

THE IMPACT OF E-COMMERCE INDUSTRY TURMOIL ON AMAZON.COM: A STRATEGIC PERSPECTIVE

Russell Casey - Clayton State University, USA

William Carroll - University of Phoenix, USA

Edited by Faith W. Smalls

Abstract

Internet retailers face intense competition in their quest to gain market share due to the large number of competitors, ease of entry, low switching costs and the strength of existing multi-channel retailers. To survive, it is critical that online retailers create a sustainable competitive advantage in their e-commerce strategy and plan for long-term strategic positioning. The article uses a case study analysis of Amazon.com's strategy to develop an understanding of the e-commerce competitive environment and the importance of building a sustainable competitive environment to create value for the firm, its customers, and its shareholders.

Introduction

Is the Internet a leech that sucks a company's assets dry? Many investors, entrepreneurs, and managers pondered this billion-dollar question as hundreds of dotcoms collapsed over the last two years. Companies, such as Boo.com, Etoys, Onsale, @home, and Webvan, are extinct and many more cling to existence. The dreams of consumers, shareholders and other stakeholders have been shattered. From their inception, these dotcoms were going to revolutionize the world and make investors and managers very rich in the process. These dreams did not materialize as planned. What went wrong?

Internet retailers face intense competition in their fight to gain a share of the \$100 billion market due to the large number of competitors, ease of entry, low switching costs, and the strength of existing multi-channel retailers (e.g., Shop.com). To survive, it is critical that online retailers create a sustainable competitive advantage in their e-commerce strategy and plan for long-term strategic positioning. This article uses a case study analysis of Amazon.com's strategy to develop an understanding of the e-commerce competitive environment and the importance of building a sustainable competitive environment to create value for the firm, its customers, and its shareholders.

Amazon.com Reports a Profitable Year, But is it Enough?

As Amazon.com's CEO, Jeff Bezos, signed his seventh annual letter to shareholders in April 2003, he was firm in his conviction that his long-term approach to offering customers the lowest prices on virtually any product they wanted and providing a quality customer experience was the only strategy that would provide long-term value

for Amazon.com's customers and shareholders. However, analysts dug deeper into the 2003 financial statements and found that every penny of the company's first annual profit came from changes in accounting for international operations and that profit margins had actually fallen below those of brick-and-mortar companies that have greater infrastructure costs.¹ Amazon.com has lucrative partnerships with Target, Toys 'R Us, Circuit City, and Drugstore.com, which generated \$5.2 billion in sales in 2003, compared to \$3.9 billion in 2002. Also, the company posted growing profits in the first two quarters of fiscal year 2004 (Amazon, 2004). However, in spite of the in flow of business, Amazon.com has yet to post a profitable year substantial enough to quiet its critics.

Bezos explains, "Our pricing strategy does not attempt to maximize margin percentages, but instead seeks to drive maximum value for customers and thereby create a much larger bottom line in the long term."² The looming question remains, "Will Amazon.com's low price strategy ever achieve consistent profitability?" It is difficult to predict whether Bezos' strategy will create a competitive advantage and hold up over the long-term to transform Amazon.com into the Wal-Mart of the Web, or watch it fall into the breakdown lane of the information highway. Analysts may have questions, but Amazon.com's customers remain active and loyal.

Company Background/History

An examination of Jeff Bezos' experiences reveals that he is quite the entrepreneur at heart. In 1994, his career had already represented success, power, prestige, and fortune. "...He was the youngest senior vice president in the history of D.E. Shaw, a Wall Street-based investment bank."³ Bezos had heard about a new record-

shattering medium called the Internet that was growing at a rate of 2,300% a year.⁴ After two months and a resignation from D.E. Shaw, Bezos and his wife headed across the country to create a new type of Internet business. Bezos narrowed down his business choices to selling CDs, videos, books, computer hardware and/or software over the Web. Unlike many dotcom entrepreneurs, Bezos conducted market research and found that the book industry was an \$82 billion a year market. He decided to focus his company on the sale of books online. Bezos strategically relocated to Seattle, Washington, the location of Ingram Books, through which Amazon.com continues to conduct 60% of its business.⁵ Bezos explains his decision to sell books:

There are so many of them! There are 1.5 million English language books in print, 3 million books in all languages worldwide. This volume defined the opportunity. Consumers keep demonstrating that they value authoritative selection. The biggest phenomenon in retailing is the big format – the ‘category killer’ – whether it’s selling books, toys, or music. However, the largest physical bookstore in the world has only 175, 000 titles.... With some 4,200 U.S. publishers and the 2 biggest booksellers, Barnes and Noble and Borders Group Inc., accounting for less than 12% of total sales, there aren’t any 800-pound gorillas in book selling.⁶

In July 1995, Amazon.com launched with fanfare as the first mover within the Internet book sales segment and became an instant hit not only with consumers, but also with the media. Bezos utilized the KISS (Keep it simple stupid) principle when creating the site, ensuring that Amazon.com’s Web pages loaded quickly. He made a smart, strategic decision by allowing his customers to post their own book reviews on the Web. According to Business Week⁷, there are some 800,000 book reviews online.

When launching Amazon.com, Bezos knew he had to keep costs down, so he rented a warehouse of only 400 square feet. This was a decision he would later regret. Martin Lindstorm⁸ explained Amazon.com’s first hectic week online. Amazon.com took

\$12,438 worth of orders, but could only fill \$846 worth of books.” This blunder created a potential loss of \$11,592 in orders, not to mention taking the risk of angering consumers by not shipping their books in a reasonable amount of time. Lindstorm explains that, during the second week, “...Amazon.com did place \$14,792 worth of book orders.” Lindstorm⁹ stated, “In the first month of business, Amazon.com shipped books to 45 countries and all 50 states.” This is quite an achievement for a start-up company.

