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AMAZON

Where Are the Limits Before It Fails to Deliver?

ONE REASON AMAZON HAS GROWN to dominate the U.S. retail market is by keeping a laser-sharp focus on customers. Yet will Amazon's customer-centric strategy prove successful – or be its undoing – in the long run?

Customer centricity has always been a lodestar for Amazon, propelling its remarkable growth. Yet, despite the e-commerce giant's success in penetrating the market, analysts have frequently questioned Amazon's potential when it comes to delivering profits. The managerial team have attributed Amazon's relatively low profitability to the costs of offering unparalleled customer service and the investments needed to increase its geographical reach. As the company continues to expand, how should it balance a fixation on customer service with the need to sustain profitability?

Innovation With an Eye on the Customer

Since going public in 1997, Amazon has moved beyond selling books to selling movies, toys, electronics, tools, video games and other merchandise, used as well as new. In 2006, it entered the cloud-computing business with the creation of Amazon Web Services. The release of the Kindle in 2007 marked the company's jump into hardware manufacturing. In a reversal of the usual business trajectory of a physical store moving online, Amazon took the unexpected step of opening a brick-and-mortar store in 2015. And in 2016, Amazon made its inaugural drone delivery, moving toward its goal of employing drones to deliver products to customers' homes.

"I would define Amazon by our big ideas, which are customer centricity, putting the customer at the center of everything we do," the company's founder, Jeff Bezos, said in a 2013 interview, the same year that he purchased *The Washington Post* for $250 million.

The company has always put a premium on easy ordering and rapid delivery; the use of data to personalize the shopping experience; and helping customers get the best deal. To drive home its customer focus, legend has it that Bezos used the "empty chair" method in meetings: an empty chair would be left at the conference table to symbolize the customer's presence when making decisions.

Amazon departments were data-driven, based on the customer experience. As Bezos explained in a 2009 *Newsweek* interview, "We start with the customer and we work backward. We learn whatever skills we need to service the customer. We build whatever technology we need to service the customer." In other words, by working backward, the software developers wouldn't pursue any project that didn't first and foremost offer compelling benefits for customers.

In 2015, Amazon's work environment came under fire in a *New York Times* exposé that alleged the company was excessively pushing its workers. The article described ruthless working conditions and "unreasonably high" standards for workers.

The following week, Bezos sent a letter to Amazon staff that stated: "The article does not describe the Amazon I know or the caring Amazonians I work with every day ... I strongly believe that anyone working in a company that really is like the one described in *The New York Times* would be crazy to stay. I know I would leave such a company."

Unlike many other Silicon Valley ventures, Amazon was not so generous in handing out perks. Indeed, workers were paid up to $5,000 to leave the company in a program called "Pay to Quit."

In the wake of the report, Amazon launched a new internal communication system called Amazon Connections. The initiative posed questions to employees on a daily basis to elicit their feelings on topics such as the work environment, job satisfaction, and leadership and training opportunities. The program was introduced at fulfillment centers, which were staffed mostly by blue-collar workers, and then expanded to other departments.

Amazon Connections would leverage real-time information to introduce positive change in the organization. "Our goal is to help develop leaders who earn trust, remove barriers to excellence and make Amazon an inspiring place to work," according to the company's description of the initiative.

A Perfect Mix – or a Perfect Storm?

In early 2017, Amazon's net income was rising, and it announced it would be creating 100,000 new full-time, full-benefit jobs in the United States over the next 18 months. At this juncture in its history, Amazon was unlike any of its competitors, due to the scope of its activities, spanning areas such as retail, logistics and web services. With such a broad focus and unique corporate culture, it was not an easy company to figure out.

Experts grappled with basic questions about Amazon: what type of company was it? And what risks was it assuming in growing at this quick a pace in so many different directions? In balancing customer centricity, employee engagement and sustainable profitable growth, would the company's approach prove tenable in the long term? □

The case study **"Amazon: Balancing Customer Centricity With Employee Engagement"** (P-1165-E) – prepared by Larisa Tatge under the supervision of IESE professors Jaume Ribera and Alejandro Lago – is available from IESE Publishing at www.iesep.com.

