

“Amazon Pharmacy at Whole Foods Market”

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Mahdi Shirvin

I. Marketing Environment

Whole Foods Market: Company

WFM Market (WFM) is the largest retailer of organic foods in the United States, 5th largest public food retailer, and 10th largest retailer overall. Its mission is “to promote vitality and well-being of all individuals by supplying the highest quality, most wholesome foods available.”

WFM has its origins as a natural food store in Austin, Texas, founded in 1978. The 1980s saw market expansion across the US, with further expansion in the 1990s through a number of acquisitions of natural food store chains. Starting in 2002, WFM began its international expansion, which included stores in Canada and the United Kingdom.

In 2017, WFM was purchased by Amazon, who also purchased that year online pharmacy specialist PillPack. At that time, WFM had over 400 stores worldwide, 91,000 employees, and a Fortune 500 company, which had a market capitalization of over \$10 billion.

WFM has just one operating segment, that being its natural and organic supermarket. The segment is a \$100 billion market, that has been growing in the high single digits over the past few years.

We were able to source a number of WFM information items on the company by searching the internet, which permitted us to construct several different analytical tools used in this paper. Here is WFM’s Business Model Canvas:

Business Model Canvas: Whole Food Markets



WFM's value proposition includes the following:

- Healthy organic food products
- Local and global community support
- Environmentally friendly
- Certified quality products
- Happy team members
- Delighted customer experience

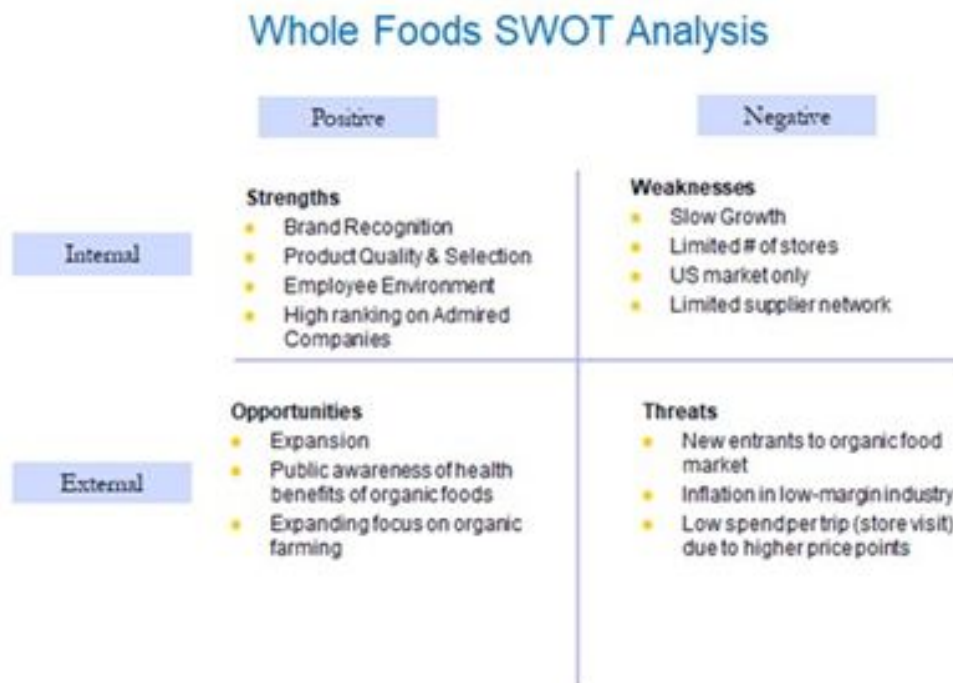
WFM strategy is to compete in selected markets, focusing in on a precise set of target groups, which they believe will position them for profitability.

In utilizing the following grid which maps market targeting with competitive advantages, we see that WFM focuses on a "Focused Differentiation" Strategy:



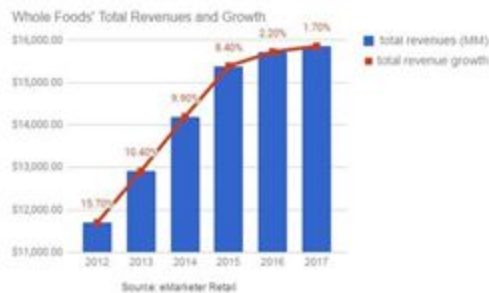
- WFM's Target Market is a Narrow Buyer Segment/Market Niche
- WFM pursues "Focused Differentiation" as its competitive advantage

In performing a SWOT analysis for WFM, we identified the following Strengths, Weaknesses, Opportunities and Threats:



From this analysis, we see that “slow growth” is a weakness, which can be offset through expansion (opportunity).

