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CRITICAL EVALUATION OF HOW WELL PLACED AMAZON IS TO SUSTAIN ITS HISTORICAL IN ONLINE RETAILING

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ABSTRACT: *E-commerce has staged a stay in modern day businesses and the retail sector is not an exception. As such, competing in the 21st century market without online presence is simply unthinkable because the Internet has offered organizations an entirely new and efficient way of delivering value to customers and achieving sustainable competitive advantage (SCA). This paper therefore, is essentially a mapping exercise that critically examined how Amazon has deployed the Internet to develop a business strategy that is changing the face of retailing and driving the company towards SCA. We first identified the key factors responsible for Amazon's current success and thereafter, presented some critical issues that the company should watch if it wants to outlast its critiques. Drawing from basic financial analysis, the resource-based view (RBV) as well as SWOT diagnosis, we argue that although Amazon generates astounding sales volume on yearly basis, the proportion of these sales that actually translates to profits is very infinitesimal because of the company's business model and rising operational costs. Interestingly too, we found that Amazon is yet to do excellent customer profiling despite its good technologies. We argue that whilst it is too early to conclude that Amazon will hit a plateau very soon, the company's long-term vision, business model, customer-centric philosophy, continuous product/process innovation and pool of unique employees are strategic resources that were found to be great sources of SCA. In the light of the abovementioned and coupled with the predictions that e-commerce will continue to grow, we reinforce that Amazon stands a great chance of putting the sharp-end of its business at the cutting-edge if it deploys resources more efficiently, keep its debt financing within plausible limits, reduce rising operating costs, examine working conditions in its warehouses and do better customer profiling.*

KEYWORDS: Amazon, E-Commerce, Online Retail, Customer Profiling, Operating Cost, Working Conditions, Operation Cost

INTRODUCTION

After making a debut into the e-tailing industry in 1994, Amazon has today grown into a very promising online retail giant. Some commentators are even beginning to call Amazon the Wal-Mart of the Internet (Francisco, 2011; Stone, 2009). But whether or not the firm is well placed to sustain its current success is actually debatable. The aim of this paper therefore is to critically analyse how well placed Amazon is to sustain its historic success. The rest of this paper is structured into three sections. First, we will present an overview of the company and the key factors responsible for Amazon's historic success. In the second section of the report, we will perform basic financial analysis of the company's annual reports and thereafter draw from the resource -based view (RBV) of the firm to strengthen the criticality of resources in Amazon's success and expose some of the weaknesses within the company's strategy. In the last section of the paper, we will pull our analysis together using SWOT and draw logical conclusions and

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recommendations that are expected to help the retail giant sustain its current lead in the e-tailing business sector.

OVERVIEW OF AMAZON'S HISTORIC SUCCESS

Amazon is the hand-made of Jeff Bezos who resigned his appoint in D. E. Shaw in 1994 to pursue what has today become very enterprising. The level of success that Amazon has achieved so far clearly evinces that Bezos was quite prophetic when he noted that pursuing the Amazon project was to shield him from regrets that would have greeted him when he turns eighty; if he refused to quit a Wall Street job at thirty. This thought came alive when "Bezos came up with the statistic that the electronic world, known as the World Wide Web, would grow at the incredible rate of 2,300 per cent monthly" (Stockport, 2004, p. 2). Today, Bezos' dream is nearly coming true because Amazon "dominates the world of e-commerce sales, estimated at $259 billion in 2013; that's a healthy 14.8 percent year-over-year gain, according to eMarketer" (Schulz, 2013) and equally ranks second after Apple in the Gartner's supply chain popularity contest of 2012 (Blanchard, 2012). Additionally, Amazon has the opportunity to continue expanding its market scope because sources citing Forrester's Research and eMarketer stated that e-commerce will continue to grow at an incredible rate (Jones, 2013; Indvik, 2013; Schonfeld, 2010).

