NBA 600: Day 11
Retail on the Web
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Daniel Huttenlocher
Today’s Class

- Second short paper on IT as differentiator versus necessary cost in retailing
- Main topic: Amazon.com
  - Some early history
  - Discussion of new directions
  - Commonalities/differences with other IT leaders
- Third short paper assignment
Inventory is largest cost in retail industry
- IT clearly important in reducing inventory levels, increasing turnover
- IT has quickly become necessary cost
  • But providing more benefits to largest retailers, possibly giving them advantage

Level of IT investment alone not enough
- Starting from the business goals and identifying where IT helps achieve those goals
  • Particularly where can lower costs
  • E.g., WalMart vs. KMart
Second Short Paper

- Increased expectations of consumers about availability and convenience
  - Low tolerance for empty shelves
- More opportunity for differentiation with customers than with inventory
  - E.g., Target aiming for higher value by spotting trends, modeling customers
- Identifying process bottlenecks important in successful IT deployment
  - Only as good as weakest link
    - Often misalignment of IT and human capital
E-Commerce: Amazon.com

- Launched in July 1995 with two goals
  - World’s largest selection of books
    - High value given large number of titles
  - Convenience that delights the customer

- Now a broad-based online retailer
  - Core business BMV (books-music-video)
  - Sales of $3.9B in 2002; Q4 up 33% y-o-y
    - Company predicted 15% sales growth in 2003
  - Sales of $5.3B in 2003 up 34%; Q4 up 28%
    - Company predicts 16% growth for 2004
  - Third party sales 22% in Q3, up from 17%
What Amazon Provides

- Online storefront – user experience
  - For own stores as well as partners and Marketplace merchants
  - Extensive focus on user experience
    • Driven many innovations, adopted others
    • Total interaction up to receipt of goods

- Payment processing

- Fulfillment
  - Via own warehouses and partnerships with distributors
  - Close ties with shippers (UPS, Fedex)
Amazon Dominates Online Retail

- In addition to own site, operates sites for many retailers
  - E.g., Toys-R-Us, Borders, CDNow, Target
    - Many retailers have completely outsourced their online presence to Amazon
    - E.g., Target started with just front-end but switched to complete solution
      - Only bright spot for Toys-R-Us in 2003
- Sales partnerships with about 50 other large merchants
  - E.g., Gap, Office Depot, Eddie Bauer, Circuit City, Nordstrom
How Amazon Got There

- Relentless focus on its two main goals
  - Selection and convenience
- Required a certain scale of business to provide selection profitably
  - In early years pursued growth necessary to achieve that scale
  - Did not scale business at expense of convenience (delighting the customer)
  - Grew quickly but leveled off after 2000
    - Sales growth to $2.76B from $1.64B in 1999
    - Next wave of growth largely from partnerships
What Others Missed

- Many saw Amazon’s focus as being growth
  - It was not; selection and convenience were
  - Mistakenly pursued growth at any cost

- Buy.com focus on “lowest prices on earth”
  - At cost of horrible customer service
    - Hard to recover from bad reputation
  - Focus on price without operational means to deliver it profitably

- Pets.com sales at below cost of goods
  - Low value goods with high shipping costs
    - Amazon did invest in it though
Amazon Did Lose Billions

- Scaling while providing a delightful user experience was expensive
  - Losses due to acquisitions, capital investments and operational inefficiencies
    - Rather than cost of goods
    - All could, in principle, be controlled over time
- Amazon did not engage in destructive focus on price
  - Price leader relative to other channels, not other Internet sites
  - Sometimes offering free shipping
Building Expensive Infrastructure

- Amazon’s initial model was to outsource fulfillment
  - Largely to Ingram a large book distributor
- Found hard to delight customers
  - Shipping delays were not under their control
    - Flexibility to ship in pieces, etc.
    - Potential logistical advantages of operating high volume business
- In 1999 opened own distribution centers
  - Drove down fulfillment costs (% sales)
    - 17% Q1’99, 14% Q1’01, 12% Q1’02, 7% in ‘03
Capital Markets Forced a Change

- Profitability rather than growth as best strategy to achieve goals
  - Q4 2000 Bezos “March to profitability”

- Lehman report questioned whether cash necessary to survive the year, Q1 2001
  - Potential problem for supplier credit relations
    - Critical for operational costs
  - March became a dash
    - More open about what was profitable and by what measures

