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AMAZON GO: VENTURING INTO TRADITIONAL RETAIL[1]

Wiboon Kittilaksanawong and Aurélia Karp wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

Amazon.com, Inc. (Amazon), one of the largest global online retailers, decided to enter the offline retail industry in December 2016 by launching its first Amazon Go store in Seattle, offering a technologically innovative way of shopping that allowed customers to make purchases without a cashier.[2] The launch was the first time that Amazon really entered the traditional retail industry. Earlier, in May 2016, the company had entered food, diaper, and housekeeping product manufacturing with its Amazon Elements brand.[3] Nevertheless, these products were only available online for American Prime Members. Founded in 1994 as an online bookstore, the company had become an e-commerce giant, leading digital sales of books and electronic products. It revolutionized the way consumers purchased products, while also becoming a trusted source of product information for potential buyers. However, the company was not profitable until 2001, while it was still experiencing some financial difficulties.[4] As of the third quarter of 2016, it was the fourth most valuable public company in the United States.[5] In 2015, it surpassed Wal-Mart Stores, Inc. (Walmart) as the most valuable online retail company in the United States.

Could Amazon reproduce its online success in the traditional offline retail segment? Could its current competitive advantages be replicated in offline retailing? Did this diversification make sense, considering Amazon's existing key resources and capabilities, the presence of established traditional retailers like Walmart, and the market trend that was increasingly moving toward online stores?

HISTORY

The Beginnings: 1994–1997

On July 5, 1994, Jeff Bezos, a 30-year-old engineer graduating from Princeton University, left his job as vice-president at D.E. Shaw & Co., a global investment firm based in New York, to create an online bookstore based in Seattle. He saw the future of selling products online and thus first sold books, videos, computer hardware and software, and compact discs. He chose to sell books because of the high worldwide demand, low price per piece, and high number of titles. His aim was to provide more varieties of books online than were available in a physical store. Amazon's main competitors were Barnes & Noble Booksellers Inc., the largest retail bookseller, and other local booksellers in the United States. The company was named Amazon.com in the year after it was created. Through a partnership with Ingram Book Group LLC, Amazon could access books at wholesale prices and sell them online at cheaper prices than physical bookstores. Within its first two months, Amazon's online sales covered more than 45 countries with sales revenue of US$20,000[6] per week. In June 1997, it went public and entered the Nasdaq stock exchange at an initial price of $18 per share, raising $54 million.

Global Expansion and Laborious Financial Results: 1998–2004

In 1998, Amazon began to expand internationally, first by entering the United Kingdom and Germany, and then moving to Europe and Asia, including France, Japan, and China. The company included different languages on its websites to serve these international markets. Bezos was not expecting to make any profits during the first four or five years of the business. Shareholders were not satisfied with the company because it was not profitable and not growing fast enough. However, this business model, with slow but efficient growth, saved Amazon from suffering too much from the 2001 dot-com bubble, and the company realized its first profits in 2001. Nevertheless, its profit was only $5 million from revenues of over $1 billion. Since 2001, the company had significantly diversified its products, from books to computers, electronics, clothes, and beauty products.

Diversification, Early Steps in the Service Industry, and Own-Brand Products: 2005–2010

Amazon continued to extend its services through AmazonFresh, a grocery service, and Amazon Music, an online music store. The company increased its product offerings through the Fulfilment by Amazon program, where products were stored in Amazon's fulfilment centres and then quickly picked, packed, and shipped to customers. It also created Amazon Prime to provide a two-day shipping service in the United States for only $79 a year. It launched Amazon Web Services Inc., which offered inexpensive, reliable, and scalable cloud computing services, including Amazon Mechanical Turk, a crowdsourcing Internet marketplace that enabled individuals and businesses to coordinate the use of human intelligence. This period also marked the beginning of Amazon's own-brand products, including the 2007 launch of the Amazon Kindle, one of the very first e-books readers, three years before the launch of Apple Inc's iBooks.

Innovating and Diversifying at a Faster Pace: 2011–2017

The company kept innovating to improve its products and services. It launched Amazon Locker, a parcel delivery service that allowed buyers to pick up purchases at secure, self-service kiosks, and Amazon Prime Air, a cargo airline and drone-based delivery system. In February 2017, the company announced that it would invest $1.5 billion to build an air cargo hub to support the increasing size of its fleet.[7] Amazon also entered new segments with its Kindle Fire and Fire HD, which competed with Apple's iPad.