Since Amazon was reincorporated in 1996 (Annual Report, 2013), the company has progressively waxed stronger with the vision of becoming the most customer-focused organization in the world through innovations (Lindic *et al*., 2012; Malczewski, 2011). Amazon has constantly expanded its customer base. For instance, in 2012, the company had an active customer base of 182 million (Thomas, 2013) as against the 1, 510, 000 customers in 1997 (Annual Report, 1997) (11952.98% increase). This means that the company has been able to double its customer base by more than 119 times. Additionally, within 8 years, Amazon was able to hit sales revenue of $5billion, a fit that took Wal-Mart the largest retailer in the world, 20 years to achieve (Chaffey, 2012).

One of the things that triggered Amazon's early recognition and success was its extensive promotional relationships with emerging internet players like Yahoo, Excite, American Online, @Home Network, Intuit and so on (Stockport, 2004). Part of Bezos' expansion strategy included acquisitions of other companies such as Telebook, Bookpages, Internet Movie Database, Planetall and Junglee including continuous addition of new product lines into its product range (Stockport, 2004). Till date, Amazon is still acquiring other companies and consistently adding new product lines to its product portfolio. Its recent acquisition of ComiXology is a perfect case in point (Stone, 2014). Although the dot.com bubble burst of 2000 caused a fall in Amazon's stock price by 75.90% and rampant acquisitions and closures of many companies (Stockport, 2004), Amazon was able to sustain the tempo of its performance (Malczewski, 2011). Sales figures have always been on the increase as the market seems to be growing according to Bezos' initial predictions (see table 1). Bezos cited selection, price, convenience (including fast and reliable fulfilment), quality, speed, and reliability of services and tools as their critical success factors (Annual Report, 2013). However, despite its sustained momentous success for nearly two decades, net profit figures of Amazon are still far from consistent (see table 1). Although Bezos' takes in this respect revolves around the long-term, a key question that has gone largely unanswered is: how long will Amazon continue netting losses? In trying to answer this question, we will track the company's financial

performance in the later section of this paper using simple financial analytical tools and thereafter present valuable implications that remains a must watch for Amazon.

AMAZON'S BUSINESS MODEL AND STRATEGY

One secret behind Amazon's business model which is still difficult for people to understand is the relationship between profit and sales. The lesser the percentage of sales which is profit, the higher profit the retailer tends to make. This becomes clearer, if you calculate their sales as a percentage of profit using the data in table 1. Evidences from the table show that Amazon's profit standing is better when the profit margins are lower. The simple interpretation of this is that Amazon increases profits through high sales volume which arises from low margins. According to GlobalData (2013), this is a strong business model. One of the keys to the successful operation of this business model is the disintermediation role that the online retailer plays (Yarow, 2013; Malczewski, 2011). This enables Amazon to deliver products and services to their clients at lower prices than competitors. Consequently, everyday low pricing model is a key strategy in Amazon's online retailing of products (GlobalData, 2013). The impact of this on sales turnover has been very astounding (see table 1).

To get higher sales volume, Amazon has aggressively diversified into many product offerings and services delivery. A theoretical justification for this strategy is rooted in Ansoff's 1957 Strategy Matrix (cited in Richardson and Evans, 2007, p. ii). Although expanding product range can help to increase key customer accounts as implied in Ansoff's model; there needs to be better profiling of customers to track their profit potential because evidence-based researches show that not all customers or even loyal customers are profitable (Kumar *et al*., 2009; Cao and Gruca, 2005). This is why Sprint Nextel fired around 1000 of their 53 million customers (Kumar *et al*., 2009). Yet, other research clusters (Kazemi and Babaei, 2011; Carbo-Valverde *et al*., 2011) stressed the importance of customer attraction. However, these two perspectives occupy opposite extremes. A balance in a company's strategic response to this issue is therefore the most optimal strategy. Smart organizations therefore reward different customers differently and at times fire customers who are consistently unprofitable. Contrary to this, all Amazon's customers receive customized services (Mirow, 2005). Even though the company utilizes web services and other technologies to boost customers' pool (Annual Report, 2013; Mann, 2013; Lindic *et al*., 2012; Malczewski, 2011; Markides, 2006; Hof *et al*., 1998), we found no evidence of key measurement strategy in place to determine each customer's contribution to profitability. This might have even accounted for Amazon's rising operational costs (see table 1 and figure 1). If this weakness is not checked, it might evolve into a big threat that may further weaken the company's financial performance.