- Pursued strategies market allowed
Amazon Marketplace

- Showing goods from independent vendors alongside own merchandise
  - Starting in late 2000
  - Amazon’s description and pricing with links to other, generally used, versions
- Now also support items not carried by Amazon itself
  - Brings Amazon and eBay closer in terms of independent merchants and merchandise
    - Different models – auction versus fixed pricing
    - eBay experimenting with fixed price
Small Retailers Online

- As small merchant what are tradeoffs of Amazon and eBay?
  - What are potential customers looking for at each site?
  - How much depth is there to the demand at each site?
    - E.g., reports of eBay merchants unable to move much volume of any particular item
  - To what degree is trust in Amazon conferred on its merchants?
    - What degree of risk does this pose to the Amazon brand?
A Page from WalMart Playbook

- In late 2001 Amazon started focusing more on price – drove additional growth
  - Free shipping on orders over certain size
    - Many studies show shipping costs are biggest impediment to shopping online
  - Discounts on certain product categories

- Had achieved scale and operational efficiencies to enable price leadership
  - Did not make price primary strategy until able
    - Quickly dropping fulfillment costs; gross sales
  - Inventory turnover rates higher than WalMart
Affording Free Shipping

- Free shipping cost it about $100M in 2003
- Longer shipping times for free delivery
  - Flexibility to lower cost for such orders
    - Consolidate into one shipment, get vendor to drop-ship, etc.
- Other savings to help cover cost
  - Stopped TV advertising, relying on print, Internet, word of mouth
    - Savings of $50M
- Resulting sales increases
  - Shipping costs substantial factor
Free Shipping and Brand

- Peoples’ expectations for quality of interactions with Amazon are high
  - Ease of use, selection, rapid delivery

- Does slower free shipping disappoint?
  - Expectation of same service even though told it won’t be
  - Ease of switching shipping options

- Focus on cost makes it important to better control inventory, avoid over stocking
  - Challenge of fulfilling customer orders quickly with less stock?
User Experience is Everything

- Online the brand is the experience
  - Major part of the offering at Amazon
  - What offline brands mainly about experience?

- Example: IBM site in late ‘90’s
  - No common design, hard to use
    - Most common requests were “help” button and search box
  - Re-designed over 10 weeks; approx. 100 people
    - Common layout, low download time, graphic design, navigability
  - First week saw 84% drop in help button, 400% increase in sales (NYT 8/30/99)
Amazon Focus on Customer

- Company attracts people with customer focus – not just in customer facing roles
  - Including software developers
- Continuous testing in their usability lab
  - Entire experience, not just Web interaction
  - Tradeoff of new features versus clutter
- Metrics to evaluate each change
  - Careful evaluation of how changes drive sales
- Leading the customer carefully
  - E.g., with one-click addressing fears by making clear it was easy to cancel
Experimental Validation

- Amazon extensively tests and evaluates changes to site
  - Feedback from focus groups and test users just a starting point
  - Test changes side-by-side with current site
    • E.g., small randomly chosen subset of visitors
  - Measure differences in click through and conversion rates
- Controlling clutter while making easier to navigate to broader range of choices
  - No accident that many others copied tab layout
Customer Experience at Amazon

- **Discovery**
  - Searching, browsing, recommendations, relatedness, what you’ve done on site

- **Community**
  - Reviewers, merchants, spending time making site richer experience

- **Shopping**
  - The bread and butter, has to be easy and fun

- **Order monitoring**
  - Sale not over until customer happy with item(s)
    - At least if want repeat business
Amazon as Technology Provider

- What is risk of conflict between Amazon’s lines of business?
  - Retailer
  - Agent or “mall”
  - Provider of online retail services
  - Is this advantageous for competitors like GSI?

- How important are the Amazon services API’s?
  - Programmatic access to merchandise available on Amazon’s site
  - Realistic “developer buzz”?
Opportunities for Amazon

- Example of arbitrage between online and offline worlds
  - Pricing differentials
- What about retailers frustrated by lack of depth on eBay?
- Relative strength of search capabilities at Amazon, eBay, search sites like Google
  - Is Froogle a threat?
  - What parts of the value chain are closest to the customer?
    - Search, description, payment, fulfillment, ...
Summary of Online Retail

- Importance of user experience on brand
  - Commitment across the company
  - Common site design, ease of navigation
    - Accurate content, so best under control of individual business group/team

- Selection and convenience are big drivers of online commerce
  - Price secondary focus for most successful firms
  - Offline retailers also improving in these areas
    - Less of a differentiator for online?

- Online community as differentiator – next