This “slow growth” issue is confirmed when we looked at their financials on a pre-Amazon merger basis:



On a pre-Amazon acquisition basis (2017), WFM did have some revenue growth, but the growth rate was declining, and revenues were plateauing. Of particular note, the quarterly trends for 2015 -- 2017 dramatically reflect this decline, into the low single digits.

WFM: Customers

WFM customers are a very specific customer base, with high incomes and focused on what they want in food purchases. WFM also has a particular appeal to the large “Baby Boomer” generation, which is becoming more concerned with healthy lifestyles and aging.

WFM’s primary target market is men and women 22 – 40 (leaning more towards a preference for women), who care about the sustainability of the earth and prefer all-natural products. Specifically, consumers who have bought from WFM in 2018 were:

- 55% in the age group 25 – 64
- 60% are college graduates

- 53% have income over \$50K

WFM identifies its customer base into four segments:

- **Foodies:** passionate about food, seeks out selection, value and convenience
- **Organics:** buys organic food to maintain their personal health; food safety is important
- **Experientials:** seeking unique products and special occasion items
- **Conscionables:** support social and environmental initiatives

Other characteristics of the WFM customer base include:

- Urban, high population areas of 200K residents or more
- Aware of how their food is grown and produced
- Loves “organic,” “fair trade,” “sustainability,” “no pesticides” -- but want products convenient in a one-stop location
- Believe eating good food is also “doing good”
- Families, Working Professionals, Mothers

WFM: Competition

Key competitors have included other natural food retailers, such as Trader Joes and Sprouts. WFM is also facing more competition recently from supermarket chains that have started to carry organic and natural foods at lower price margins, attempting to attract WFM clientele. These include Kroger, Albertsons, Safeway, Publix and Walmart.

When examining the various analysis available online in terms of Michael Porter’s Five Competitive Forces, a summary of each market threat is as follows:

Industry Competitors and Substitutes: **High**

Supplier Power: **Medium to High**

Buyer Power: **Low to Medium**

Potential Entrants: **Low**

As supplied by WFM itself, the following circle chart shows how WFM is positioning itself against its strongest competitors and its featured market attributes of Quality & Loyalty, Convenience and In-Store Experience.



WFM also differentiates itself by certifying its food and through stringent high-quality standards. Its supply chain is also unique – relying heavily on specific local (and global) producers that must meet the WFM benchmarks.

II. Identification of an Unfulfilled Market Need and Designing an Offer to Fill It

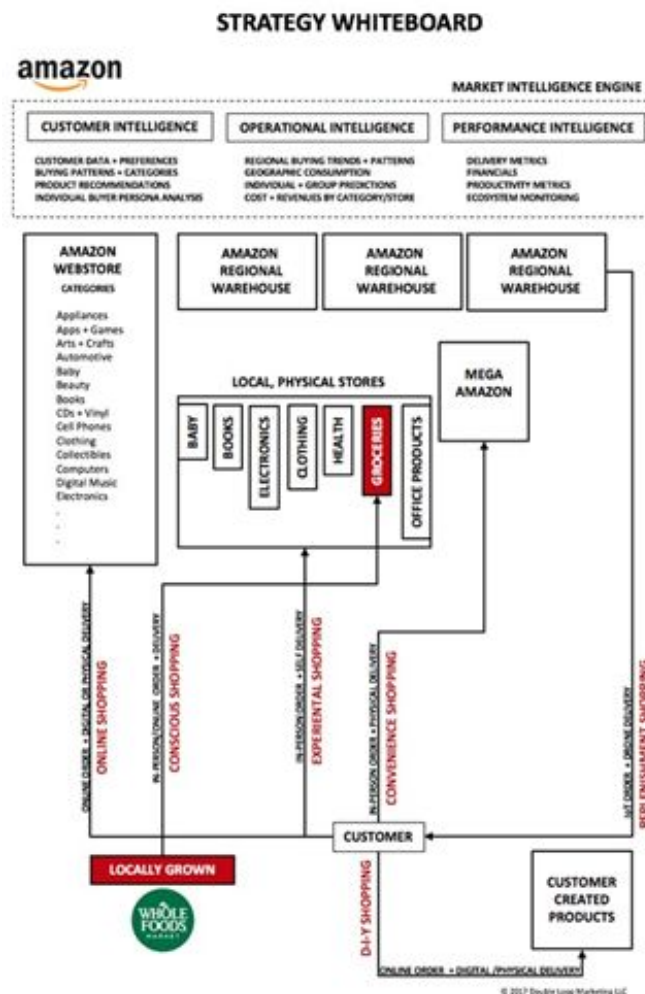
We are recommending that WFM add a new offering to its stores – a WFM Pharmacy -- using “PillPack” as the lead product to introduce this new in-store concept. WFM currently does not have a pharmacy, but now WFM’s owner (Amazon) is in the pharmacy business with Amazon’s purchase of PillPack in 2017.

