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Final Case Study: Amazon

Amazon is a retail giant in the e-commerce sector of the economy founded by Jeff Bezos in 1994. Internet usage was growing at 2,300 percent per year, and Bezos saw a massive business opportunity. Initially, Amazon only sold books, but began selling other goods in 1998 after acquiring the Junglee Corporation, which sold a number of goods over the internet. Amazon has gradually expanded into other areas of the e-commerce market since then, and has become the worlds largest online retailer. Amazon employs a broad differentiation strategy, but have focused on being a low cost provider to gain market share and long term profit potential. Amazon sells items from many third party providers, but also has their own offerings. Customers have low cost options, high cost options, and best cost options; allowing Amazon to appeal to a wide swath of customers. Amazon is focused on providing the best customer experience possible, and has been successful as they have been ranked number one in customer satisfaction many years.

Amazon's main strengths are their delivery network, a large base of registered credit cards, successfully offering differentiated products to appeal to a large number of customers, and the ability to pursue a long term strategy over short term profits. Amazon's delivery network is comprised of a set of regional distribution centers that deliver goods to people who ordered from Amazon and live near the center. Amazon places these distribution centers in large metropolitan areas to cut down on delivery costs, and the time it takes to deliver goods to customers. Deals with the United States Postal Service and FedEx, the use of robots within these centers, and predictive algorithms to maintain appropriate inventory levels allow Amazon to keep costs down. In 2012 Amazon purchased Kiva Systems, a company that makes robots used in warehouses, for 775 million dollars (Rusli). Amazon was rapidly expanding their distribution network at the time, because they were advertising their Prime service that allowed customers to receive two day shipping in exchange for a yearly fee. Providing two day delivery required a massive distribution network that is extremely expensive to maintain, and the use of robots can help keep costs down. Amazon also uses predictive algorithms to maintain appropriate inventory levels and pack orders before they are sent in (Kline). This allows Amazon to employ a just-in-time strategy with their inventory, reducing wasted space in their warehouses. Ideally each warehouse will have enough of a good to satisfy all orders between shipments, but no more. Keeping more inventory than necessary decreases efficiency and raises the costs of maintaining each warehouse, and these predictive algorithms help solve those problems.

Amazon's business model gives them a massive advantage over competitors like Walmart, Target, and Costco. Amazon has a massive advantage stemming from their business model as an online only retailer, and from their ability to buy in massive bulk granting them cheaper prices than smaller rivals. Operating as an e-commerce only business cuts costs since Amazon doesn't have to pay for storefronts like physical retailers, and distribution centers aren't subject to taxes. Walmart and other massive retailers take advantage of economies of scale to get similar price advantages from suppliers, but they have the costs associated with both physical storefronts and distribution centers whereas Amazon only has the costs of distribution centers. While large physical retailers have e-commerce operations, they can't match Amazon's prices on their online stores or customers would shop at their physical stores less, making them less profitable. Smaller e-commerce only companies don't have the costs associated with maintaining physical storefronts, but they can't get the same prices from suppliers as Amazon since they buy in much smaller quantities. Amazon's business model is structured such that they have much lower costs than their competitors. Amazon has a massive number of registered credit cards, which makes it more likely customers will shop from Amazon than other competitors. While there is virtually no cost in switching to another online retailer and purchasing from them, customers are less likely to go through the process of registering with a different site when Amazon has competitive prices. Why waste the time. Amazon has successfully differentiated their product line by allowing third party's to sell their goods on the Amazon marketplace, and increasing their own product line with offerings like Amazon Web Service. Amazon also tracks customer purchases, and uses them to recommend products that each particular customer will likely desire. Offering a wide range of products and helping customers find products they desire, increases Amazon's user base giving them more revenue generating opportunities and a larger market share.

Amazon's biggest advantage is their shareholders allowing the company to focus on activities that will be beneficial in the long term instead of short-term profits. Amazon has returned low profits relative to their revenue for most of the company's existence, yet investors continue to give them a premium valuation. In 2014, Amazon was valued by the market at 22 times their reported book value(Roth, CNBC). This allows Amazon to expand their distribution network, enter new geographical markets, and gain market share by charging lower prices than competitors. Competitors both in the e-commerce and physical segments of the retail market have to report profits every quarter or their investors will bail while Amazon does not. This doesn't just give Amazon an advantage, it makes them impossible to compete with; especially in e-commerce. Focusing on long term position has allowed Amazon to develop their distribution network, differentiate their product line, and grow large enough that they benefit from economies of scale when purchasing from suppliers. This has given Amazon a sustained competitive advantage.

