

Amazon: Friend or Foe?

This year marks the 20th anniversary of the founding of Amazon.com, the formerly humble online bookstore that grew to offer every product imaginable and in so doing changed retail forever. According to the National Retail Federation, at \$44 billion in domestic sales (\$77.5 billion globally), Amazon is now the ninth-largest retailer in America, online or otherwise, and by far the fastest growing in the top 20, up 27.2% year over year (see Figure 1). On Cyber Monday in 2013, worldwide customers ordered 36.8 million items from Amazon. Following Amazon's announcement to add 80,000 seasonal jobs for the 2014 holiday season (up from 70,000 in 2013), all signs point to another record holiday season for the giant e-tailer.

But is what's good for Amazon good for consumer products brands? It's a complicated question. For most brands, the short answer is: Yes. While the risks of partnering with Amazon are real and substantial, the potential rewards are enormous. Powerful brands that demonstrate true consumer pull and real differentiation, like Apple and Nike, are exceptions. For everyone else, to ignore Amazon is to cede sales at best, and court irrelevancy at worst. Amazon is already among the most powerful channels in the world, and it's growing stronger every day.

There are risks, clearly, but we know what they are and how to mitigate them. Of course, different products and brands require different solutions. There is no one-size-fits-all strategy. What's true for everyone, however, is that a successful digital strategy must address Amazon head-on. Only then can companies turn the online giant from a frightening foe into a powerful ally.

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Figure 1
Top 10 U.S. Retailers

Top 10 Rank	Company	2013 USA Retail Sales ('000)	USA Sales Growth ('13 v '12)	Worldwide Retail Sales ('000)	2013 Stores
1	Wal-Mart	\$334,302,000	1.7%	\$473,979,000	4,779
2	Kroger	\$93,598,000	1.6%	\$93,598,000	3,519
3	Costco	\$74,740,000	5.2%	\$105,100,000	447
4	Target	\$71,279,000	-0.9%	\$72,596,000	1,793
5	The Home Depot	\$69,951,000	6.6%	\$78,812,000	1,965
6	Walgreen	\$68,068,000	1.3%	\$70,096,000	7,998
7	CVS Caremark	\$65,618,000	3.1%	\$66,682,000	7,621
8	Lowe's	\$52,210,000	3.6%	\$53,417,000	1,717
9	Amazon.com	\$43,962,000	27.2%	\$77,551,000	N/A
10	Safeway	\$37,534,000	-3.7%	\$42,982,000	1,335

Source: National Retail Federation; Kantar Retail

Digital Commerce Comes of Age

In the second decade of the 21st century, most people still buy much of what they want or need at brick-and-mortar stores. Even the best-performing online retail sectors – such as computers/electronics and apparel/accessories – derive only about 20% of total sales from online stores.

At the same time, all the key growth indicators are trending in digital's direction. For instance, while mall traffic is down 20% since 2010, and will likely continue to decline, virtually all the growth in retail sales is being captured by ecommerce (see Figure 2). Plus, online retail sales are expected to continue double-digit growth through 2018. That's why brands in all sectors have no choice but to develop a comprehensive digital vision and strategy.

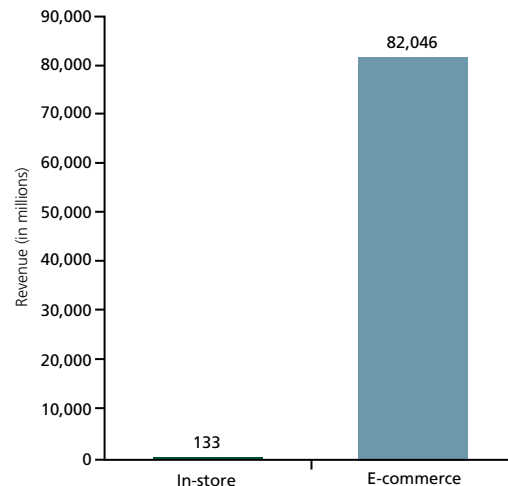
The key questions you should be asking yourself are:

- 1. What are my digital channels?** My website? Other websites? Mobile apps? Social networks? They're all critical and they're all unique.
- 2. How do I drive traffic?** Customer acquisition strategies vary widely. Options are numerous, and include digital advertising, personalized emails, and online communities that build consumer knowledge, brand awareness and customer loyalty.
- 3. How do I drive conversion?** Among the variables are website design, ease of navigation, customer service, shipping costs and return policies, and integration with other channels – both physical and digital.
- 4. How do I structure merchandising and pricing?** What kinds of products sell best online? What should my assortment be, and how does this integrate with what my stores or wholesale accounts carry? What can I offer online that is unique? How do I handle pricing and promotions differently online than in physical channels?
- 5. How do I expand beyond my proprietary channels in a way that is additive to my existing distribution ecosystem?** It's this last, critical question that leads inevitably to Amazon.