Amazon.com continued to grow until the end of 1996 when the company pulled in only \$16 million dollars in sales.^{10 11} More warehouse space was needed. Amazon.com expanded its shipping facilities to Wilmington, Delaware and into a 93,000 square foot warehouse in Seattle, Washington. In 1998, sales had increased to \$610 million and Amazon.com now was stocking 16 million items.¹² Business was great, revenue per employee was \$392,000, and the company spent \$300 million to construct nine distribution warehouses, including two in Europe.¹³ The investment in warehouse space was prompted by the decision to expand the product line to include merchandise such as toys, CDs, DVDs, computers, software, and videos. An auction feature was also added. Amazon.com sought to produce short-term results and boost revenues, which proved successful in the short-term.

Amazon.com completed its first public offering in May 1997 and Bezos explained his strategy in his 1997 letter to shareholders that he includes with every annual report because it continues to clearly define his vision:

It's all about the long term. We believe that a fundamental measure of our success will be the shareholder value we create over the long term. This value will be a direct result of our ability to extend and solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher

*profitability, greater capital velocity, and correspondingly stronger returns on invested capital.*¹⁴

In 1997, Amazon.com continued its sole offering of books, but Bezos set the stage for future expansion into other e-commerce opportunities in his letter to shareholders. In fact, Bezos uses his 1997 letter to shareholders each year to cement the following investment philosophy:

- Relentless focus on customer
- Long-term over short-term
- Bold investments to capture market leadership
- Spend wisely and maintain a lean culture
- Growth is essential to the business model
- Hire and retain talented and versatile employees

In 1998, Amazon.com demonstrated how the strategy works by expanding its offerings to include music, videos, and gifts, tripling its customer accounts to 6.2 million and increasing revenues by 313% since 1997 to \$610 million. However, the company's outlook for profitability was bleak as the company posted a loss of \$124.5 million.¹⁵ The company used the proceeds from the public offering to strengthen its infrastructure by adding 1,500 employees, doubling its domestic and global distribution capacity with centers in Nevada, the U.K., and Germany, and increasing inventories from \$9 million to \$30 million by the year's end. Bezos explained:

*We're fortunate to benefit from a business model that is cash-favored and capital efficient. As we do not need to build physical stores or stock those stores with inventory, our centralized distribution model has allowed us to build our business to a billion-dollar sales rate with just \$30 million in inventory and \$30 million in net plant and equipment. In 1998, we generated \$31 million in operating cash flow, which more than offset net fixed asset additions of \$28 million.*¹⁶

The picture became cloudier in 1999 when Amazon.com suffered a loss of \$720 million.¹⁷ This was almost six times the loss of 1998! This in a year that, again, saw the company's customer base and revenue double as sales outside the U.S. accounted for 22% of the business and Amazon.com became the top online retailer in Europe.¹⁸ Amazon.com also launched several service expansion initiatives in 1999, including Auctions, zShops, Toys, Consumer Electronics, Home Improvement, Software, Video Games, Payments, and a wireless initiative, Amazon Anywhere. Bezos continued to tout the capital efficiency of the company's business model during 1999, but was asked by a Stanford University student "I have a 100 shares of Amazon.com. What do I own?" A surprised Bezos responded, "What do you own? You own a piece of the leading e-commerce platform."¹⁹

The year 2000 was not much better to Amazon.com or its shareholders with sales of \$2.8 billion.²⁰ Amazon.com shareholders lost 80% of their value in 2000 and 19% alone on June 24, 2000, but even after posting an \$863 million loss, Bezos asserted in his annual letter, "...the company is in a stronger position now than any time in the past." Lehman Brothers analyst, Ravi Suria, disagreed, writing in his June report that in order for Amazon.com to be successful, "it must be able to generate the cash operating profile of a successful retailer...It is essentially this yardstick that we use to analyze the company...and as the rest of this report shows, we find it woefully lacking."²¹ In 2000, Amazon.com launched its co-branded toy and video game store with Toysrus.com, adding to its growing list of strategic partners including drugstore.com, sothebys.com, ashford.com, Audible, and NextCard Inc.

The company was poised for a turnaround in the fourth quarter holiday season of 2001, posting a profit of \$5 million dollars in its first \$1 billion plus quarter. Although international sales jumped 75% and customer accounts serviced grew by 20%, the profit was tempered by the fact that in 2001, Amazon.com paid four cents on every dollar for interest on company debt.²² In response to a 50% decrease in sales in 2001, over the previous year, and increased pressure to slash costs, Amazon.com let go 1,300 employees, or 13% of its workforce, and closed a distribution center and a customer service center in hopes to deliver on Bezos' promise to investors that the company would turn a profit by December 31, 2001.²³ In 2001, the company also reorganized around four business segments: U.S. Books, Music and DVD/Video; U.S. Electronics, Tools and Kitchen; Services; and International, but this structure created additional inter-company transaction and coordination challenges and was dropped in favor of a geographic organization around North American and International segments in 2003.²⁴

Although Amazon.com posted another profitable fourth quarter in 2002, the company demonstrated that it could be profitable outside the busy holiday season with its first off-season profit of \$15.6 million on \$1.13 billion in sales during the 3rd quarter of 2003. The off-season profit helped Amazon.com start to chip away at a long history of losses and dispel the concerns that the company could not turn a profit without the operating efficiencies associated with the seasonal spike in sales.²⁵ Bezos attributed the landmark achievement to a two-year effort to reduce prices and offer free year-round shipping and vowed to continue the strategy at least over the short-term in an analyst teleconference stating "It's not like we've gotten full benefit out of that."²⁶