Amazon acquired several companies, including GoodReads, an online social networking site for sharing books and reviews, and LoveFilm, a DVD-by-mail and streaming video-on-demand provider that competed with Netflix in Europe. It acquired Kiva Systems to develop robots that efficiently moved products in warehouses, thereby shortening delivery times.

The company launched Amazon Video Direct to compete with YouTube,[8] and it also developed and operated Amazon Video, an Internet video-on-demand service where customers could buy, rent, and instantly watch digital movies and TV shows. Amazon opened its first physical bookstore, Amazon Books, in Seattle, selling products at the same prices as those available in the online stores. These strategic moves allowed Amazon to become a global online retail giant. By 2015, its market capitalization surpassed that of Walmart.

AMAZON'S DEVELOPMENT

Headquartered in Seattle, Amazon was one of the big four global digital companies: Google, Apple Inc., Facebook Inc., and Amazon. It had worldwide operations, with websites serving markets in 14 countries in North America, Europe, and Asia, and shipping services in 75 countries.[9] Its business was expanding rapidly. The number of full-time and part-time Amazon employees increased 47 per cent in one year to reach 268,900 in 2016.[10] This was 23 times more employees than its online competitor EBay and twice as many as Apple, but it was less than 12 per cent of the employees of its offline competitor Walmart. Amazon announced a plan to hire 100,000 full-time employees in the United States from January 2017 to mid-2018, potentially becoming one of the largest technology employers in the country.[11]

Amazon offered a wide range of products on its website, including books, apparel, and even food. As of February 2017, Amazon.com had 48 categories of products—both new and used—that were created and sold both by Amazon itself and by other companies. Most products were in the digital and multimedia sectors. The company had diversified a lot over the years but mainly within online businesses.

The company's revenues from online retail sales largely surpassed those of its competitors: in 2015, its online retail sales were 5.5 times greater than those of Walmart, making it the leader in the online retail market[12] (see Exhibit 1). Amazon made $71.84 billion in online retail sales between November 2014 and November 2015. This was more than the combined online sales of Apple, Walmart, Sears, Roebuck & company, The Gap Inc., Costco Wholesale Coporation, Target Corporation, The Kohl's Corporation, Best Buy Co., and The Home Depot Inc.[13] In the second quarter of 2016, Amazon hit a record profit for the third straight quarter—$857 million ($1.78 per share) on revenue of $30.4 billion.[14] This record far surpassed analysts' estimates of profits per share of $1.11 and revenues of $29.5 billion. In 2016, its online retail sales accounted for half of all online retail sales in the United States.[15] According to Amazon's chief financial officer, Brian Olsavsky, these positive financial figures were a result of "working very hard on efficiency" and "benefits of operating at scale."[16]

For years, as Amazon's online retail sales and profits increased continually, the company kept on investing in research and development (R&D) to improve its offers and to develop new market sectors. In 2016, Amazon decided to enter food and consumable goods manufacturing through Amazon Elements, available only online for American Prime Members, and offline retailing through Amazon Go in Seattle, the first brick-and-mortar convenience food store that employed mobile e-commerce, machine learning, and computer vision to allow customers to make purchases without a cashier.[17]

However, Amazon's performance in the third quarter of 2016, especially in terms of profits, was lower than expected, and this caused its stock price to decrease by 7 per cent. While its revenues were as expected, at $32.7 billion, its profits were $252 million, which was much lower than in the second quarter.[18] Earnings per share were only $0.52—below the estimated $0.78. Still, as of the third quarter of 2016, Amazon was the fourth most valuable public company in the United States.

This poorer performance resulted largely from increased investments in improving existing offers and developing new offers. Such investments were expected to increase as Amazon entered offline retail segments, which required at least buying physical stores. As Olsavsky said, "We are in a period of advancing up our investments in the second half of 2016, even more so than in prior years."[19] In May 2016, to raise more capital, Bezos sold over one million of his shares—the largest amount he had ever made—for $671 million. In August 2016, he sold another record one million shares for $756.7 million, reducing his shares in Amazon to 16.9 per cent (see Exhibit 2).

AMAZON'S COMPETITIVE ADVANTAGES

Amazon's success was not only due to its first-mover advantage but also came from a combination of competitive advantages related to marketing, supply chain, innovation, and customer-centricity.