Winning with Amazon

Amazon is a \$77-billion global behemoth with 244 million registered users. Their customers are famously loyal, especially the more than 20 million who pay \$99 per year for free two-

Figure 2
Change in U.S. Retail Sales (2006-2011)
Store-based retail sales are not growing. Virtually all growth in consumer spend is being captured by e-commerce.



Note: 2011 is the most recent year with annual figures; analysis excludes Building materials and supplies stores, Health and personal care stores, and General merchandise stores due to data limitations, and Nonstore retailers and Gas Stations due to relevance
Source: L.E.K. Consulting

day shipping with Amazon Prime. They have every incentive – price, selection, convenience, trust, customer service – to order from Amazon, even when they make their buying decisions someplace else. That's why selling on Amazon is the 21st Century equivalent of selling on Main Street. You have to be there because that's where the customers are.

But selling on Amazon carries its own challenges. Among them:

- 1. Price scraping:** Amazon's practice of deploying algorithms that scour the Web to ensure Amazon always offers the lowest possible price.
- 2. Channel conflict:** No brand wants its relationship with Amazon to destroy established relationships with other important channels. It's a delicate balance that requires elaborate planning and execution.
- 3. Inventory markdowns:** Amazon enforces strict controls on inventory through aggressive automatic markdowns to reduce its inventory levels.

4. Brand dilution: This can be among the most damaging consequences of associating with Amazon, who may be recognized as a price leader and a “mass” retailer among certain customer segments.

5. Amazon Marketplace: It’s the Wild West of Amazon – a loosely managed network of third-party sellers who display their products to Amazon’s many eyeballs, but generally handle pricing, inventory and fulfillment themselves.

Again, these dangers can be managed, but only by engaging Amazon in different ways for different sectors, brands and products. For instance, high velocity core items should be treated differently than new products and still differently from closeout items. In short, there are different business models available to effectively manage risk while maximizing growth across all types of brands and products (see Figure 3).

For instance, a traditional wholesale relationship with Amazon can be a game-changing distribution channel for certain kinds of wholesalers, but it may work best for high-volume SKUs, core items and basics. Beyond those items, automatic markdowns and price scraping can create undue channel conflicts, margin pressure and consumer price confusion. Operating as a branded seller on Amazon generally mitigates these issues while creating the opportunity to showcase new, lower-volume products in addition to building brand awareness with millions of Amazon customers; however, realized margins will be lower.

Another example: While in most cases, brands are right to be wary of Amazon Marketplace, it can nevertheless be an effective closeout channel for last season’s items, and therefore a tool for managing working capital and freeing cash for reinvestment in new products.

Figure 3
Which Amazon Model Might be Right for Your Brand?

Business Characteristics	Traditional Wholesale	Branded Seller	Marketplace
Product Type	Core	New	Closeout
SKU Velocity	High	Low	Any
Brand Dilution Risk	Low	High	Low
Channel Conflict Risk	Moderate or Low	High	Low

Source: L.E.K. Consulting

Finally, even the most careful planning can be upended by third parties. Your brand can end up on Amazon despite your best efforts. How you manage that – by controlling who can and can’t sell your brand, defining which channels are acceptable, clearly specifying pricing, and enforcing consequences for breaking the rules – is key to building a holistic Amazon strategy that creates value.

In Sum

If done properly, integrating Amazon into your business can unleash potential that is thrilling and vast. Outside of brands with true consumer pull and loyalty, brands that choose not to engage with Amazon run the very real risk of becoming invisible to their customers, especially as digital commerce captures an ever-increasing share of consumer spending. Again, there is no magic bullet, no simple rulebook, for working with Amazon. Every case is different. But there are options for every product and every brand to make Amazon a friend, not a foe. Good planning to determine which ones make the most sense for your business could be the ticket to cashing in on a new friendship.

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