Evolving from its humble garage beginning in 1994, Amazon.com reported in 2004, that it has customers in all 50 states and more than 150 countries, with distribution facilities in the U.S., including sites in New Castle, Delaware; Coffeyville, Kansas; Campbellsville and Lexington, Kentucky; Fernley, Nevada; Grand Forks, North Dakota; as well as in France, Germany, and the U.K. The company has customer service centers based in the U.S, including locations in Grand Forks, North Dakota; Tacoma, Washington; and Huntington, West Virginia as well as in Germany, Japan and the U.K..²⁷

Evolution of the Business Model and Amazon's First Mover Advantage

Jeff Bezos reinvented the Amazon.com business model several times going from a virtually operated Internet bookseller to a platform provider and Internet department store with warehouses and distribution channels loaded with merchandise ranging from books and DVDs to electronics and jewelry.²⁸ Bezos is particularly proud of the core value propositions he developed for Amazon.com and related this particular customer story:

*Bill Gates laid it out in a magazine interview. He said, 'I buy all my books at Amazon.com because I'm busy and it's convenient. They have a big selection, and they've been reliable.' Those are three of our four core value propositions: convenience, selection, [and] service. The only one he left out is price: we are the broadest discounters in the world in any product category. . . . These value propositions are interrelated, and they all relate to the Web.'*²⁹

From its inception in 1995, Amazon.com has consistently held that offering competitive pricing to its customers is a critical element of its business strategy. However, the company's business model expanded from selling books to Bezos telling us his current vision is offer "...Earth's largest selection and be Earth's most customer

centric company; to build a place where people can come to find and discover anything they might want to buy online.”³⁰

Amazon.com benefited from the first mover advantage by being the first of its kind to offer books online. In December 2000, Amazon.com’s site experienced 67 million unique shoppers compared to Barnes and Noble, the closest online competitor, which only attracted 11 million visitors.³¹ The numbers are skewed because they do not reflect the number of Amazon.com visitors that actually made a purchase, but demonstrate the sheer volume distance between Amazon.com and its nearest multi-channel distributor.

Superior brand recognition resulted from Amazon.com’s first mover advantage. Amazon.com gained first mover advantage by beating Borders.com and Barnes and Noble.com to the Internet. Fifty-two percent of the population recognized Amazon.com by the end of 1998.³² By being the first to the market, Amazon.com gained the following advantages listed in the table below:

1. A well regarded brand name ³³
2. The ability to suggest other products based on previous buying habits ³⁴
3. Amazon.com receives better rates from publishers ³⁵
4. Leading market share in books, CDs, and other items
5. A 19-day inventory turnover compared to 5 months from brick-and-mortar retailers ³⁶
6. Time magazine named Jeff Bezos 1999 Man of the Year ³⁷
7. Repeat customers make up almost 2/3 of Amazon.com’s customer base ³⁸
8. Amazon.com holds the patent on the one-click ordering system ³⁹
9. Amazon.com increased operating income 212% and 58% year-over-year 2002 and 2003, respectively ⁴⁰
10 Amazon.com achieved customer satisfaction score of 88 in 2003, representing the highest score ever earned in an online or offline service industry ⁴¹

There was a common belief in the late 1990s that the first mover to gain customers would win market share and rule the space and this led to wild dotcom

advertising spending evidenced by widely viewed, but expensive 1999 and 2000 Super Bowl advertising by firms anxious to stake their claim. In fact, so much emphasis was placed on first-mover advantage that few were looking at the recipe for Internet commerce success. Although Amazon.com's first mover position gained it an advantage, Porter (2001), dismissed the myth surrounding first-mover advantage as being overrated (2001). Little or no switching costs between online service providers, especially retail, make the first-mover advantage a short-lived strategy. Mellahi and Johnson (2000) studied Amazon.com, and found, like Porter, that the first-mover advantage is easily copied and short lived, especially as it pertains to Amazon.com. First-mover advantage on the Internet is not as important as first thought. The real advantage comes from patented innovations that prevent a competitor from copying the innovation (Mellahi & Johnson, 2000).

The key to a sustainable advantage on the Internet is strategic positioning, which Porter (2001) defines as, "...doing things differently from competitors, in a way that delivers a unique type of value to customers." Offering a different set of features, a different array of products or different logistical arrangements are examples of strategic positioning. Amazon.com has several sustainable competitive advantages (SCAs) that arise from strategic positioning that should contribute to sustained profitability if executed correctly. Amazon.com has patented *one-click* ordering, an SCA that cannot easily be copied or duplicated as Amazon.com holds the patent. Amazon.com's innovation to automatically suggest other items based upon previous purchases has become valuable both to customers and the company. Amazon.com also owns a patent on the Associates program, allowing consumers to have access to online stores from

which it draws royalties. Amazon.com simply handles the transaction processes for these retailers. It can be argued that by allowing the sale of used books on its Web site, Amazon.com has created an SCA by creating a sense of community.

Amazon.com mirrors EBay's business model which aims to create a sense of community, a bond per se, that keeps people coming back to do business. Amazon.com makes it extremely easy for consumers to sell or buy books online. The company handles the payment transaction and then deposits the money, minus the fee, into the seller's bank account. EBay, the Web's most popular and profitable online auction, implemented a similar process. Theoretically, the strategy helps Amazon.com sell more items by allowing a customer with limited funds to purchase more items instantly. This generates repeat customers.