EVALUATING AMAZON'S FINANCIAL PERFORMANCE

Table 1 captures some key financial data such as net sales and profits, total assets and liabilities as well as current assets and liabilities on Amazon's financial report between 1997 and 2013. The choice of this period was to ensure that the relevant data were available and accurate. It can be observed from table 1 that even though sales turnover increased steadily, Amazon continuously netted losses for six years (1997-2002). In the same period, net losses averaged $500519.33. Thereafter, inconsistent net profit margins were generated for nine consecutive years (2003-2011). In 2012, the company also made losses whereas profit was made in 2013.

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To determine the possible explanation for this inconsistent trend and its consequences, we employed basic financial tools and consequently discussed our findings in line with some established theoretical underpinnings. Table 2 reports the company's gearing and liquidity ratios which were calculated using the formulas in the appendix. Figure 1 charts the growth in net sales, operating costs and net profits. The idea was to determine how much of the organization's transactions that were financed on debt and how prudent the firm was in its use of financial resources.

Table 1 Amazon's Financial Indices

Year	Net sales ($) in thousands	Operating expenses in thousands	Net profit ($) in thousands	Current assets ($)in thousands	Total assets ($) in thousands	Current liabilities ($)in thousands	Total long-term liabilities ($)in thousands
1997	147,787	61,413	-31,020	137, 709	149, 844	44, 551	76, 702
1998	609, 819	242,719	-124, 546	424, 254	648,460	161, 575	348, 140
1999	1, 639, 839	896,400	-719, 968	1, 006,477	2, 465, 850	733, 234	1, 466, 338
2000	2, 761, 983	1,519,657	-1,411, 273	1, 361, 129	2, 135, 169	974, 956	2, 127, 464
2001	3, 122, 433	1,210,815	-567, 277	1, 207, 920	1, 637, 547	921, 414	2, 156, 133
2002	3, 933, 936	928,494	-149, 132	1, 615, 676	1, 990, 449	1, 065, 958	2, 277, 305
2003	5, 263, 699	986,573	35, 000	1, 820, 809	2, 162, 033	1, 252, 701	1, 945, 000
2004	6, 921, 000	1,161,572	588, 000	2, 539, 000	3, 248, 000	1, 620, 000	1, 855, 000
2005	8, 490, 000	1,607,000	359, 000	2, 929, 000	3, 696, 000	1, 899, 000	1, 551, 000
2006	10, 711, 000	2,067,000	190, 000	3, 373, 000	4, 363, 000	2, 532, 000	1, 400, 000
2007	14, 835, 000	2,698,000	476, 000	5, 164, 000	6, 485, 000	3, 714, 000	1, 574, 000
2008	19, 166, 000	3,428,000	645, 000	6, 157, 000	8, 314, 000	4, 746, 000	896,000
2009	24, 509, 000	23,380,000	902, 000	9,797,000	13,813,000	7,364,000	1, 192, 000
2010	34, 204, 000	32,798,000	1, 152, 000	13,747,000	18,797,000	10,372,000	1, 561, 000
2011	48, 077, 000	47,215,000	631, 000	17,490,000	25,278,000	14,896,000	2, 625, 000
2012	61, 093, 000	60, 417,000	-39, 000	21,296,000	32,555,000	19,002,000	5, 361, 000
2013	74, 452, 000	73, 707, 000	274, 000	24, 625, 000	40, 159, 000	22, 980, 000	7, 433, 000

Source: Annual Financial Reports of Amazon (1997-2013).

