



Beyond the hype: What will Amazon's Australian entry really look like and what can retailers do about it?

For well over a year, Australia has been captivated by the prospect of Amazon's launch. Though launch is clearly fast approaching, some of the attendant claims (particularly regarding the impending destruction of the local retail sector) appear overheated.

Amazon's entry will be significant, and quite likely achieve mid-single billions in turnover within a few years. However, by its own standards, we expect the retailer to take a considered, phased approach to deploying capital and building its Australian business.

In this *Executive Insights*, we share perspectives on some key factors in Amazon's launch, as well as impact mitigation strategies that can be considered by incumbent retailers.

Some important questions need to be addressed:

- What does the Australian opportunity look like from Seattle?
- Why has Amazon chosen to launch in Australia now?
- What will the launch profile look like?
- How will consumer behaviors change?
- What should local businesses be doing to prepare?

What does the Australian opportunity look like from Seattle?

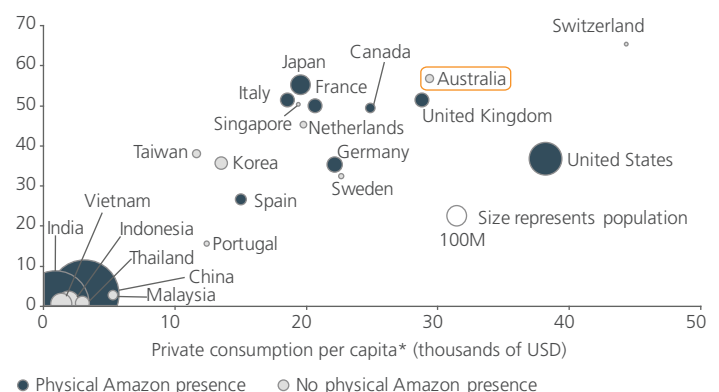
Amazon's ability to grow is limited by its lack of physical presence. Amazon already has a \$400 million plus Australian e-commerce business. However, it also faces some serious

limitations. While the broader e-commerce and omni-channel retail markets are developing in Australia, Amazon's lack of on-the-ground presence constrains its potential, and there are indications turnover may have tapered in recent years.

Demographically, Australia is an attractive target for Amazon. At a household level, Australian consumers are "high-grade" prospects for Amazon's offer: They are relatively rich, under-served, and time-poor. Australia is one of the most populous wealthy countries in which Amazon does not have a physical presence (see Figure 1).

Figure 1
Wealth demographics, key countries (2016)

Percentage of population classified as middle class (>\$100k USD income per adult)



Note: * Excludes wholesale and some government purchases

Source: Credit Suisse; The World Bank; EIU; L.E.K research and analysis

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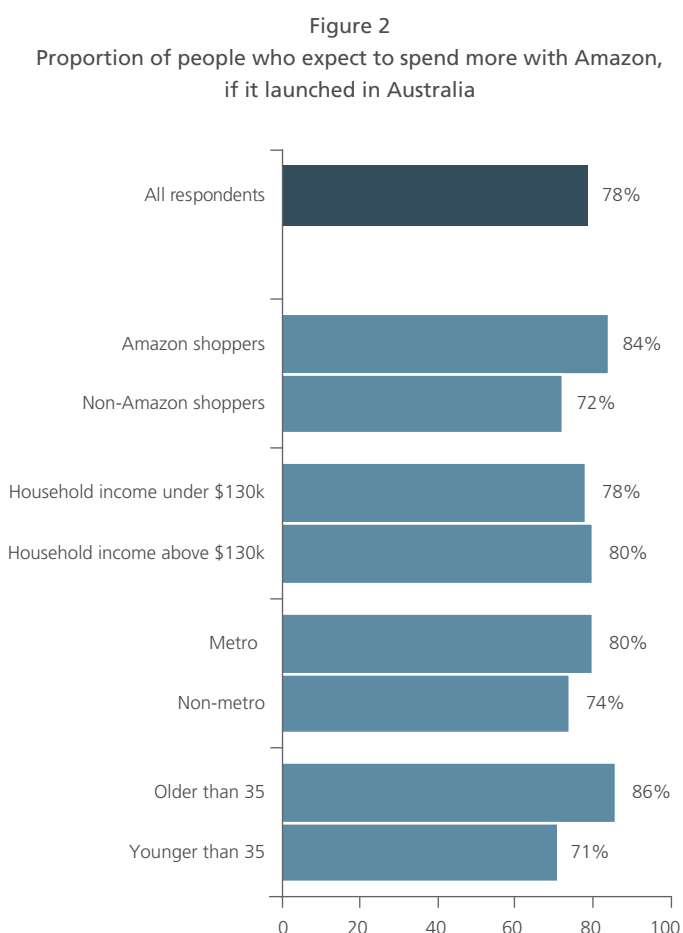
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Australians believe they are paying too much for goods online. A total of 68% of shoppers surveyed by L.E.K. Consulting believe the prices Australians pay for online goods are too high compared with those in other markets. Even considering the physical remoteness and high costs to serve in Australia, these views appear to have some merit in many categories.