Porter (2001) determined the following:

If average profitability is under pressure in many industries influenced by the Internet, it becomes all the more important for individual companies to set themselves apart from the pack to be more profitable than the average performer. The only way to do so is by achieving a sustainable competitive advantage by operating at a lower cost, by commanding a premium price, or by doing both. Cost and price advantages can be achieved in two ways. One is operational effectiveness...and the other is strategic positioning (p.8).

Porter (2001) defines operational effectiveness as "...doing the same thing your competitors do, but doing them better." Operational effectiveness includes, but is not limited to, employee talent, superior technologies, and management structure (Porter, 2001). Unfortunately, not many Internet companies have been able to create operational effectiveness. Operational effectiveness provides a temporary competitive advantage because, overall, it is not sustainable over time as it can be easily replicated.

Just like selling used books on the Internet, forming co-branding agreements has

helped Amazon.com create a sustainable competitive advantage. Co-branding agreements are long-term contracts (usually 10 years) and guarantee added revenues to Amazon.com for future years. Allowing other retailers from Gap Inc. to Footlocker to sell their merchandise on the Amazon.com site allows the company to enter new markets, like apparel, sporting goods and gourmet foods, where it has little expertise while reducing its inventory and distribution risk.⁴² Co-branding and its Associates program allow Amazon.com to do what it does best, fulfill orders.

There is no mystery behind Bezos' vision for the future of Amazon.com's business model. In April 2004, Amazon.com announced a new retail jewelry category, and Bezos explained to us that "While the average margin in jewelry retailing is approximately 40 % to 50 %, we target substantially lower margins on our jewelry sales, and lower still – about 13 % – on diamond jewelry.... This is in keeping with our strategy of driving growth through low prices."⁴³ In his Spring 2004 speech to shareholders, Bezos confirmed Amazon.com's direction: "There is still a lot of room for category expansion. We have a structural advantage. We intend to have the lowest prices, and we think our business model supports that." Bezos summarized his support for the low price strategy by stating, "Lowering prices is easy. Being able to afford to do so is difficult." Bezos ultimately notes that the practice has "driven sales growth and brought more customers to the company's various online stores."⁴⁴

Marketing

Bezos describes Amazon.com's marketing strategy as one that is designed to, "strengthen and broaden the Amazon.com brand name, increase customer traffic to our websites,

encourage customers to shop in many product categories, promote repeat purchases, and develop incremental product and service revenue opportunities.”⁴⁵ An emphasis is placed on improving the total customer experience through the delivery of personalized Web pages and services, ease of use, selection, availability, free on-time shipping and of course the lowest prices possible.

Amazon.com uses a variety of online and traditional advertising, including sponsored links, e-mail, print media, direct marketing, television, and other offline advertising campaigns to reach customers. Bezos feels that the company’s direct marketing efforts are unique and effective: “I would claim that Amazon.com is one of the few companies that really have put a huge amount of effort into one-to-one marketing with the personalization features on our website.”⁴⁶

Examination of Amazon.com’s annual reports reveals that Amazon.com spends about 24 cents for every dollar of profit on advertising alone. Industry reports show that brick-and-mortar competitors, who have the advantage of a visual reminder of their existence, spend only four cents per every dollar of profit.⁴⁷ Therefore, for every dollar Amazon.com receives, it must spend 24% of it to attain one customer. This is not considering the overhead costs associated with warehousing such as labor, utilities, and taxes. An online business must advertise to ensure its survival. Although Amazon.com expects absolute dollars spent on advertising to increase in 2004, the company has successfully cut ineffective programs and clamped down on advertising as a percentage of net sales over the past 5 years dropping costs from \$166 million or 10% of sales in 1999 to \$123 million, or 2% of sales, in 2003.⁴⁸

Alliances and Partnerships

Amazon.com has entered into several contractual agreements to differentiate its site and provide an ever-growing variety of products. In order to find some way to offset low margins and to generate much needed revenue, Amazon.com entered into co-branding agreements with major chains such as Target, Circuit City, and Toys 'R Us, the first such contractor. In the agreement, Toys "R" Us contracted to pay Amazon \$50 million a year for 10 years for the exclusivity provision, as well as a percentage of its sales on the Amazon.com site. According to the Henershots,⁴⁹ "In this model the traditional retailer becomes mainly a merchandiser that pays Amazon.com both to offer their products on the Amazon.com site and to fill orders using Amazon.com's warehouses and fulfillment system." According to Warner,⁵⁰ the co-branding agreements will prove to be a successful venture, as "Amazon.com will run all or part of their e-commerce operations. It will sell the retailers' products on Amazon.com and, in some cases; it will warehouse products, distribute orders, and run the partner's website." This creates a win-win situation for both companies. Amazon.com benefits because it receives a much needed infusion of cash, and the retailer benefits from Amazon.com's ability to distribute products. Product margins for these co-branding agreements are as high as 60%⁵¹ and provide much needed revenue streams.