Amazon is in a good competitive position, but investors demanding profits increase could throw a wrench in their long term business model. Graham Ruddick argues that many e-commerce retailers struggle to make profits because they spend so much maintaining delivery networks. He says that while delivering goods is very expensive, on a large scale it could become extraordinarily efficient, allowing online retailers to make massive profits. Amazon has been investing heavily in their distribution network in hopes of taking advantage of an economy of scale, whereby the company has so many distribution centers that each delivery costs very little. Expanding their distribution network while charging lower prices has given Amazon small profit margins and is why they have been making little, if any, profit. While investors remain focused on long-term profit potential they could begin demanding the bottom line improve. Amazon would have to stop investing in their distribution network before it becomes efficient, which would lower their long-term profit margins, increase delivery times, and force them to raise prices. Amazon has also had some products flop. Amazon released the Fire phone in 2014, and the product failed to make any impact in the mobile phone market. Amazon is big enough that no single product failure will tank the company, but it could be a sign that the company is spreading itself to thin. Given the company's thin profit margins, more product failures could force investors to start demanding short-term profits. Amazon would not be able to complete their distribution network which would increase shipping costs harming their future profitability.

Amazon clearly has more strengths than weaknesses as is shown by their standing within the e-commerce market. Intra-industry competition provides a moderate force to Amazon. Many online retailers compete with Amazon in niche markets, and together these companies provide a moderately strong competitive force to Amazon. However, Amazon is too big for any company to truly compete with them in the online sector of the retail market. Potential new entrants into the e-commerce market present a significant competitive force to Amazon. The barriers to entering the industry are very small, as new firms only need a website that has the potential to be scaled as traffic to the site increases to enter the industry. While these firms will have a difficult time threatening Amazon's position in the market, increasing competition forces Amazon to cut prices and increase spending on advertising which harms their bottom line. Since it is easy to enter the e-commerce industry, many new firms are entering every month creating a strong competitive pressure on existing firms like Amazon. Amazon's buyers have strong bargaining power because they can shop at any online store or physical retailer that sells the products they want. There is no monetary cost in switching to another seller, just the time spent registering with a different website or going to a store. While some people may choose to shop with Amazon to avoid those activities, they provide little deterrent to customers. Buyers have many options to shop at, and have strong bargaining power when purchasing goods from companies like Amazon. Amazon's suppliers have moderate bargaining power. Amazon purchases inventory from many different suppliers across the globe, and each individual supplier has a good Amazon doesn't or can't produce. Many of these suppliers are the only company that Amazon can purchase a certain good from, which increases their bargaining power dramatically. However, Amazon purchases in such large quantities that it decreases the bargaining power of the supplier, as the supplier would lose a large number of sales if Amazon decides not to purchase their good. These forces balance each other out meaning Amazon's suppliers have moderate bargaining power. Substitute sellers within the retail sector of the economy are physical retailers like Walmart, Target, and Best Buy. These substitute sellers provide a strong competitive force to Amazon, because they offer similar goods at relatively competitive prices. While Amazon has developed their delivery network so they can deliver goods quickly, purchasing from physical retailers allows customers to obtain the good that day. Customers who want a good the same day will likely purchase it from a substitute competitor to Amazon which means Amazon faces strong competitive pressures from these sellers. While Amazon faces strong competition and can be threatened by competitors in niche parts of the e-commerce market, they are too big for any competitor to truly threaten their standing within the market.

Amazon has a number of opportunities they can take advantage of to increase their revenue streams and cut costs moving forward. Due to massive investments, Amazon has small profit margins and should pursue any opportunities to cut costs. Backwards integration, whereby Amazon either produces goods they currently purchase from suppliers or takes over their delivery network, could cut costs. Amazon has been exploring the possibility of creating there own delivery network called “Last Mile”, instead of outsourcing it to UPS and FedEx (Bell). Amazon has been growing faster than UPS and FedEx, and being able to deliver their own packages could save the company money. On the delivery front, Amazon CEO Jeff Bezos has mentioned the possibility of using drones to deliver packages, and the company could always get in on the potential driverless truck market if it comes to fruition. Employee costs would be cut significantly, increasing Amazon’s profits. The e-commerce market has grown quickly in the past decade, and acquiring other e-commerce companies would reduce competition and allow Amazon to expand into new market segments. Purchasing a company increases Amazon’s production capabilities allowing them to backwards integrate certain production activities reducing supply chain costs. While Amazon sells many different goods, acquiring new companies differentiates their product line further which helps them appeal to more customers and gain market share. Opening physical stores could allow Amazon to enter new parts of the retail market. Earlier this year Amazon purchased Whole Foods for $13.7 billion, in hopes of disrupting and revolutionizing the grocery store market. Amazon has a larger distribution network than most grocery stores, and could leverage it to maintain lower costs than the rest of the industry. Offering high quality, organic, food like Whole Foods already does while charging lower prices could differentiate Whole Foods from other grocery stores and generate massive market share increases. Amazon will likely try to automate large parts of Whole Food, which would cut costs and allow them to make lots of money. The last opportunity for Amazon going forward is entry into developing markets like China. As supply chains have been globalized over the past thirty to forty years, massive income and wealth gains have been made by the third world. While consumption in these countries is nowhere near U.S. levels, they do present opportunities for Amazon to expand. If Amazon can complete their distribution network and make it economically efficient they will be able to become one of the most profitable companies ever.

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