Australians really want Amazon to launch locally. Overall, 78% of e-commerce shoppers surveyed expect to increase spend with Amazon when it launches (see Figure 2). This support is remarkably consistent among different groups: Australian consumers are interested in Amazon's offer. This applies whether they are current Amazon shoppers or not, high or low-income earners, metro or non-metro dwellers, old or young.



Source: L.E.K. consumer research, 2017

Why has Amazon chosen to launch in Australia now?

Amazon's global supply chain has developed sufficiently to face the challenges of delivering to a low-density, dispersed Australian market. It now has a more substantial supply chain than either FedEx or DHL, meaning goods can be distributed from offshore to serve a global market. Amazon's improved supply

chain also allows it to offer its Global Store, with products from international websites available in local currency and language, dispatched from a centralized location (i.e., Singapore).

The Australian landscape is growing more competitive.

EBay has grown its Australian business. Local retailer multichannel propositions are improving, and category specialists such as The Iconic offers free delivery within two to three hours in metro Sydney. While Alibaba's Australian operation is currently focused on B2B (sourcing), it is expanding and has the capacity to rapidly build a mainstream B2C model.

Amazon's range of private-label products is now sufficiently large to provide a competitive advantage at launch. It has more than 4,000 SKUs across 37 brands, on a spectrum from price-led products (e.g., HDMI cables, Bluetooth speakers) to innovation-led products (e.g., Amazon Kindle, Echo). These products can be deployed during launch without negotiations with local distributors.

Similar models are thriving in Australia. We spoke with several industry experts who claim Amazon will draw confidence from the successful recent growth of Aldi (a relentlessly efficient discounter) and Netflix (approximately \$10/month media subscription, comparable in some ways to Amazon's Prime service).

There is now a sales tax kicker. As of July 2018, international players will be required to collect sales tax, removing the previous 10% price advantage over local retailers. By establishing a physical presence in Australia, Amazon can offset its GST against locally incurred expenses.

Amazon's move to Australia, as this change occurs, is no accident, and parallels its U.S. network expansion as sales tax exemptions for out-of-state retailers were removed.