Amazon.com also utilizes its Associates program to expand its market beyond its own Web site and concentrate on its strength of order fulfillment and distribution. Bezos noted:

Our Associates program directs customers to our websites by enabling associated websites to make our products available to their audiences with fulfillment

*performed by us. In addition, we offer an everyday free shipping option at www.amazon.com and www.amazon.ca for certain orders that exceed a specific amount, and offer similar options for our internationally focused websites. Although marketing expenses do not include our free shipping offers or promotional offers, we view such offers as an effective marketing tool.*⁵²

At Amazon.com's 2004 shareholder meeting, Bezos outlined his plan to continue to help other retailers implement and run e-commerce sites and stated, "You can ask yourself: Are you giving away the keys to the kingdom? "But the online e-commerce world could be so big that it is not a winner-take-all situation."⁵³ However, in late May of 2004, Toys "R" Us brought a lawsuit against Amazon.com, alleging that Amazon.com allowed competitors to sell products on the site that are exclusive to Toys "R" Us. Seeking to terminate the agreement, or collect \$200 million in returned fees, Toys "R" Us threatens a critical revenue element, but Amazon.com contended that the suit held no merit and that it may sell certain products as long as they are not placed in direct competition with Toys "R" Us.⁵⁴ Although Amazon.com later launched a \$750 million countersuit seeking dissolution of the contract, the firms entered mediation to iron out theory differences because they need each other.⁵⁵ The spat only illuminates the fragility of the advantage offered by these agreements, the competitive atmosphere among retailers, and the potential restrictions co-branding can place on product offerings and category expansion.

Financial Performance

Bezos' view on financial performance went against common wisdom in 1997 when he described his position on profitability:

We are not profitable. We could be. It would be the easiest thing in the world to be profitable. It would also be the dumbest. We are taking what might be profits

*and reinvesting them in the future of the business. It would literally be the stupidest decision any management team could make, to make Amazon.com profitable right now.*⁵⁶

In 2001, Amazon.com's CEO stated that, "People had higher expectations for the next couple of years than are likely to be realized ...And people have much lower expectations for the next couple of years than are likely to be realized over the next 10 years."⁵⁷ However, Bezos continues to stand by his original statement to shareholders, stressing "It's all about the long term"⁵⁸ and has changed his position little in his outlook for 2004 when he stated "Worldwide adoption of our everyday free shipping reached another record high point this quarter.... While free shipping is expensive for the Company, it saves our customers tens of millions of dollars each quarter, and we plan to keep it in place indefinitely."⁵⁹

Shop.org's annual report states that there are two primary drivers of profitability in offline, online and catalog retailing: 1) the margins the retailer can earn and 2) the frequency at which they can turn over inventory.⁶⁰ Although traditional retailers earn a 40% margin, they usually only turn over inventory 3 times a year for a 120% return on capital, but even at a 5% gross margin an Internet company like Amazon.com that averages a 20% margin and 18 times inventory turnover can achieve a similar return.⁶¹

Bezos is the first to admit that the 212% and 58% increases in year-over-year operating income in 2002 and 2003, respectively, were primarily due to drastic price reductions and free shipping offers during those years,⁶² but stresses that the company is able to support these pricing strategies due to the primarily fixed costs of providing the customer experience and aggressive management of costs through reducing process defects. Amazon.com squeezes profitability out of its business model every time it

slashes prices and offers free shipping. Although analysts worry about the impact of continuing price reductions to profitability, they generally agree that fixed-cost management and the contribution of high-margin third-party sales offset the loss from price reductions. But they also question whether increased demand created by free shipping offers is offsetting the \$43 million cost of providing them in the first quarter of 2004.⁶³ Industry analysts suggest in their review of Amazon.com's first quarter of 2004 that the massive incremental price cuts and free shipping offers during 2001 and 2002, and the absence of further price reductions during 2003, signal that Amazon.com has run out of options to reduce prices and still remain profitable.⁶⁴ Has Amazon.com's first-mover and low cost advantage started to wear thin?

Industry & Competitive Landscape

Industry analysts assert that the greatest challenge facing e-tailers is the ability for consumers to click from one site to another in search of the lowest price. Only 10 years ago, finding the best price for a book or movie meant driving from store to store. However, now buyers can go online and compare prices for new and used books on at least 10 different Web sites. This one characteristic of the Internet retail industry exemplifies the challenge facing Amazon.com and demonstrates the threat of all five competitive forces identified by Porter⁶⁵: 1) the entry of new competitors; 2) the threat of substitutes; 3) the bargaining power of buyers; 4) the bargaining power of suppliers; and 5) the rivalry among the existing competitors.

The Internet - Revolutionizing Retailing?

With the launch of Etoys.com, many analysts predicted the demise of Toys ‘R Us. Brick- and-mortar companies were in serious trouble. No longer would people travel to stores to buy items. Consumers could save time by doing it online. Sensing the threat, brick-and-mortar stores countered immediately by creating their own online stores. The Internet competition, causing competitors to fervently vie for a piece of the market share, recklessly launched companies to get first-mover advantage without the benefit of strong business plans and target market research. This mad rush set off a chain of events within the stock market and brick-and mortar-companies. Forced to invest billions of dollars to ward off the competition, brick-and-mortar companies were left dumbfounded by the astronomical amount of money required to operate an Internet company.

The Spring of 2000, marked the demise of many dotcom retailers when the stock market corrected and investors and venture capitalists began to demand profits from many firms that either lacked a viable business model, had questionable profit potential, poor cash management practices, or lacked expertise in running a dotcom enterprise.⁶⁶ The information superhighway is lined with the more than 500 dotcom retailers that failed during 2000 and 2001 with names like eToys, Pets.com, Garden.com, Living.com, ValueAmerica.com, and Mortgage.com. However, there were some survivors that typically either had offline retail experience, or were able to generate enough revenue to weather the storm.⁶⁷ The Boston Consulting Group (BCG), in 2000, analyzed 109 E-commerce failures and found six factors that helped predict these failures: (Krantz, 2000)

Reason	Number of companies*
Poor revenue, cost, and profit model	59
No competitive advantage	55
Lack of benefit to consumers	34
Problems in organization and execution	15
Ineffective warehouse management And fulfillment	8
Firm's Web site conflicted with existing business partners	6
*Note: for some companies, failure was Attributed to more than one reason	Source: Boston Consulting Group, 2001

The 2003 Forrester State of Retailing Online Report⁶⁸ summarizes the current market environment:

1. Online retailing has grown from a \$13 billion upstart distribution channel in 1998 to a bustling \$96 billion marketplace in 2003
2. 1999 signaled a shift in market share as many of the purely Web based dotcom retailers went out of business in 1999 and 2000.
3. Multi-channel retailers with both online and physical presence accounted for 72 percent of online sales and dominated the market in 2003.
4. Multi-channel retailer dominance comes from their ability to leverage existing brand, marketing and physical presence, and from consumers using multiple channels to research, purchase and gain delivery on their purchases.