Other sectors, like healthcare, should start learning from what Amazon does well – or they might be disrupted next.

Deliver Customer Satisfaction

by Anders W. Fogstrup
General Manager, Mundipharma Germany & Nordics

NUMEROUS ARTICLES HAVE BEEN PUBLISHED asking how long Amazon can go on being "The Everything Store" and whether its limited profitability is actually a success. To my mind, what's truly different about Amazon is the one thing it does better than anyone else: deliver customer satisfaction. To me, this answers the question of whether the Amazon model is sustainable.

Since the earliest days of trade, customer wants and needs have driven buyer behavior, and those who can deliver exactly what the customer wants and needs will persevere. For Amazon, having an inventory of stock keeping units (SKUs) is just a means to an end; it enables an operational model of flawless distribution to deliver the one thing that truly matters: customer satisfaction.

Will Amazon achieve world domination? Amazon has proven itself able to meet customer wants and needs in traditional goods markets, and its platform is second to none. This makes it a prime target for competitors, but for now, Amazon sets the standard. Others seeking to challenge Amazon's position will find their main hurdle in the near future will be scale.

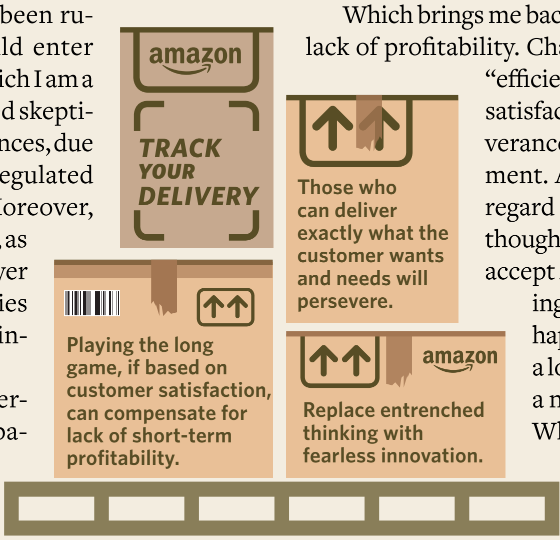
Recently there have been rumors that Amazon could enter healthcare, a sector of which I am a part. Some have expressed skepticism about Amazon's chances, due to the complex, highly regulated nature of this market. Moreover, healthcare is fragmented, as in many countries the payer is the state, whose priorities shift with each new administration.

Yet, from a global perspective, healthcare is basically the same: delivering solutions to customers (patients). For decades, the dominant players and operating models have been largely unchanged, and everyone is fighting to retain control of their part of the chain. Standard procedures deliver marginal, incremental efficiencies by treating all patients alike, while total costs are increasing.

To an outside observer, healthcare has all the hallmarks of a market ripe for disruption. Until now, a "servitization" trend in healthcare has not really taken off. Some gains have been made in outcome-based payment and value-based pricing, but neither side of the payer equation seems willing to commit to a paradigm shift toward customer satisfaction. Neither healthcare payers nor providers have managed to find the right formula to break the traditional price-per-pill model. For a company like Amazon, which excels in customer satisfaction and unconventional thinking, this entrenched thinking must be appealing. Assuming healthcare is of interest to Amazon, the question is whether the determinants of customer satisfaction in goods are replicable in people's health.

I believe what will determine a successful disruption of healthcare is the culture of the challenger. For this, we should look to Jeff Bezos and the leadership he applied to build Amazon to what it is today. Based on what I've heard and read, the core Amazon mindset is one of a lack of fear and an ability to innovate. To break decades of entrenched structures in healthcare, certainly both of these qualities will be required.