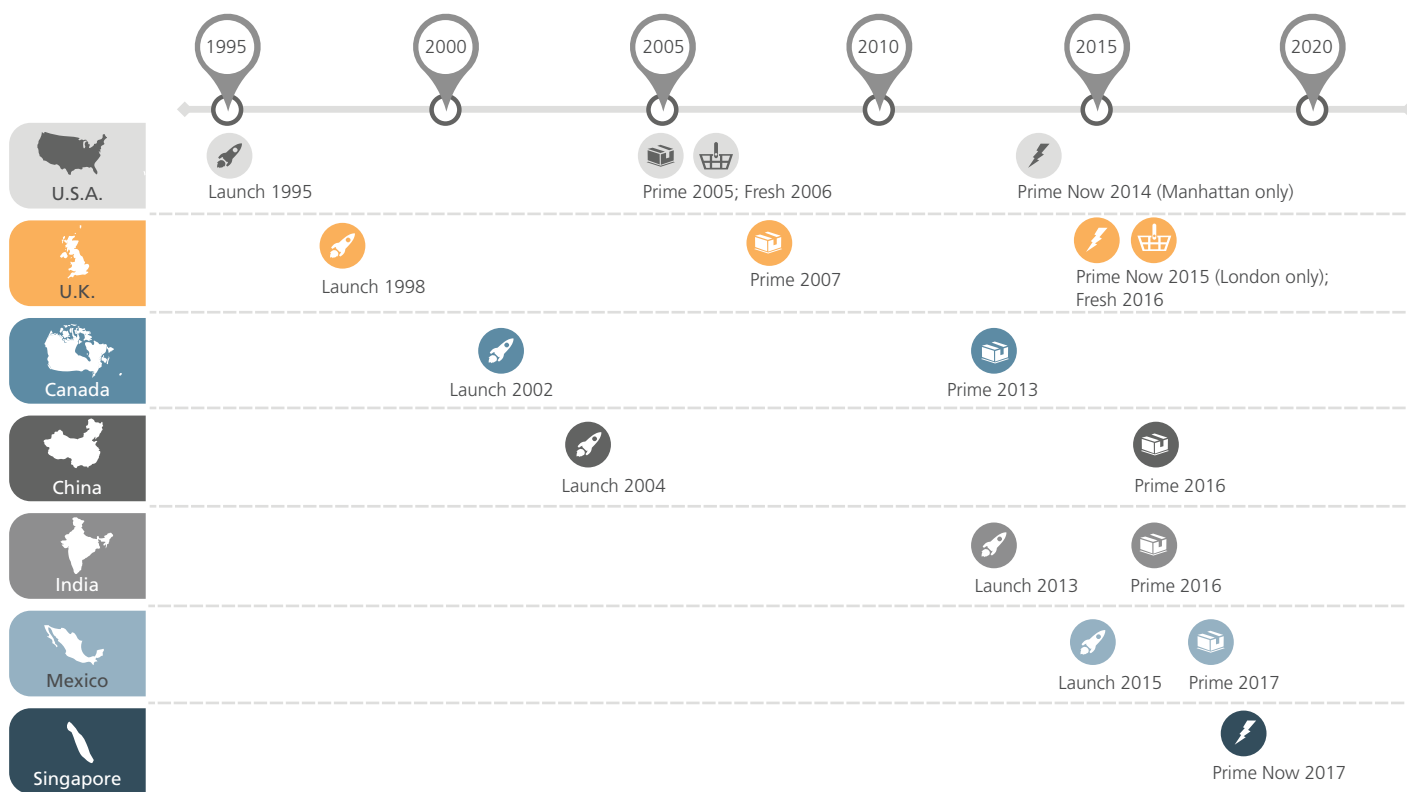
What might the launch profile look like?

Amazon's phase 1 launch looks likely to occur prior to Christmas 2017, though we do not expect all core functionality to be available on day one. Several sources noted that Amazon never rushes its launches, preferring to take the time required to execute flawlessly. The recent (delayed, but thriving) launch in Singapore is a case in point (see Figure 3).

Amazon's approach in recent international growth markets (particularly Mexico and Canada) suggests it will deploy a phased entry model that is particular to Australia. In recent launches, Amazon has tailored its approach considerably to local conditions and become faster at rolling out its complete offer (see Figure 3).

Amazon will establish a limited number of east coast fulfilment centers to drive the first wave of its growth. We expect three to five sites to be established within the first two years — the first in Dandenong, Victoria, was acquired in July.

Figure 3
Amazon rollout timeline — selected markets



Note: *As of February 2017, offered in 28 cities; **As of February 2017, offered in 10 cities
Source: Amazon; L.E.K research and analysis

Amazon will launch with its full set of first and third-party sales models.