Consumers in general are becoming much more comfortable shopping and buying online and Nielson/NetRatings reports⁶⁹ that the global average for time spent online rose 13% in 2002 over 2001 and that the overall number of global, at-home Internet users grew by 18% in the same period. Half of the 60 million consumers in Europe who have an Internet connection bought products offline after having investigated prices and details

online.⁷⁰ The 2002 Shop.org/BizRate.com online holiday mood study found that 49 % of online consumers claimed an increased level of online shopping during the holiday season and 84 % were “somewhat” or “very” satisfied with their online experience.⁷¹ Although many consumers still have a fear of having their credit card information stolen online and media attention to hackers and viruses has dampened enthusiasm for purchasing over the Internet, consumers are becoming more comfortable making online purchases with stores they already know and trust from their offline shopping experiences.⁷²

There are four primary factors that contribute to the success of multi-channel retailers: 1) improved operating margins, 2) falling marketing costs, 3) a drop in customer service and fulfillment costs, and 4) increased integration and tracking between online and offline channels.⁷³ Catalog-based retailers utilized their existing direct marketing infrastructures to raise operating margins from 6% in 2001 to 22% in 2002 and store-based retailers were able to leverage their offline resources to reduce cost of goods sold from 65% of sales in 2001 to 40% in 2002. However, purely Web-based retailers achieved falling average margins of 16% in 2002, due primarily to high marketing costs associated with competing against multi-channel retailers that could rely upon existing brand recognition, customers, and their offline advertising campaigns and presence. The future of online retailing continues to point to the advantages of multi-channel retailers' ability to further cut costs through increased integration of offline and online staffing and marketing activities, while also further blending the offline and online shopping experiences by capitalizing on consumers' multi-channel shopping behaviors.⁷⁴ Where

do pure Internet retailers gain a competitive advantage when faced with the competitive strength of the multi-channel retailers?

Competitive Environment

Jeff Bezos detailed the competitive landscape in a 2004 statement to shareholders:

*We believe that the principal competitive factors in our market segments include selection, price, availability, convenience, information, discovery, brand recognition, personalized services, accessibility, customer service, reliability, speed of fulfillment, ease of use, and ability to adapt to changing conditions, as well as our customers' overall trust in the entire experience in transactions with us or facilitated by us on behalf of third-party sellers.*⁷⁵

The environment for Amazon.com's products and services is intensely competitive and includes 1) offline retailers, catalog retailers, publishers with significant brand awareness, sales volume, and customer bases, many of which also operate Internet sales channels; 2) other online e-commerce sites; and 3) Web portals and search engines that conduct e-commerce, or collaborate with other retailers.⁷⁶

Competition in the e-commerce sector will only intensify as consumers "poach value" by surfing multiple retail channels to research and find the lowest price for goods and services.⁷⁷ Other companies in the retail and e-commerce service industries may enter into business combinations or alliances that strengthen their competitive positions. Examples of companies making inroads would be Wal-Mart's first venture into the top 50 retail sites, Google's new Froogle shopping site, and the 8% increase in AOL's proprietary shopping channel traffic to almost 12 million unique visitors during 2000.⁷⁸ Additionally, most Web shoppers are also store customers. Ninety percent of its online customers also shop in a Wal-Mart store at least once a month, and 36% visit 6 times a month.⁷⁹

Even Microsoft is gearing up its research and development machine to develop a world-class desktop search engine, hinting to a coming conflict among search engines and pure online shopping malls as the primary consumer approach to online shopping.⁸⁰

Amazon.com's CEO summarized the competitive landscape in a 2004 speech:

*As various Internet market segments obtain large, loyal customer bases, participants in those segments may expand into the market segments in which we operate. In addition, new and expanded Web technologies may further intensify the competitive nature of online retail. The nature of the Internet as an electronic marketplace facilitates competitive entry and comparison shopping and renders it inherently more competitive than conventional retailing formats. This increased competition may reduce our sales, operating profits, or both.*⁸¹

Conclusion

When looking at one's Internet strategy, or creating an Internet business, two things are vital to even having a chance of survival on the Web. One is creating an SCA that will give a business enough time to build customer loyalty and profits. The second is positioning. If a company creates a competitive advantage, it must continue to improve upon that strategy. A competitive advantage is a living, breathing entity. To maintain a sustainable competitive advantage requires constant nurturing and encouragement to grow and adapt to its environment. This concept is no different from companies that establish a sustainable competitive advantage and then permit, through inaction, corporate environmental factors to destroy it.

The goal when launching an Internet company is to try not to differentiate on price since information on the Internet flows freely, making the consumer highly educated about costs of products and services compared to competitors. Internet companies, as well as brick-and-mortar companies will have to be aware of this, or they may end up dotcom failure statistics. Is the Internet a leech that sucks a company dry?