PillPack operates as an online prescription delivery service. PillPack packages the prescriptions in a unique way, in that they are organized by when and how much the

customer needs to take them, sorting the meds by date and time. Our hypothesis is that this change to both WFM and PillPack would be synergistic, and should help expand both lines of businesses for Amazon.

WFM: Linkage within the Amazon Strategy

The following chart lay out a strategic blueprint of Amazon and its various business units -- identifying the strategic fit for WFM. WFM is part of the Amazon portfolio of “bricks and mortar” stores, as well as an element of the Amazon online presence. WFM “Locally Grown” element matches to Amazon’s “Conscious Shopping” profile.



WFM's strategies are not developed in a vacuum -- they are now part of the Amazon realm and must be aligned with Amazon's strategic direction.

Pharmacy Benefits Manager (PBM)

We are now going to cover a bit about the Pharmacy landscape in the United States. A Pharmacy Benefit Manager (PBM) is a third-party administrator of prescription drug programs for commercial health plans, self-insured employer plans, Medicare Part D plans, the Federal Employees Health Benefits Program, and state government employee plans. The main PBMs are Express Script, CVS Caremark and United Health. Amazon (and WFM) would need to work with PBMs as well as with the manufacturers of pharmaceuticals.

STP (Segmentation, Targeting, Positioning)

Currently Amazon only makes PillPack available online. As such, to introduce it through a new Pharmacy location in WFM retail locations, consumers would need to commute to WFM stores if they were not already WFM customers.

To differentiate against the competition, Pillpack could offer 30 days' supply in store -- and -- if a customer is willing to pick up their prescriptions in the store PillPack would provide them a limited 10 to 15 percent discount for the grocery shopping -- if they were not currently existing WFM customers.

Since current WFM customers view WFM as an organic and healthy place -- not associated with disease and pharmaceuticals -- WFM should brand its new pharmacy with the title of the **Amazon Pharmacy at Whole Foods Market**. In addition, WFM also it has all organic supplements and vitamins offerings, which they can determine to keep separate, or include in the new pharmacy, depending on consumer reaction.

In order to test out this concept, and to utilize some of the tools we learned about in this course, we went ahead and conducted two surveys on this new idea. While certainly

not a perfect testing analysis, it does give us some real-world feedback on what we are proposing.

The primary data has been gathered using two different surveys:

1). We surveyed twelve individuals, that ranged in age from 20 to 60. All of them are currently pharmacy customers of CVS or Walmart. Here is what they told us:

- Age Group 20 -- 30: Three responses. Two would prefer WFM to open a pharmacy. One is currently a WFM customer and one is not (but would be interested in becoming one if WFM did offer the pharmacy and a discount!). The third respondent said No to picking up their prescriptions at WFM.
- Age Group 30 -- 40: Two responses. One preferred WFM to open a pharmacy, and the other was not in favor. Interestingly, both are WFM customers.
- Age Group 40 -- 50: Two would like to WFM to open a pharmacy and are willing to purchase PillPack. Both are WFM customers.
- Age 50 -- 60: Six responses. Two prefer WFM opening a pharmacy and would like to pick up their pill pack. One said maybe and the remaining three said No. Note that none of these six respondents shop at WFM.