The following fulfilment options are expected at launch:

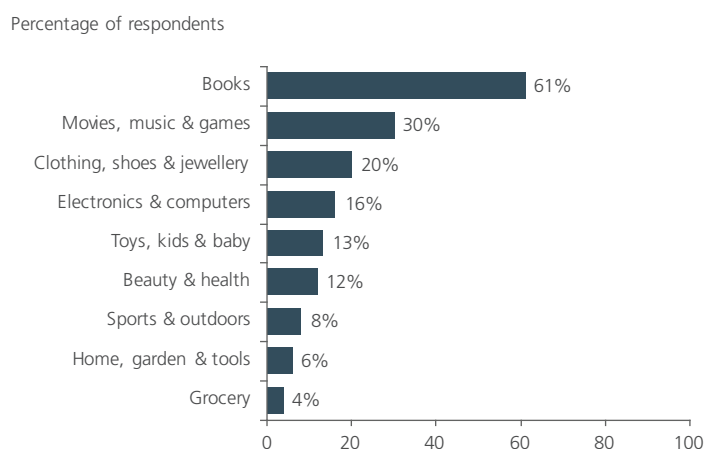
Feature	Description
First party	First party involves selling goods wholesale to Amazon retail. Amazon then controls pricing
Third party	Third party means selling products directly to consumers through the Amazon Marketplace.
Third party Fulfilled by Amazon	Third-party variant in which Amazon holds popular third-party seller inventory and fulfils it through the Amazon distribution network.
Global Store	The Global Store makes products available from Amazon's international network (fulfilled fast from offshore).

Partnerships will be key to creating the Australian offer:

- A significant amount of product will likely be fulfilled remotely, e.g., from Singapore
- Amazon is expected to partner with Australia Post and Toll for logistics and last mile

- Third-party sellers in the Amazon marketplace will be central to the offer; Amazon is currently soliciting and preparing local sellers
- Amazon is leveraging its existing international relationships to secure key brands for first-party sales in core categories

Figure 4
Categories already purchased by Amazon shoppers (2017)



Source: L.E.K. consumer research, 2017

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Prime is a key part of Amazon's growth model, and is likely to be offered in metro Sydney and Melbourne within 12 months of launch. Amazon Prime is a subscription service that allows members to access unlimited free shipping (within one or two days), and a range of media content for about US\$99 a year. Prime drives customer stickiness, and many of Amazon's private-label ranges require Prime membership to access. Amazon also offers a range of Prime variants (like Prime-Now, a two-hour metro delivery service) in selected cities.

Amazon will match lowest prices in categories, rather than compete via deeper discounts. Amazon's general pricing approach is to use heavy data analytics to identify and match prices within a category, rather than undercutting prices (though it does offer deep promotional discounts on key items). Its marketplaces model creates an environment of price transparency between alternative sellers, and encourages them to compete with one another on price. These settings quickly establish Amazon's platform as the low priced provider, and rapidly remove margin from categories where it competes.

Private label is also likely to form a key part of Amazon's launch offer. Amazon's private label range is of sufficient scale to offer a compelling proposition at launch. The range, including electronics, clothing and wellness (see Figure 5). This range can be quickly mobilized at launch, as the need to negotiate with local distributors is removed.

Amazon private label ranges are priced to deliberately disrupt high-volume branded products. The range typically consists of more affordably priced high-utility items like HDMI cables, washcloths and notebooks.

Innovation items, such as the Kindle and Echo, are relatively low-price but act as a connection to the wider retail platform.

Amazon's Fresh grocery service is likely to lag by three to five years. The offer appears too capital intensive to be included in a capital-rationed launch offer. Amazon has not yet achieved a sustainable 'Fresh' position in any of its global markets. One source claims that Amazon Fresh has "lost money from spoilage at more than double the rate for a typical supermarket"¹, and Amazon has recently announced it will cut back on the service across nine states in the U.S.².