The answer is no. The real cause lies in the managers, investors, and entrepreneurs that attempt grow too fast and who, unreasonably, believe the Internet medium is going to grow at unbelievable rates. Most importantly, the business models of failed dotcoms lacked any chance of making money. Amazon.com has a chance to make it, but it will need to return to its core competencies and to do what it does best—delivering books, warehousing, and product distribution. If Amazon.com does not proceed with caution, will it become yet another failed dotcom?

References

- ¹ Stires, D. (2004) Amazon's secret. *Fortune*. 149(8). P. 144.
- ² Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>.
- ³ Kotha, S. (1998, April). Competing on the Internet: The case of Amazon.com [Electronic version]. *European Management Journal*, 16(2), 212-222.
- ⁴ Kotha, S. (1998, April). Competing on the Internet: The case of Amazon.com [Electronic version]. *European Management Journal*, 16(2), 212-222.
- ⁵ Saunders, R. (1999). *Business the Amazon.com Way: Secrets to the world's most astonishing web business*. Dover, NH: Capstone US.
- ⁶ Kotha, S. (1998, April). Competing on the Internet: The case of Amazon.com [Electronic version]. *European Management Journal*, 16(2), 212-222.
- ⁷ Hof, R.D., Neuborne, E. & Green, H. (1998, December 10). Amazon.com: the wild world of e-commerce. *Business Week*, 3608, 106-14.
- ⁸ Lindstrom, M (2001). Shhh! The e-tailing infant comes of age. Retrieved January 20, 2002 From <http://www.dualBoo.com/cbb/ch1/EtailingNow>.
- ⁹ Lindstrom, M (2001). Shhh! The e-tailing infant comes of age. Retrieved January 20, 2002 From <http://www.dualBoo.com/cbb/ch1/EtailingNow>
- ¹⁰ Lindstrom, M (2001). Shhh! The e-tailing infant comes of age. Retrieved January 20, 2002 From <http://www.dualBoo.com/cbb/ch1/EtailingNow>.
- ¹¹ Hof, R.D., Neuborne, E. & Green, H. (1998, December 10). Amazon.com: the wild world of e-commerce. *Business Week*, 3608, 106-14.
- ¹² eBay vs. Amazon.com [Electronic version]. (1999, May 31). *Business Week*, 128.
- ¹³ eBay vs. Amazon.com [Electronic version]. (1999, May 31). *Business Week*, 128.
- ¹⁴ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>.
- ¹⁵ eBay vs. Amazon.com [Electronic version]. (1999, May 31). *Business Week*, 128.

-
- ¹⁶ Annual Report. (1998). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>.
- ¹⁷ Loomis, C.J. & Watson, N. (2000, May 1). Amazon.com [Electronic version]. *Fortune*.
- ¹⁸ Annual Report. (1999). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>
- ¹⁹ Annual Report. (1999). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>
- ²⁰ Mandel, M.J., Hof, R.D., Himelstein, L., Foust, D., Muller, J. (2001). Rethinking the internet.
- ²¹ Morgenson, G. Analysts talk and Amazon.com shares reel. *New York Times*. June 24, 2000. pg. C1.
- ²² Lashinsky, A. (2002, January 23). Amazon.com is Still No Wal-Mart. *Business 2.0*. Retrieved August 19, 2002, from <http://www.business2.com/articles>
- ²³ Hof, R.D. (2001) Amazon's go-go growth? Gone. *Business Week*. 3719.
- ²⁴ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>
- ²⁵ Wingfield, N. (2004). Leading the news: Amazon reports annual net profit for the first time. *Wall Street Journal*. January, 28, 2004
- ²⁶ Wingfield, N. (2004). Leading the news: Amazon reports annual net profit for the first time. *Wall Street Journal*. January, 28, 2004
- ²⁷ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>
- ²⁸ Wingfield, N. (2004). Amazon goes for gold with discount jewelry. *Wall Street Journal*. April 22, 2004.
- ²⁹ Kotha, R., Rindova, V. (2001). Accumulating reputation through strategic action flows: lessons from Amazon.com and its competitors in internet retailing. *UW Business School Working Paper*. [http://us.badm.washington.edu/kotha/Papers/repstock-1001\[2\].pdf](http://us.badm.washington.edu/kotha/Papers/repstock-1001[2].pdf)

-
- ³⁰ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>
- ³¹ Nielsen/NetRatings (2002). Nielsen/NetRatings finds string global growth in monthly internet sessions and time spent online between April 2001 and April 2002. *Nielsen/NetRatings*. June 10, 2002. http://www.nielsen-NetRatings.com/pr/pr_020610_global.pdf
- ³² eBay vs. Amazon.com [Electronic version]. (1999, May 31). *Business Week*, 128.
- ³³ Mellahi, K. & Johnson, M. (2000). Does it pay to be a first mover in e-commerce: The case of Amazon.com. *Management Decision*, 38(7), 445-452.
- ³⁴ Mellahi, K. & Johnson, M. (2000). Does it pay to be a first mover in e-commerce: The case of Amazon.com. *Management Decision*, 38(7), 445-452.
- ³⁵ Mellahi, K. & Johnson, M. (2000). Does it pay to be a first mover in e-commerce: The case of Amazon.com. *Management Decision*, 38(7), 445-452.
- ³⁶ Hof, R.D., Neuborne, E. & Green, H. (1998, December 10). Amazon.com: the wild world of e-commerce. *Business Week*, 3608, 106-14.
- ³⁷ Ramo, J.C. (1999, December 27). Jeffrey Preston Bezos: 1999 Person of the Year. The fast-moving Internet economy has a jungle of competitors... and here's the king [Electronic version]. *Time*, 154(26), 50.
- ³⁸ Mellahi, K. & Johnson, M. (2000). Does it pay to be a first mover in e-commerce: The case of Amazon.com. *Management Decision*, 38(7), 445-452.
- ³⁹ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>
- ⁴⁰ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>
- ⁴¹ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>
- ⁴² Wingfield, N. (2004). Leading the news: Amazon reports annual net profit for the first time. *Wall Street Journal*. January, 28, 2004
- ⁴³ Foster, L. (2004). Toys R Us files Amazon lawsuit. *Financial Times*. May 24, 2004.
- ⁴⁴ Cook, J. (2004). Call him bargain barrel Bezos; look out, Wal-Mart: Amazon.com intends to slash prices on, well, everything. *Seattle Post – Intelligencer*. May 26, 2004.

