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ECONOMIC TRENDS

The Amazon-Walmart Showdown That Explains the Modern Economy

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With Amazon buying the high-end grocery chain Whole Foods, something retail analysts have known for years is now apparent to everyone: The online retailer is on a collision course with Walmart to try to be the predominant seller of pretty much everything you buy.

Each one is trying to become more like the other — Walmart by investing heavily in its technology, Amazon by opening physical bookstores and now buying physical supermarkets. But this is more than a battle between two business titans. Their rivalry sheds light on the shifting economics of nearly every major industry, replete with winner-take-all effects and huge advantages that accrue to the biggest and best-run organizations, to the detriment of upstarts and second-fiddle players.

That in turn has been a boon for consumers but also has more worrying implications for jobs, wages and inequality.

To understand this epic shift, you can look not just to the grocery business, but also to my closet, and to another retail acquisition announced Friday morning.

Men's dress clothing, mine included, can be a little boring. Like many male office workers, I lean toward clothes that are sharp but not at all showy. Nearly every weekday, I wear a dress shirt that is either light blue, white or has some subtle check pattern, usually paired with slacks and a blazer. The description alone could make a person doze.

I used to buy my dress shirts from a Hong Kong tailor. They fit perfectly, but ordering required an awkward meeting with a visiting salesman in a hotel suite. They took six weeks to arrive, and they cost around $120 each, which adds up fast when you need to buy eight or 10 a year to keep up with wear and tear.

Then several years ago I realized that a company called Bonobos was making shirts that fit me nearly as well, that were often sold three for $220, or $73 each, and that would arrive in two days.

Bonobos became my main shirt provider, at least until recently, when I learned that Amazon was trying to get into the upper-end men's shirt game. The firm's "Buttoned Down" line, offered to Amazon Prime customers, uses high-quality fabric and is a good value at $40 for basic shirts. I bought a few; they don't fit me quite as well as the Bonobos, but I do prefer the stitching.

I'm on the fence as to which company will provide my next shirt order, and a new deal this week makes it a doubly interesting quandary: Walmart is buying Bonobos.

Amazon vs. Walmart

Walmart's move might seem a strange decision. It is not a retailer people typically turn to for $88 summer weight shirts in Ruby Wynwood Plaid or $750 Italian wool suits. Then again, Amazon is best known as a reseller of goods made by others.

Walmart and Amazon have had their sights on each other for years, each aiming to be the dominant seller of goods — however consumers of the future want to buy them. It increasingly looks like that "however" is a hybrid of physical stores and online-ordering channels, and each company is coming at the goal from a different starting point.

Amazon is the dominant player in online sales, and is particularly strong among affluent consumers in major cities. It is now experimenting with physical bookstores and groceries as it looks to broaden its reach.

Walmart has thousands of stores that sell hundreds of billions of dollars' worth of goods. It is particularly strong in suburban and rural areas and among low- and middle-income consumers, but it's playing catch-up with online sales and affluent urbanites.

Why are these two mega-retailers both trying to sell me shirts? The short answer is because they both want to sell everything.

More specifically, Bonobos is known as an innovator in exactly this type of hybrid of online and physical store sales. Its website and online customer service are excellent, and it operates stores in major cities where you can try on garments and order items to be shipped directly. Because all the actual inventory is centralized, the stores themselves can occupy minimal square footage.

So the acquisition may help Walmart build expertise in the very areas where it is trying to gain on Amazon. You can look at the Amazon acquisition of Whole Foods through the same lens. The grocery business has a whole different set of challenges from the types of goods that Amazon has specialized in; you can't store a steak or a banana the way you do books or toys. And people want to be able to make purchases and take them home on the spur of the moment.

Just as Walmart is using Bonobos to get access to higher-end consumers and a more technologically savvy way of selling clothes, Amazon is using Whole Foods to get the expertise and physical presence it takes to sell fresh foods.

But bigger dimensions of the modern economy also come into play.

A Positive Returns-to-Scale World

The apparel business has long been a highly competitive industry in which countless players could find a niche. Any insight that one shirt-maker developed could be rapidly copied by others, and consumer prices reflected the retailer's real estate costs and branding approach as much as anything.

That helps explain why there are thousands of options worldwide for someone who wants a decent-quality men's shirt. In that world, any shirt-maker that tried to get too big rapidly faced diminishing returns. It would have to pay more and more to lease the real estate for far-flung stores, and would have to outbid competitors to hire all the experienced shirt-makers. The expansion wouldn't offer any meaningful cost savings and would entail a lot more headaches trying to manage it all.

But more and more businesses in the modern economy, rather than reflecting those diminishing returns to scale, show positive returns to scale: The biggest companies have a huge advantage over smaller players. That tends to tilt markets toward a handful of players or even a monopoly, rather than an even playing field with countless competitors.

The most extreme example of this would be the software business, where a company can invest bottomless sums in a piece of software, but then sell it to each additional customer for practically nothing. The apparel industry isn't that extreme — the price of making a shirt is still linked to the cost of fabric and the workers to do the stitching — but it is moving in that direction.

And that helps explain why Walmart and Amazon are so eager to put a shirt on my back.

Already, retailers need to figure out how to manage sophisticated supply chains connecting Southeast Asia with stores in big American cities so that they rarely run out of product. They need mobile apps and websites that offer a seamless user experience so that nothing stands between a would-be purchaser and an order.

Larger companies that are good at supply chain management and technology can spread those more-or-less fixed costs around more total sales, enabling them to keep prices lower than a niche player and entrench their advantage.

These positive returns to scale could become even more pronounced. Perhaps in the future, rather than manufacture a bunch of shirts in Indonesia and Malaysia and ship them to the United States to be sold one at a time to urban office workers, a company will have a robot manufacture shirts to my specifications somewhere nearby.

If that's the future of clothing, and quite a few companies are working on just that, apparel will become a landscape of high fixed costs and enormous returns to scale. The handful of companies with the very best shirt-making robots will win the market, and any company that can't afford to develop shirt-making robots, or isn't very good at it, might find itself left in the cold.

What It Means for the Economy

If retail were the only industry becoming more concentrated, it would be one thing. But a relative few winners are taking a disproportionate share of business in a wide range of industries, including banking, airlines and telecommunications. A study by the Obama White House's Council of Economic Advisers found that in 12 of 13 industry sectors, the share of revenue earned by the 50 largest firms rose between 1997 and 2012.

That in turn may help explain why the income gap has widened in recent years. Essentially, the corporate world is bifurcating between winners and losers, with big implications for their workers.

Research by Jae Song of the Social Security administration and four colleagues found that most of the rise of inequality in pay from 1978 to 2013 was because some companies were paying more than others — not because of a wider gap between high-paid and low-paid workers within a company.

"Employees inside winning companies enjoy rising incomes and interesting cognitive challenges," the Stanford economist Nicholas Bloom, one of the co-authors of that paper, wrote recently in Harvard Business Review. "Workers outside this charmed circle experience something quite different."

And David Autor of M.I.T. and four colleagues found in a recent paper that the rise of these "superstar firms" — the big winners in the kind of face-off that Walmart and Amazon are now engaged in — is a likely explanation for the decrease in the share of the overall economic pie that is going to workers.

How much of that is because of shifting technology — as opposed to changing corporate behavior, or loose antitrust policy — is an open debate.

What isn't is this: The decision by Amazon and Walmart to compete for my grocery business — as well as for space in my closet — is a tiny battle in a war to dominate a changing global economy.

And for companies that can't compete on price and technology, it could cost them the shirt off their backs.

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