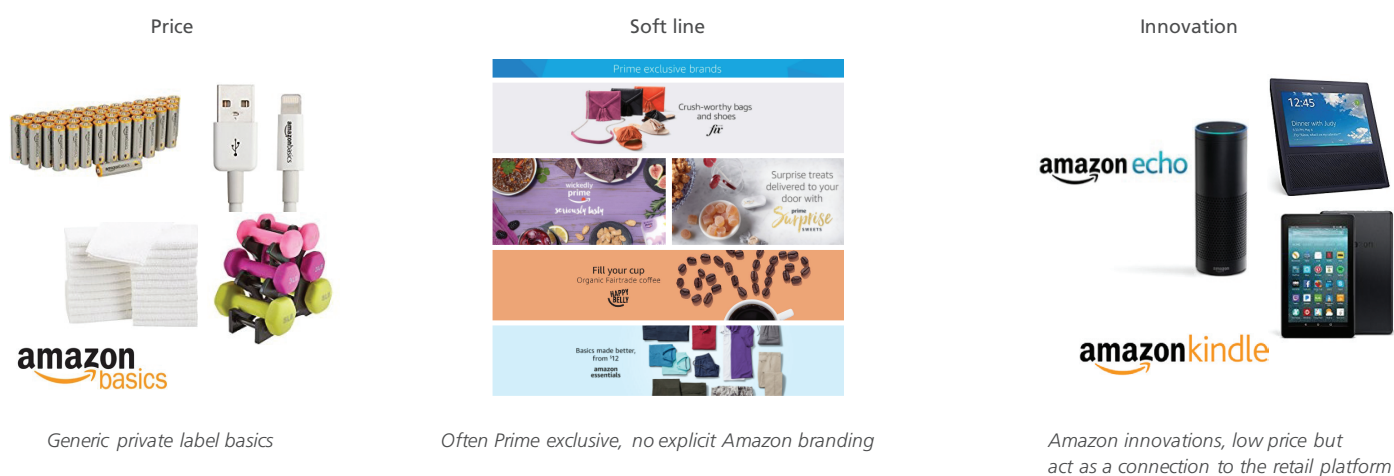
Furthermore, the recent US\$13.7 billion acquisition of Whole Foods can be viewed as some acknowledgment of the need to establish a better back end for grocery. Additionally, the geography and climate of Australia tend to make it a relatively challenging market for fresh home delivery.

How will consumer behaviors change?

Consumers' brand loyalty can be disrupted when purchasing channels change. For example, a customer at Costco may break a lifetime of loyalty to a certain toothpaste to access a bulk deal. By providing attractive private-label options, Amazon will encourage users to switch.

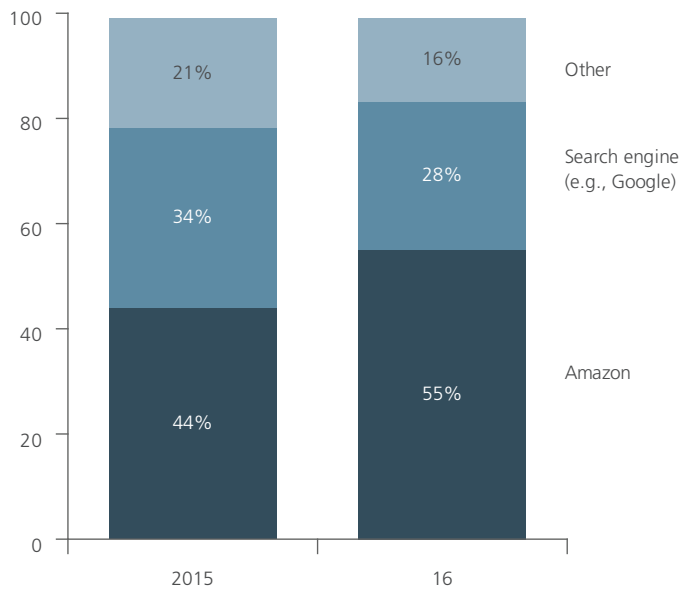
Amazon's success with private label is largely driven by customers' trust in the Amazon brand. On top of this, product information pages and customer reviews can reinforce the decision to switch from an established incumbent brand.