2). The other survey was done through the “Next-Door App” for the block of area Independence and Park Blvd in Plano, Texas. This survey was limited as it did not include any demographic questions, but did ask if the respondent was shopping at WFM, would they like WFM to open a pharmacy and offer PillPack? Here are the results:

- Nine respondents said yes, they are WFM shoppers and would like WFM to open a pharmacy.
- Nine other respondents, who were also WFM shoppers, but did not want WFM to open a pharmacy.
- Seven respondents were not WFM shoppers.

Of course these two surveys were interesting to do and a great learning experience, but for our recommendation we also looked at broader sources of research:

- Looking at GlobalData research, 61% of consumers are happy with mail-order service, but many would also like Amazon to have a physical presence for healthcare purchases.

III. Marketing Mix

Product

Core benefits: “The Amazon Pharmacy at Whole Foods Market.” The Pharmacy would use PillPack as its lead product and primary means of packaging its prescriptions. The pharmacy will be designed to serve people who manage multiple medications, with automatic refill with 24/7 customer service, and free shipping if requested.

There are two types of PillPack packaging: recyclable dispenser and premium dispenser:

- Recyclable dispenser: 6" x 6" x 3.25", Made of recyclable cardboard
- Premium dispenser: \$15 and made of molded plastic, durable 6.75" x 6.75" x 3.5," with a travel pouch 5" x 5" x 1"

Packet details (inside the dispenser): fits five medications (up to ten individual pills) in a single packet, but the amount can vary depending on specific medications. If there are more than five medications scheduled for a certain time of day, multiple packets can be included.

PillPack includes a medication list that shows prescription details for every pill in packets, including:

- Prescriber name
- Pill image
- Medication name and strength
- Directions for use

The patient's physician can update the PillPack account with new medications at anytime.

Costs

The detailed costs of setting up a new pharmacy inside one WFM store are shown in the table below, and indicates whether they are fixed, variable or a mix of the two types of costs. The table also includes the cost of producing and selling products per unit. In total, the overall cost of setting up a new pharmacy is \$650K, and producing one PillPack will cost \$11.70. Costs to manufacturing the PillPack are omitted from this table as such costs would be included in the Costs of Goods Sold category (Inventory).

Research and planning	\$ 90,000	Fix
Production of pill pack	\$ 7	Variable (per unit)
Design Store	\$ 38,000	Fix
Layout	\$ 88,000	Fix
Hire employee process	\$ 37,700	Fix
Purchase Inventory and Supplies	\$ 270,000	Fix and variable
IT costs	\$ 30,000	Fix
Marketing and communications for PillPack	\$ 2	Variable
Loss of restaurant sales	\$ 97,000	Fix
Distribution for PillPack	\$ 2.7	Variable

Further description of the cost elements:

- Design Store and Layout costs: store design and layout and modification costs such as relocating merchandise, purchasing and installing new shelves.

- IT costs: incremental expenses for adapting the current IT system with the new products, the accounting and the cashiers.
- Impacts of new space allocation in the store: loss of restaurant sales (as a suggestion) represent the cannibalization costs. The restaurant area will be delivered and used for pharmacy, it will affect the restaurant sales.

Pricing Strategy

Given the characteristics of the WFM shopper, we recommend that with the introduction of “the Amazon Pharmacy at Whole Foods Market,” that WFM adopt a market-based or competition-oriented pricing strategy:

- WFM Pharmacy’s biggest competitor is Walmart, and they are positioned as low to medium quality but affordable in consumer perceptions. Alternatively, consumers think of WFM as high quality, high price.
- Whole Food Shoppers are used to paying more and are less likely to be influenced by coupons or discounts. As such, competitively matching prescription drugs, OTC, and other pharmaceutical offerings to mirror Walmart’s prices will give the illusion of a discount for the WFM shopper. WFM shoppers will not be inclined to pay “Walmart prices” for “Whole Food Quality.”
- With the aging population increasing, particularly the Baby Boomer generation, more and more families are looking for locations where they can do one stop shopping.

With the introduction of the pharmacy and a market-based pricing strategy, WFM should realize new customers and greater revenue. Having a WFM store with the added convenience of having a pharmacy at the same place as their groceries will allow for greater customer accessibility and experience.