Brand Awareness and Innovative Marketing

Amazon's marketing strategy relied on its strong brand awareness. As Bezos said, "Brand names are more important online than they are in the physical world."[20] In another interview, he noted the importance of communicating the story of Amazon's brand: "You can have the best technology, you can have the best business model, but if the storytelling isn't amazing, it won't matter . . . Nobody will watch."[21]

The company implemented innovative marketing to receive free press coverage and to increase good customer perception of its products and services. Its community banana stands gave away about 4,500 free bananas daily to Seattle inhabitants to create more links with customers and improve its brand image. Since bananas were also the most popular item sold by Amazon's rival, Walmart, some analysts thought this campaign could be seen as a way of attacking Walmart by showing that Amazon also sold good-quality fresh items.[22]

Amazon chose to advertise its first unexpected offline retail venture, Amazon Go, through video teasing, which successfully created a buzz among the general public. Amazon did not really need to spend a lot of money to advertise this brand-new offline offer, as media outlets were already talking about this innovative retail marketing approach. Amazon's competitors also started to react to the resulting widespread public awareness by creating their own videos, which generated even more visibility for Amazon Go.

In 2015, Amazon spent $2.8 billion on digital marketing, an increase of 40 per cent from the year before.[23] The company also established partnerships with digital celebrities to promote its products.[24] However, these marketing activities were not the only reason for Amazon's success, and Amazon focused less on offline advertising than digital brands like Apple and Samsung. As Bezos said, "In the old world, you devoted 30 per cent of your time to building a great service and 70 per cent of your time to shouting about it. In the new world, that inverts."[25]

Efficient Supply Chain Management to Create a Convenient Shopping Experience

As an online retailer, Amazon revolutionized the way customers shopped for products through its efficient supply chain management, which made a wider range of products available and delivered those products faster than its competitors. The company's global presence and available worldwide shipments allowed customers to easily buy almost anything from any country from Amazon. Unlike Walmart, Amazon did not need a physical shop; it just needed a warehouse to store products. It also had products delivered directly from the producer to the customer. Its fast delivery came from the strategic location of its warehouses, the high levels of available product inventory, its fast order management, and its partnerships with delivery companies. For example, in Japan, Amazon partnered with Yamato Holdings Co., Ltd., allowing buyers to receive products within a day of their orders.[26] This very efficient delivery also came from its investments in robotics.

From the beginning of its business, Amazon sold many products at highly competitive prices, usually cheaper than those of offline competitors. Bezos even said, "There are two kinds of companies, those that work to try to charge more and those that work to charge less. We will be the second."[27] This ability to reduce prices came from the high economies of scale Amazon could generate on some products because of their high turnover. Unlike offline retailers, Amazon did not pay expensive rent for physical shops but efficiently managed warehouses at strategic locations to maximize its inventory turnover. Its strategy to sell more at a low price meant the company's margins were usually lower than those of competitors, and this was one reason why it was not profitable for many years.

Customer-Centricity and Innovation

Bezos's strategy had always been to focus on customer needs. He said, "We've had three big ideas at Amazon that we've stuck with for 18 years, and they're the reason we're successful: Put the customer first. Invent. And be patient."[28] Since the beginning of online business, Amazon kept innovating to create the best possible user experience. The company emphasized the ease of use of its websites. It also reduced product delivery time, proposing even same-day deliveries in some cities. This customer-centric approach allowed the company to be more innovative. As Bezos said, "If you're competitor-focused, you have to wait until there is a competitor doing something. Being customer-focused allows you to be more pioneering."[29] The company increased the number of products it offered over the years to satisfy customer needs, particularly through partnerships with prominent players such as retailer Toys "R" Us Inc.

AMAZON'S PRIVATE LABELS AND OFFLINE RETAIL OFFERS

Amazon had already launched a bookstore in a university in Seattle, which offered over 6,000 book titles, and it planned to open a second one in San Diego. Although Amazon did not have much experience in the traditional manufacturing and retail business, it decided in 2016 to enter grocery product manufacturing and brick-and-mortar food retailing. This decision went against the general trend of business models followed by many competitors, which were increasingly moving from offline physical stores to online stores. However, Bezos did not see this decision as a risk. Instead, he saw it as a normal evolution of business, and said, "What's dangerous is not to evolve."[30]

New Brands

After developing many electronic devices under its own brand, Amazon decided to enter the higher-margin grocery and household goods sectors. In May 2016, the company announced the launch of three brands available for purchase online on its websites: Happy Belly (which offered grocery products including milk, coffee, cereals, and pasta), Wickedly Prime (which offered ready-to-eat prepared foods), and Mama Bear (which offered baby products including baby food, cleaning wipes, and diapers).[31] Amazon thus not only sold grocery and household products online but also produced them through private labels, allowing the company to have potentially higher margins.[32] On its websites, the company explained that this move was driven by its customer-centric capabilities.[33] According to Amazon, the product offerings would be improved based on the clients' feedback. It wanted to create and promote brands that would be seen by customers as more trustworthy than others.

