unless you're a retailer. Enter Amazon, how will they tackle this problem to create a more seamless transition of meat from supplier to customer to consumer?

2. **COMMODITIZING NICHE MARKETS.**
While Amazon doesn't appear to have an ideological slant about meat labels, Whole Foods certainly does. And if Amazon is going to drive cost out of the system (within appropriate bounds) and expand the Whole Foods shopping base, does that mean Amazon will find a way to make Bell & Evans' style labels the new commodity chicken label?

3. **COMPETITIVE PRESSURE.**
Your retail customers will likely feel severe competitive pressure. How will they respond and what impact will that have on your business relationships? Will they look to structure longer term commitments or will it be the inverse?



RETAILERS: WHAT CHANGES TO THE VALUE CHAIN SHOULD I EXPECT?

1. **SOPHISTICATED PRICING.**
Having a guy in the office who's been pricing meat for 30 years will no longer be sufficient. Chances are Amazon will go hire people who know meat (the same way they poached Walmart's logistics experts), plus they'll bring the horsepower of sophisticated data analytics to optimize pricing based on the profit objectives of each category, likely to an item level. As mentioned above, Amazon will leverage dynamic pricing to maximize profit and volume. Will other retailers?

2. **REFINED SUPPLY CHAIN MANAGEMENT.**
Amazon will work at innovating around the logistics and distribution of meat up and down the chain in an effort to find ways to eliminate cost from the entire system.

3. **SERVICE.**
Kroger is looking at partnerships with Instacart for grocery delivery, Walmart is leveraging their acquisition of Jet.com. All in an effort to maintain step with the gorilla in the room that is Amazon's exceptional service.

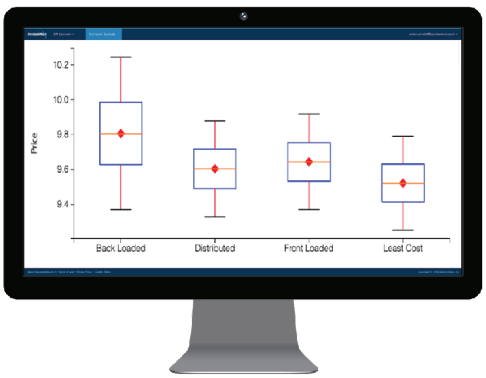
4. **PRODUCT ASSORTMENT.**
There will be tension here as companies make tough trade off decisions between maximizing product assortment to compete with Amazon and maximizing profit per category.

DECISIONS TO RETHINK IN THE MEAT VALUE CHAIN

With Amazon in the game, value chain leaders in the meat industry must recalibrate their decision-making efforts. Using static spreadsheets or gut-feel as the foundation for decision-making will serve no one well.

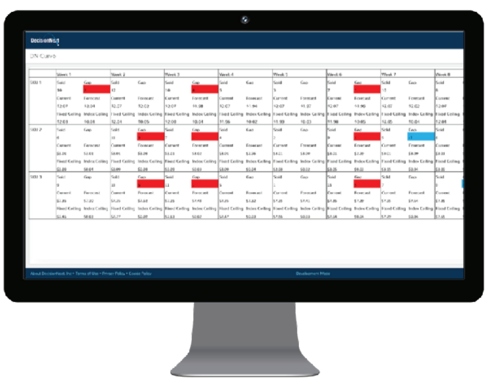
Artificial intelligence and machine learning are the cornerstones of Amazon's operational efficiency. Furthermore, the ability to forecast markets and understand the power of agility in environments of uncertainty give them a leg up in the industries they serve.

What does that look like in the meat industry? Here's some examples of the types of decisions various entities should reevaluate:



PACKER:

- What is the right hedging strategy for buying live animals?
- How far forward sold should we be on loins or bellies?
- Based on price elasticity by customer/channel, how should I price meat by customer?



FURTHER PROCESSOR:

- How far forward bought should we be on raw materials?
- When should we lock in pricing on raw materials?
- Where there is flexible bill of materials, what is optimal sourcing mix?

RETAILER

- When should we lock in prices on pork loins?
- What beef ad should we run in 1 month? 2 months? 3 months?
- How much to buy, when?

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