Which brings me back to criticisms of Amazon's lack of profitability. Changing healthcare from an "efficiencies game" to a "customer satisfaction game" requires perseverance and a long-term commitment. A short-term investor may regard that as unfavorable. So far, though, the stock market seems to accept Amazon's high Price/Earnings and low profitability. Perhaps the market is anticipating a long-term commitment into a new market like healthcare. What we have learned from Amazon over the years is never to count it out.



Address reputational concerns or it could lead to problems with "consideration to purchase" for Amazon's prized customers.

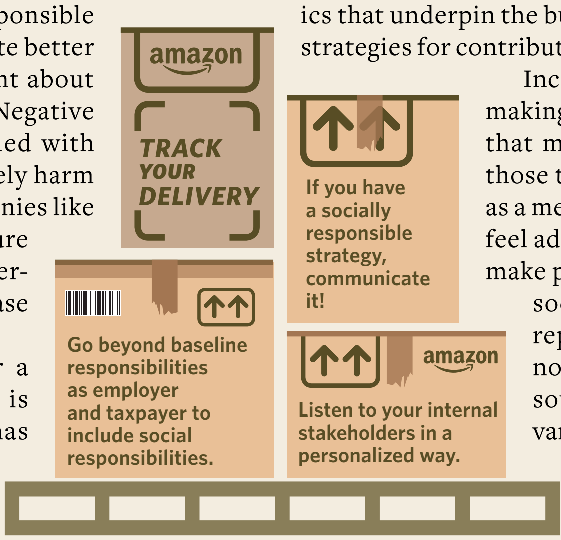
Mind Your Reputation

by Maria Sánchez Vargas
Communications Director, LG

AMAZON ENJOYS AN EXCELLENT REPUTATION in the eyes of consumers. It consistently appears in Havas Group's annual ranking of the World's Most Meaningful Global Brands for the functional and personal benefits it offers consumers – from delivering good quality products at fair prices to making life easier and assuring peace of mind. Can those factors alone ensure its sustainability?

Amazon's entire philosophy is about focusing on customers, who already number well over 300 million. A pioneer of the gig economy, Amazon invented a whole new way of consuming and changed the way the world shops. It's also a job creator, employing more than 560,000 full- and part-time workers worldwide, representing a 66 percent increase over 2017. And that doesn't even count contractors and temporary personnel.

Despite those positive points, Amazon gets a bad rap for being a demanding employer and it is being closely watched by regulators for potential anticompetitive practices. The shine has come off the halo of the world's tech companies, as society demands that they become much more socially responsible – or at least communicate better and be more transparent about what they actually do. Negative media attention, coupled with inaction, could ultimately harm the reputation of companies like Amazon and lead to future problems at the consideration stage of the purchase process.



The good news for a company like Amazon is that, being digital, it has the means to reach massive audiences, form close connections with them, maintain open lines of communication – and turn that into competitive advantage.

First, Amazon should focus on internal stakeholders as much as external consumers. This would require taking an honest look at how it communicates with and engages all employees in fulfilling organizational goals. This needs to be done in a personalized way that helps employees appreciate the societal benefits of what they are doing. Building trust cannot be done just through digital means; there must be a tangible human element. This is the challenge of digital: staying true to the human aspect in what we do and how we do it.

Second, Amazon should involve the societies where it operates. Analyzing local concerns and listening to citizen groups in the different countries where it operates would help the company define a plan of action that is locally relevant and socially responsible, going beyond its baseline responsibilities as an employer and as a taxpayer. If such a strategy already exists, it should be widely communicated.

Which brings me to my final point: reputation is as much about communication as it is the company's actual behaviors and stakeholder relationships. Thoughtful, relevant communication can help lessen criticism and reputational harm. It's about communicating not just business practicalities but rather the values and ethics that underpin the business and the business strategies for contributing to society.

Increasingly, consumers are making it clear that the brands that matter to them most are those that transcend their role as a mere service provider; they feel admiration for brands that make positive contributions to society. Given this trend, reputation management is now, more than ever, a key source of competitive advantage. Amazon should remember this as it ponders its sustainability.