While Amazon Elements products had been available only in the United States and only to Amazon Prime members, a small segment of Amazon's entire customer base, Amazon contracted with multiple manufacturers to produce this new range of products. These manufacturers included TreeHouse Foods Inc., which was also manufacturing similar goods for other retailers. This development could be seen as an attempt by Amazon to catch up and compete even more with other retailers such as Walmart and Target, which had had their own product brands for years.

Because Amazon's brand awareness was so high, it could develop these new offers easily without having to spend millions of dollars on advertising and other marketing activities. Amazon could adapt its product offers to meet consumer demands by utilizing its enormous customer databases. However, as Amazon had not been a traditional retailer before, this strategic move might be seen as risky. Indeed, this was not the first time that Amazon had tried to produce baby products. In 2014, the company had launched its own diapers on its websites, but removed them from Amazon.com only few weeks after the launch due to manufacturing defects and negative customer feedback.[34] Nevertheless, Bezos was not the kind to give up easily after one failure. He said, "If you're not stubborn, you'll give up on experiments too soon. And if you're not flexible, you'll pound your head against the wall and you won't see a different solution to a problem you're trying to solve."[35]

These new Amazon-branded products could also create tensions with suppliers who were currently presenting their products on Amazon.com, potentially putting Amazon in an even tougher position to negotiate with them.[36] Should Amazon's own brands be showcased on its websites while the company aimed to be a leader in the sale of its own-brand products? Should these own-brand products be marketed the same way as products available from other suppliers? Was the launch of its own-brand products considered unfair competition?

Amazon Go

Amazon's business model was designed under the assumption that retail businesses were all growing and moving toward the online environment. However, with Amazon Go, the company clearly revised its business model to combine online and offline retailing. The company opened its first brick-and-mortar food store on December 5, 2016, near its headquarters in Seattle. It announced this new initiative only by posting a video about the Amazon Go concept that day.[37] Immediately after the post, media outlets around the world wrote about it. The store was accessible only to the company's employees for beta testing, while a public opening was planned for early 2017.

It seemed that Amazon might be planning to extend Amazon Go to the United Kingdom. According to the *Guardian*, the company had registered a British trademark for the store concept in December 2016, on the same day it opened the Seattle store.[38] The company refused to comment to the newspaper about this potential U.K. expansion. However, such an expansion would not be surprising given that the company had often before used the United Kingdom as its first non-U.S. market to test new offers. These strategic moves implied that Amazon might be thinking of developing the Amazon Go concept globally.

The Amazon Go store, which sold staple foods, was 1,800 square feet (over 160 square metres) in area. Its uniqueness was its fast and convenient electronic payment system. Customers just entered the store, picked up the products they wanted, and left the store without having to queue to process payments.[39] When customers took products from the store, sensors would concurrently transmit information about the purchases to its online processing system, which would debit the price of those products directly from the customers' Amazon Prime accounts before the customers left the store.[40] Amazon Go and Amazon.com had the same aim: to revolutionize the way people consumed in their everyday life and to offer the best possible customer experience. According to the company, this shopping technology was really not a new concept, as Amazon's teams had already been working on it for four years.[41]

The automated grocery store raised significant concerns among Amazon's employees due to the potential job cuts in Amazon stores. It was estimated that, through this technology, Amazon's grocery stores might eliminate thousands of jobs in the long term.[42]

COMPETITION IN THE OFFLINE RETAIL MARKET

Amazon Go and Amazon's private labels, including Amazon Elements, targeted markets that were quite similar to those of its major grocery retail competitors, Walmart and Target. Over the years, Amazon had surpassed these large retailers in terms of online sales, but would the company be able to reproduce this online success in the offline markets? Though it might generate greater profit margins, the offline retail market was extremely competitive, requiring much larger investments.