Promotion

Currently PillPack uses TV ads, Internet advertisement (such as Facebook banners) and the Amazon website as part of its promotional activities. For the new target customers, the promotion plan should become a bit more flexible and advanced:

- Personal selling: in the WFM retail stores, the sales employees should be very engaged, and promote the product specially for new target.
- Sales force promotion is really important, since the sales employees need to be involved with the in-store customers, WFM needs to motivate them as much as possible. As a consideration, WFM should look to link part of their salaries to revenues from the new Pharmacy as a small commission.
- Push advertisement should also be used, particularly during the growth part of the Product Life Cycle.
- PillPack should still be advertised on TV, in conjunction with other media.
- Amazon Prime members should receive emails about the product and the promotions.

Three important components to consider for advertisement are: content, budget, and approach. At this stage the customers are aware of their needs which is drugs, but they might not have any brand preferences or even ever heard about PillPack. Based on this criteria, the advertising plan should be divided into two major categories: Pre-Launch and Growth Stage, and After Maturity:

- First stage: the budget will have to “set to the objective” which is taking more market share and brand awareness, as well as the heavy sales promotions. The content should be comparable with the top brands in the market.
- Second Stage: will launch with characteristics like competitive advertisement, and mass marketing, and be budgeted on the percentage of sales.

First stage	Second stage
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<ul style="list-style-type: none"> • Budget to objective • Comparative • Heavy promotions 	<ul style="list-style-type: none"> • Budget as a percentage of sale • Competitive • Mass marketing
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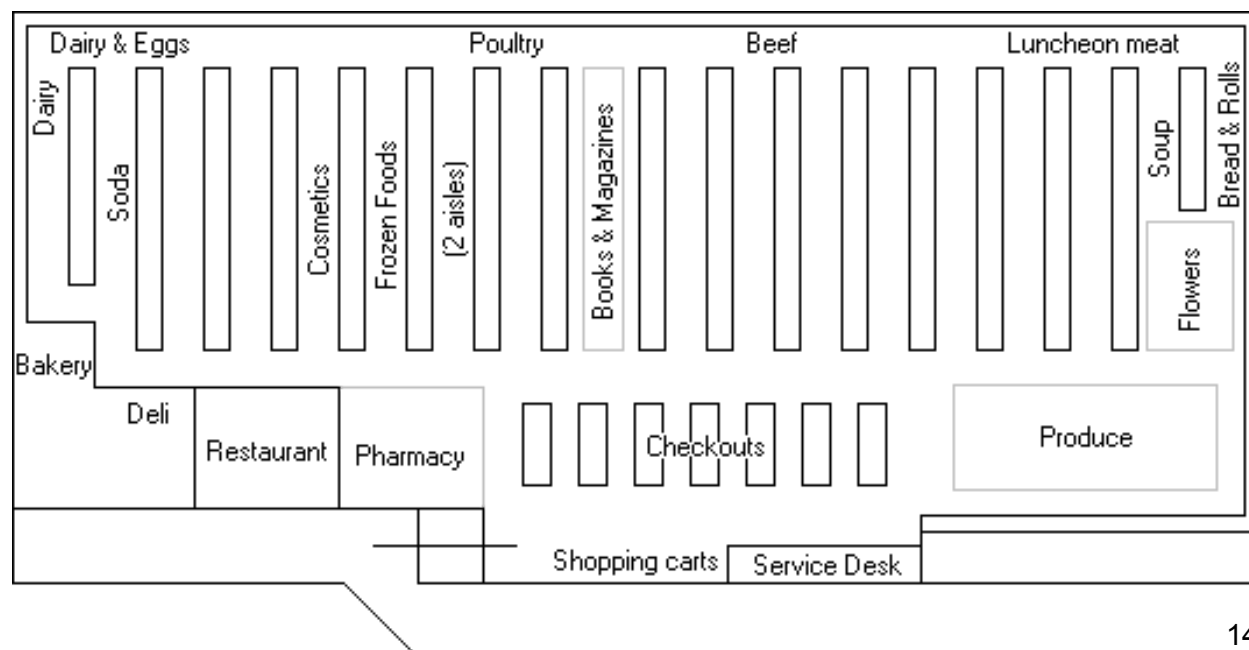
Place

The distribution for PillPack includes two levels, which is the original packaging (which is a durable product and it is expected for customers to buy it once and keep using it), and the monthly refills. Currently both types of PillPack uses the Amazon Prime distribution channel.

We recommend to keep using this distribution channel since free delivery is one of the core advantages of PillPack. To attract new customers, as we are recommending, the PillPack becomes the lead offering for the new pharmacies in the WFM stores.