Hang in there: profitability will probably come when the company stabilizes.

Patience Is a Virtue

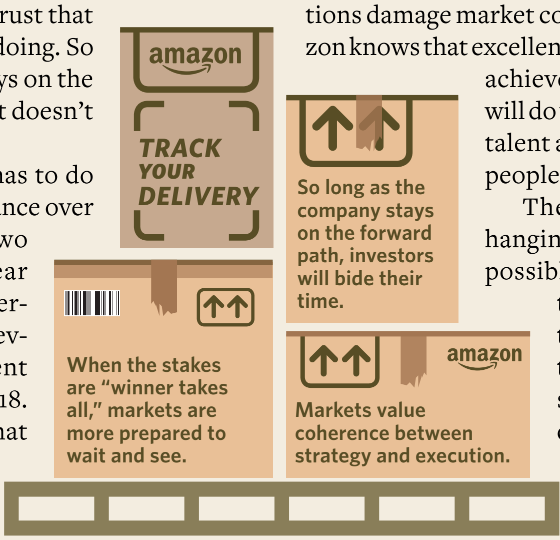
by Javier Darriba
Entrepreneur, Tech Adviser and Investor

LOOKING AT AMAZON'S 2013-15 FINANCIAL RESULTS, we see major fluctuations and even some quarterly losses. Even so, the company's market cap has generally appreciated over the last 10 years. Remarkably, in late 2014, when Amazon's market value was approaching (and eventually surpassed) Walmart's, its net profit margin was still negative while Walmart's was a positive 3.3 percent. How could this be? How can markets tolerate or reward low or negative profit margins for so many years? There are several reasons.

The first is historical. Amazon was founded in 1994. Like many other startups during the dot-com era, Jeff Bezos' company reported millions of dollars in losses as it found its feet. Even as what was then just an online bookstore began to take off, Bezos focused on long-term growth rather than short-term profitability. He stuck to his mantra: "Put the customer first. Invent. And be patient."

Since going public in 1997, the company has never paid dividends to its shareholders, instead plowing all of its profits back into further innovation and growth. Perhaps because Amazon has consistently followed this coherent growth strategy, investors are willing to trust that Bezos knows what he's doing. So long as the company stays on the forward path, the market doesn't seem too bothered.

The second reason has to do with Amazon's performance over time. Over the past two decades, year-over-year revenue growth has averaged 30 percent, with revenue growing 43 percent in the first quarter of 2018. Such results indicate that the company is still conquering markets, giving hope to investors that profitability will come when the company stabilizes.



Amazon's business has greatly evolved beyond its beginnings in online retail. Today, Amazon Marketplace covers an ever-widening variety of categories. Amazon Prime, its subscription service that includes special delivery deals as well as streaming services to rival Netflix, is predicated on a winner-takes-all business model that leverages powerful network effects. The same goes for logistics, another area that Bezos has entered in his ongoing quest to offer the best possible customer experience and where economies of scale are key.

This is the third reason why investors are willing to bide their time. It's this patience – of Bezos and the markets – that explains how Amazon is able to ship low-priced orders in just 24 hours. Instead of calculating the profitability of each order, Amazon sees customer lifetime value as the true path to profitability.

Note the subtle shift in emphasis of the company's mission, from "offering customers the lowest possible prices" to "innovating new solutions to make things easier, faster, better and more cost-effective" in pursuit of being "Earth's most customer-centric company." This self-confessed "customer obsession" is a significant indicator of its future fortunes. Indeed, as the Amazon Prime subscriber base expands internationally, pundits predict price hikes are coming.

Could negative reports about worker conditions damage market confidence? I doubt it. Amazon knows that excellence in execution can only be achieved with a great team, so it will do whatever it takes to attract talent and be a place where many people will want to work.

The only dark cloud I see hanging over Amazon's future is possible intervention by regulators to break up a potential monopoly. Splitting the company up might scupper its growth plans, delaying profitability further. But as Bezos would say: be patient.