Importantly, Amazon had no solid experience in managing physical chain stores. Many competitors, particularly established grocery retailers, viewed such announcements with humour. Amazon was clearly a latecomer without sufficient knowledge of brick-and-mortar retail markets, while efficient delivery systems allowed more customers to shop for products online. Monoprix S.A., a major French retail chain located in key areas in city centres, made a parody of Amazon Go's video, saying that Amazon should have better served its customers' needs.[43] This reaction was similar to the response to Amazon's entrance into the online food market, in which it became a big player. By 2016, the Amazon Prime service had over 63 million users; these users could be potential users of Amazon Go and Amazon Elements as well.[44]

Amazon's biggest competitor in the online retail market was Walmart, an American retailer operating in both offline and online markets through its own brick-and-mortar stores and websites. It was the largest offline retailer in the United States and the second online retailer after Amazon. Amazon and Walmart had been competing in the online market for years. Walmart had even sued Amazon in 1998 for hiring former Walmart executives and thus stealing its trade secrets.[45] Doug McMillon, the president and chief executive officer of Walmart, commented that Walmart's high number of stores gave it a competitive edge over purely online stores such as Amazon and that, by being in both offline and online markets, the company could do "quick last minute delivery that is free, cheaper, pushes cutoff shopping during holidays, and . . . brings people into stores."[46] The opening of Amazon Go stores and the development of Amazon's own-brand grocery products could thus become a serious threat to Walmart.

CONCLUSION

The launch of Amazon Go and Amazon Elements, as well as other private labels, clearly demonstrated Amazon's intention to move from being online only to becoming a mixed offline and online retail and manufacturing company. Amazon Go and Amazon Elements had several similarities: they were offline, were reserved only for Amazon Prime members, were in the grocery segment, and had the same competitors. These initiatives, which were seen as good opportunities for Amazon to generate higher profits, meanwhile put the company into a riskier position due to its lack of experience in traditional retailing. In online retail sales, Amazon's performance had surpassed its mixed online and offline retail competitors over the years, demonstrating its strengths in marketing, supply chain, and customer-centricity in online segments.

Could Amazon replicate the competitive advantage that contributed to its online success in the offline retail markets? Could the company leverage its existing online assets and capabilities in the offline segments? Given this diversification, how could Amazon manage the efficiency of its operations and the quality of its products in the long term? Did the company have capabilities to do so? Would Amazon Go change the way people bought and consumed as Amazon.com had done so successfully before? Would the company be able to go against the trend of grocery shopping, which was increasingly moving toward online markets? Could the company develop these offline retail offers globally? Could competitors easily imitate this innovative shopping technology? Finally, given potential job cuts, would Amazon face resistance from store employees and unions?

EXHIBIT 1: DIGITAL SALES WORLDWIDE, BY RETAILER (IN $MILLIONS)

Amazon.com	71,844
Walmart	13,188
Apple	10,740
Macy’s	4,710
Home Depot	4,267
Best Buy	3,672
Costco	3,498
Nordstrom	2,620
Gap Inc.	2,505
Target	2,491
Williams-Sonoma	2,459
Kohl’s	2,282
Sears Holdings	2,084

Source: Phil Wahba, “This Chart Shows Just How Dominant Amazon Is,” *Fortune,* November 6, 2015, accessed April 16, 2017, http://fortune.com/2015/11/06/amazon-retailers-ecommerce/.

EXHIBIT 2: AMAZON’S YEAR END FINANCIAL RESULTS

	2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Revenues (million $)	14,835	19,166	24,509	34,204	48,077	61,093	74,452	88,988	107,006	135,987
Gross Margin (%)	22.6	22.3	22.6	22.3	22.4	24.8	27.2	29.5	33.0	35.1
Operating Income (million $)	655	842	1,129	1,406	862	676	745	178	2,233	4,186
Operating Margin (%)	4.4	4.4	4.6	4.1	1.8	1.1	1.0	0.2	2.1	3.1
Net Income (million $)	476	645	902	1,152	631	−39	274	-241	596	2,371
Earnings Per Share ($)	1.12	1.49	2.04	2.53	1.37	−0.09	0.59	−0.52	1.25	4.90

Source: “Amazon.com Inc. AMZN,” Morningstar, accessed April 16, 2017, http://financials.morningstar.com/ratios/r.html?t=AMZN.

ENDNOTES

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