For the monthly refills, customers can still have their prescriptions delivered to their homes -- or -- they can pick them up at the Amazon Pharmacy at the WFM.

The PillPack distribution system is a vertical corporate distribution system, so there are less things to decide on the retail part of the channel. However, important to mention, is the layout of the store.



Here we see a hypothetical placement of the pharmacy, which suggests minimizing the trade-off changes and the cost of the changes. Of course a more detailed analysis of space utilization would need to be conducted, along with product and SKU profitability in order to determine how to maximize the space trade-off and efficiency.

IV. Break-Even, Profitability and Long-Term Projections and Risks

Break-Even Analysis

For the Break-Even Analysis we used the assumption that the gross margin for prescription and non-prescription drugs was 21.2%. This assumption is based off of the industry average for independent pharmacies in the United States in 2016 (see resource 31). The fixed costs to renovate each store was the \$650K number reached earlier in the paper. We found the break-even sales revenue to be about \$3.1M.

A	B	C
Prescription Drugs Gross Margin	Fixed Cost per Store	Breakeven Analysis in Sales Dollars
21.20%	650,000	\$ 3,066,037.74

Profitability Analysis

For the profitability analysis we first found the percentage of total revenue that the pharmacy section was for Kroger and Albertsons which was 8.67%. We then calculated the average revenue growth of WFM between 2015 to 2017 which was 2.06%. According to WFM annual report their 2017 revenue was \$16M. We then forecasted their revenues for the next seven years at the growth rate of 2.06%. This was necessary

because Amazon no longer reports the independent revenue of WFM in their financial statements. The following were key steps and assumptions we made:

- We assumed that the initial percentage of total revenue for the WFM pharmacy would be 2% of revenue and steadily grow until reaching 7% of total revenue in 2024. We then used the gross margin of 21.2% to calculate gross profit.
- We assumed that net income would be 60% of the gross margin for the project (our best estimation). The number that we used to discount the project's cash flows was 11.25%, which is Amazon's weighted average cost of capital (see Resource 36).
- After discounting the cash flows, we found that the project had a Net Present Value (NPV) of \$54,189,543 and an Internal Rate of Return (IRR) of 17%. This means that the project will generate a profit of \$54 million dollars in 2019 dollars over the course of the five projected years. Additionally, the internal rate of return specifies that in order to break-even on the project the return on investment will have to be 17%.
- Consequently, we believe that the "Amazon Pharmacy at Whole Food Market" should be approved, as it will provide incremental revenue and profits at a very attractive rate of return.
- The amount of revenue generated by sales of the PillPack device itself was excluded because we could not find an accurate or reliable number of customers that frequent WFM. So, we focused on the profits that solely the pharmacy would generate.

	2015	2016	2017	Average
Albertsons	8.60%	8.60%	8.30%	8.50%
Kroger	9%	8.70%	8.80%	8.83%
Average				8.67%

Whole Foods Revenue by Year	2015	2016	2017
	15,389	15,724	16,030
Percentage Change		2.18%	1.95%
Average of % Change	2.06%		

Per Store	Total Stores	Total Renovation Cost
650,000	500	\$ 325,000,000.00

Gross Margin	Revenue Growth		Whole Foods 2017 Revenue	2018 Forecasted	2019 Forecasted
21.20%	2.06%		\$ 16,030,000,000.00	\$ 16,360,218,000.00	\$ 16,697,238,490.80
Industry Pharmacy Revenue Average	8.67%		Pharmacy Revenue		
			New Total Revenue		

2020 F	2021 F	2022 F	2023 F	2024 F
\$ 17,041,201,603.71	\$ 17,392,250,356.75	\$ 17,750,530,714.10	\$ 18,116,191,646.81	\$ 18,489,385,194.73
2% of revenue	4% of revenue	5% of Revenue	6 % of revenue	7% of revenue
\$ 340,824,032.07	\$ 695,690,014.27	\$ 887,526,535.70	\$ 1,086,971,498.81	\$ 1,294,256,963.63
\$ 17,382,025,635.78	\$ 18,087,940,371.02	\$ 18,638,057,249.80	\$ 19,203,163,145.61	\$ 19,783,642,158.36