- ⁴⁵ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>
- ⁴⁶ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>
- ⁴⁷ Hof, R.D., Neuborne, E. & Green, H. (1998, December 10). Amazon.com: the wild world of e-commerce. *Business Week*, 3608, 106-14.
- ⁴⁸ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>
- ⁴⁹ Hendershott, P., Hendershoot, R.J. & Hendershott, T.J. (2001, Spring). The future of virtual malls [Electronic version]. *Real Estate Finance*, 18(1), 25-32.
- ⁵⁰ Warner, M. (2001, November 26). Can Amazon.com be saved [Electronic version]? *Fortune*, 144(11), 156-158.
- ⁵¹ Amazon.com: 'we've never said we had to do it all' [Electronic version]. (2001, October 15).
- ⁵² Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>.
- ⁵³ Cook, J. (2004). Call him bargain barrel Bezos; look out, Wal-Mart: Amazon.com intends to slash prices on, well, everything. *Seattle Post – Intelligencer*. May 26, 2004.
- ⁵⁴ Foster, L. (2004). Toys R Us files Amazon lawsuit. *Financial Times*. May 24, 2004.
- ⁵⁵ Desjardins, D (2004). Toys "R" Us, Amazon, take conflict to court. *DSN Retailing Today*. 43(14). P. 1.
- ⁵⁶ Shankar, V. (1997). Payoff still elusive in Internet. *The New York Times*. January 2. P. 17.
- ⁵⁷ Mandel, M.J., Hof, R.D., Himelstein, L., Foust, D., Muller, J. (2001). Rethinking the internet.
- ⁵⁸ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>
- ⁵⁹ Q2 2004 Financial Results. (2004). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-otherreports>

-
- ⁶⁰ Christensen, C.M., Tedlow, R.S. Patterns of disruption in retailing. *Harvard Business Review*. 78(1).
- ⁶¹ Christensen, C.M., Tedlow, R.S. Patterns of disruption in retailing. *Harvard Business Review*. 78(1).
- ⁶² Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>.
- ⁶³ Rowen, M.J., Landwehr, A., Wickland, A.S. (2004). Amazon.com: First quarter 2004 review. *Prudential Equity Group LLC. Research*. May 11, 2004.
- ⁶⁴ Rowen, M.J., Landwehr, A., Wickland, A.S. (2004). Amazon.com: First quarter 2004 review. *Prudential Equity Group LLC. Research*. May 11, 2004.
- ⁶⁵ Porter, M.E. (1980). *Competitive Strategy*. New York: Free Press.
- ⁶⁶ Mahajan, V., Srinivasan, R. (2002). The dot.com retail failures of 2000: were there any winners? *Academic of Marketing Science Journal*. 30 (4). p. 474.
- ⁶⁷ Mahajan, V., Srinivasan, R. (2002). The dot.com retail failures of 2000: were there any winners? *Academic of Marketing Science Journal*. 30 (4). p. 474.
- ⁶⁸ Shop.org (2003). The State of Retailing Online. *Forrester Research*.
- ⁶⁹ Nielsen/NetRatings (2002). Nielsen/NetRatings finds string global growth in monthly internet sessions and time spent online between April 2001 and April 2002. *Nielsen/NetRatings*. June 10, 2002. http://www.nielsen-NetRatings.com/pr/pr_020610_global.pdf
- ⁷⁰ Markillie, P. (2004). A perfect market. *Economist*. 371(8375).
- ⁷¹ Azoulay, J.F. (2003). Shop.org forum addresses multi-channel retailing. *Apparel Magazine*. 44(8).
- ⁷² Shop.org (2003). The State of Retailing Online. *Forrester Research*.
- ⁷³ Shop.org (2003). The State of Retailing Online. *Forrester Research*.
- ⁷⁴ Shop.org (2003). The State of Retailing Online. *Forrester Research*.
- ⁷⁵ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>
- ⁷⁶ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>

- ⁷⁷ Nunes, P.F, Cespedes, F.V. (2003) The customer has escaped. *Harvard Business Review*. 81(1). p96-106.
- ⁷⁸ Wingfield, N. (2004). Google: the IPO: Google partnerships may hurt online rivals; large internet firms rely on search-engine ad links and risk customer loyalty. *Wall Street Journal*. April 30, 2004.
- ⁷⁹ Zimmerman, A. (2003). Wal-Mart revamps web site to appeal to holiday shoppers. *Wall Street Journal*. October 29, 2003. pg B3.
- ⁸⁰ Peterson, K. (2004). Google aims to beef up in areas traditionally dominated by Yahoo!, MSN. *Knight Ridder Tribune Business News*. May 3, 2004. pg. 1.
- ⁸¹ Annual Report. (2003). Amazon.com Company website. <http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-annualreports>