

# Amazon poses a double threat to Australian retailers

Written by The Conversation

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Amazon is a low-margin retailer sitting on other higher-margin businesses. shutterstock

E-commerce giant Amazon has struck a deal to [acquire Whole Foods Market](#) , an American supermarket chain with more than 400 stores. The move has put

[even more pressure](#)

on Australian retailers as

[Amazon sets up shop in Australia](#)

But the real threat to Australian retail lies in Amazon's business model. It is a low-margin retailer that owns several other [highly profitable and fast-growing](#) businesses, such as cloud services. These other businesses can and do cross-subsidise its retail operations.

[JB Hi-Fi](#) and [Harvey Norman](#) have suggested they will compete with Amazon on price, but given the cost structure of Australian retailers this may not be possible.

## Amazon is very lean

While Amazon is extremely large, it is very lean. [In 2016 alone](#) , Amazon sold US\$94.7 billion of product globally. But the cost of buying (or manufacturing) these products was US\$88.3 billion, leading to a gross profit of just US\$6.4 billion.

This means the mark-up Amazon puts on its products is very small. For example, in 2016 Amazon's gross profit margin (gross profit divided by sales revenue) was just 6.8%. [JB Hi-Fi](#) had a margin of 21.9%,

[Woolworths](#)

26.8%,

[Wesfarmers](#)

31.0%,

[Harvey Norman](#)

31.4%,

[Myer](#)

42.1% and

### [Super Retail Group](#)

a whopping 43.4%.

But Australian retailers also face high operational costs (wages, advertising, marketing and leases). The two largest, Wesfarmers and Woolworths, both have operating expenses in excess of 24.0% of sales revenue, while Myer, Super Retail Group and Harvey Norman are all around 40.0%. JB Hi-Fi is an outlier at just 16.3%.

Another important measure to consider is the net profit margin. This shows what percentage of each dollar of sales the company ultimately earns after all costs (including tax) are factored in. Net margin is calculated by dividing net profit after tax by sales revenue.

The net profit margins for Australian retailers are, for the most part, quite low – around 2-3%. This means they don't have much room to move on price. If they drop prices, many will become unprofitable. So even if Amazon doesn't start a price war in Australia, its business model is such that prices will be extremely competitive.

## Amazon has other businesses

Most Australian retailers are only retailers. Some of the larger groups, such as [Myer](#) and [Wesfarmers](#), operate across a few industries. But they ultimately still earn nearly all their revenue from buying and then re-selling physical products.

[Amazon](#), on the other hand, has a profitable and booming services business. Its “services sales” represents about US\$41.3 billion in sales, or 30% of its revenue. This covers third-party seller fees (Amazon charges other companies for access to its marketplace and warehouses), Amazon Web Services (a fast-growing provider of cloud services), digital subscriptions, advertising services and co-branded credit card fees.

In its [2016 annual report](#), Amazon reported US\$12.2 billion in revenue from Amazon Web Services alone. The scariest thing for Australian retailers is that this has increased four-fold since 2013, and is responsible for nearly 75% of Amazon's operating profit.

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Amazon, then, not only has a large, low-margin online retail offering, but is supported by a fast-growing, high-margin cloud service.

### Finding new ways to compete

Most Australian retailers will need to look at other ways of saving costs if they are to remain competitive with Amazon. For example, Coles and Woolworths can put [even more pressure on suppliers](#) to reduce their costs. Coles has [recently signalled](#) that it will pursue this strategy. And all of our retailers can try to reduce the cost of leases, and shift or reduce staff.

The small margins of most Australian retailers mean reducing prices alone isn't a viable long-term strategy, especially as Amazon Web Services gains steam and Amazon is profitable in other countries.

Not every retailer will come under the same pressure, though. In the short term at least, groceries are still likely to be purchased in stores. But the same can't be said of clothing and electronics. This means Woolworths and Wesfarmers should not be as concerned as Myer, Super Retail Group and JB Hi-Fi.

The answer for retailers may be to look past price and [compete on other aspects of the shopping experience](#), such as convenience or customer service. But only time will tell if that's what the Australian public wants.

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