Year		12/31/19	12/31/20	12/31/21	12/31/22	12/31/23	12/31/24
Revenue			\$ 340,824,032	\$ 695,690,014	\$ 887,526,536	\$ 1,086,971,499	\$ 1,294,256,964
Gross Margin	21.20%		\$ 72,254,694.80	\$ 147,486,283.03	\$ 188,155,625.57	\$ 230,437,957.75	\$ 274,382,476.29
Net Income	60.00% of gross margin						
Cash Flow	\$ (325,000,000.00)	\$ 43,352,816.88	\$ 88,491,769.82	\$ 112,893,375.34	\$ 138,262,774.65	\$ 164,629,485.77	
Amazon WACC	11.25%						
XNPV	\$ 54,189,543						
IRR	17%						

Competitor Reactions

We expect the competitive reaction to WFM establishing pharmacies in its retail stores will be high because of the similarity of the products (identical prescription drugs) and the small amount of national grocery chains with pharmacies (Walmart, Costco, Kroger, etc.).

We believe the most likely reaction for WFM competitors to be that they would create their own version of the PillPack product. The most likely competitor to do so would be

Walmart, since they have the financial resources to do so. Additionally, Walmart was initially in talks to buy PillPack before Amazon made an all cash offer (see Resource 37). If rival firms were to introduce their own version of Pillpack, WFM would lose the competitive advantage that its service provides.

How WFM Responds

We would actually expect to see the competitive response to be not just from WFM, but also from Amazon itself. Amazon would react to rivals introducing their own version of PillPack by combining the service with its Prime two-day shipping. Combining their vast distribution network with the PillPack service should be a synergistic opportunity for Amazon. By doing so, they will combine the convenience of having medications organized for the consumer with the added luxury of expedited shipping.

Plans of Expansion

Looking to the future, there are a few ways that WFM may choose to expand, one of which will be to open new retail WFM stores. WFM has roughly 500 stores, which is quite less than Walmart's 4,769 store locations and Kroger's 2,419 store locations.

Opening new WFM locations will greatly benefit distribution, flow of goods into new locations, and more shoppers will recognize and be aware of the fact that WFM now has an in-store pharmacy.

Ultimately, the expansion of WFM will allow them to compete in areas where consumers may only have access to Walmart or Krogers -- where there could be a concentration of the WFM customers described earlier in this paper.

Planning in the pharmacy in the new store design for WFM should eliminate the need to some of the "retrofitting" costs that would be required for existing WFM stores, as well as avoiding the internal cannibalization impacts,

Another plan of revenue expansion WFM could undertake would be to charge for PillPack. Currently, payment from the consumer side is comprised of an insurance copay + OTC medications/vitamins, and shipping is free. However, if WFM decided to charge a small service fee they could further capitalize on potentially greater profits. Alternatively, if WFM does decide to charge a small service fee, they could offer a discounted rate or waive the fee altogether if they are an Amazon prime member.

Other Risks: Changes in Public Policy

A potential risk that could change the entire landscape of the healthcare field would be the election of a new president that supports Medicare for all.

Pharmacies and hospitals make more money off of private insurance because of their higher reimbursement rates when compared to an individual with Medicare. Private insurers in 2015 on average paid 236% of Medicare rates, and by 2017 that grew to 241% of Medicare rates (White, 2019)¹.

If federal public policy and ensuing regulations changed (i.e., “medicare for all”), it could make offering PillPack dramatically less profitable since individuals who wish to use PillPack for their medication delivery service will now pay co-pays from their Medicare for all plan instead of a privately insured one. Profits from prescription drugs could decline, because of the lower reimbursement rates. In this scenario, WFM (and Amazon) would need to reevaluate its pharmacy strategy. This could include developing countermeasures such as finding new ways to reduce its costs, or potentially exiting this line of business.

¹ “Prices Paid to Hospitals by Private Health Plans Are High Relative to Medicare and Vary Widely” By: Chapin White, Christopher Whaley https://www.rand.org/pubs/research_reports/RR3033.html

Summary

- “Amazon Pharmacy” is a good opportunity for placement in WFM Markets (WFM).
- WFM can better support existing grocery customers and bring in new customers.
- WFM will need to look at what “store space” trade-off will need to be made to fit in this new offering --requires further detailed analysis of product line profitability, customer foot traffic patterns, and space utilization.
- The Amazon Pharmacy can potentially be a bigger opportunity online for Amazon -- but that is another analysis.
- Ultimately, this recommendation is about influencing customer behavior to change how and where they make their pharmacy purchases.

Resources

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