Figure 5
Amazon's private label brands spectrum



Source: Amazon.com

Figure 6
First preference for product searches



Source: BloomReach, 2015–16

Amazon will aim to be the first stop for customers buying anything online. Instead of “Googling” products to buy, customers will “Amazon” them. This behavioral shift is already evident among U.S. consumers (see Figure 6).

Prime Now two-hour delivery opens up a wider range of categories for online purchase. It provides a convenient alternative to brick-and-mortar stores. As such, it opens up categories that are traditionally emergency or impulse buys, e.g., laundry detergent, baby formula. Although Prime Now is unlikely to be a feature of Amazon’s Australian launch, this may be a significant driver of consumer behavior change in the long term. It will add further to the growth of basket volumes Amazon is likely to trigger.

What should local businesses be doing to prepare?

Amazon’s entry into Australia is likely to be considered and phased. Its offer will expand as Amazon develops local capabilities.

For local retailers, international examples reveal a number of ways to position for Amazon’s launch.

Improve the in-store experience. Offer value that Amazon cannot match. For instance, in the U.S., Best Buy developed Magnolia Design Center showrooms that allow customers to experience and design their own high-end home entertainment systems. Nespresso’s barista bars play a similar role in the home coffee category.

Re-engineer customer relationships. Improve loyalty programs and shipping offers. Amazon’s success in Japanese electronics has been muted by the **generous loyalty programs** in Japanese brick-and-mortar stores. Rakuten Ichiba, the largest marketplace

in Japan, uses the Rakuten Super Points scheme in which customers receive up to 10% back on purchases made through its site. These points are transferable to convenience stores, tourism websites and banks.

Retailers may also wish to consider offering a Prime-like services and delivery bundle — partly to defend against share loss to Amazon, but also simply to match modern consumer needs. Several Australian retailers already offer such an option. The Iconic, for instance, offers a standard two-day shipping time and an express three-to-five hour option in metro locations for most items. Dan Murphy’s offers a \$50 per year subscription for unlimited delivery.

Get big: reinvest profits in building scale. In categories of focus for Amazon, the largest players often survive, and the second and third players are the losers. In the books category, Barnes & Noble remains while Borders is no more; in electronics, Best Buy outlasted Circuit City.

Double down on private label. The less branded the better. Dixon’s Carphone in the UK developed a strong brand range, with “good, better, best” options. It tailors these brands according to its customer research, and provides competitive prices by leveraging its relationships with suppliers.

Bring the customer in-store through personalization of services, kitting and customization. For instance, Dixons Carphone aims to sell supplementary services like phone screen repairs and tutorials. Last year, profits from these services comprised half of its approximately 4% operating margin. Kitting, or bundling, requires bringing together bundles of products that are typically used together — a set of plumbing supplies, for instance. Customization might involve tailoring clothes to fit perfectly, or personalizing items like sneakers.

For brand owners, Amazon can have advantages if approached carefully. Careful direct engagement is the best path. Amazon has many avenues to range products it views as important, and it has the means to compete with those who do not play ball (from third-party/international sourcing to creation of private-label product to compete with holdouts).

For those that have a distinctive brand, and control SKUs and pricing carefully (with Amazon and across their wholesale relationships), there is little to fear and much to gain from dealing with Amazon.

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Conclusion

In the years ahead, Amazon will have a profound and lasting impact on Australian retail. However, the rollout will be more considered and steady than many expect.

Retailers with high-cost, undifferentiated experiences will quickly leak share. However, there is a range of strategies available to limit the downsides. Therefore, the competitive impact on individual players may be slower to materialize than some expect.

Product suppliers, small retailers and brand owners have opportunities to profit from Amazon's platform.

Amazon will without doubt raise competitive standards and consumer expectations in Australian retail, but it will also drive growth and provide a range of new opportunities across the market. The persona some commentators project onto Amazon as winner-takes-all disruptor of Australian retail is surely misplaced.

¹ Bloomberg.com

² <https://techcrunch.com/2017/11/03/amazon-fresh-is-shutting-down-in-some-neighborhoods-including-ones-in-san-francisco/>

About the Authors



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