Looking at table 2, gearing ratio is inversely related to profitability. As Amazon invested more in debt financing, net profits plummeted accordingly. This neatly symbolizes that excessive debt financing can actually expose a firm to risk of bankruptcy. This finding is consistent with the results of previous research (Brander and Lewis, 1986). Looking at table 2 more closely, it can be argued that debt financing is not totally bad. Between 2003 and 2007, Amazon was still making profits even though it was highly geared. Evidence-based researches equally supported this finding (Campello, 2006; Kovenock and Phillips, 1997). Consistent cash inflows might have accounted for this trend (Riley, 2012). One possible explanation for Amazon's initial high debt financing may be as a result of the firm's determination to respond to growing needs of customers via rapid expansion strategy. Amazon was able to achieve this fit by investing heavily on its supply chain (Yarow, 2013). On a general note therefore, it may not be out of place to argue that even though debt financing is good in some respects, such financing will yield better results if they are efficiently utilized and are within good limits.

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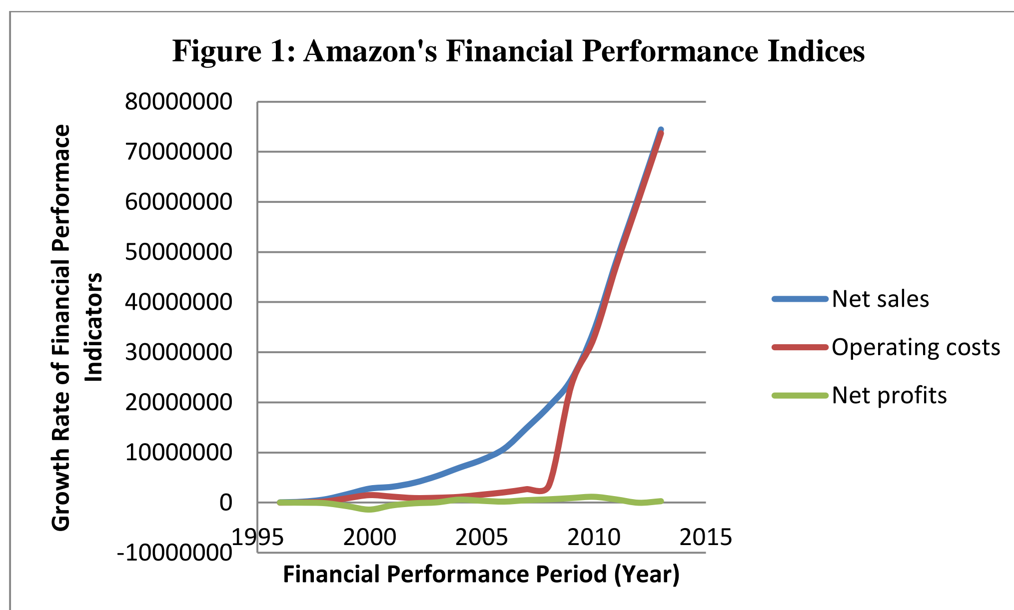
Table 2 Amazon's Liquidity and Gearing Ratios (1997-2013)

Year	Net profit ($)	Gearing (%)	Liquidity ratio
1997	-31,020	72.85	3.09
1998	-124, 546	71.50	2.63
1999	-719, 968	84.63	1.37
2000	-1, 411, 273	183.37	1.40
2001	-567, 277	301.08	1.31
2002	-149, 132	246.33	1.52
2003	35, 000	213.89	1.45
2004	588, 000	113.94	1.57
2005	359, 000	86.31	1.54
2006	190, 000	76.46	1.33
2007	476, 000	56.80	1.39
2008	645, 000	25.11	1.30
2009	902, 000	18.48	1.33
2010	1, 152, 000	18.53	1.33
2011	631, 000	25.28	1.17
2012	-39, 000	39.56	1.12
2013	274, 000	43.27	1.07

To determine whether Amazon's debt financing has been efficiently utilized, we examined the liquidity ratios and charted the operational costs. The results show that Amazon's liquidity ratios are in good standing and that the firm seems to be well placed to meet its short-term financial obligations but the operational costs have been rising at a rate faster than profit growth rate (see figure 1). It can also be observed from table 2 that Amazon netted losses in 2012 as debt financing increased. Whilst this may possibly be as a result of Amazon's heavy capital investment during the 2012 financial year (Annual Report, 2012), it again points out that excessive debt financing may not be the best for the company. Additionally, operating costs have also been growing at almost the same rate with net sales. Such rising costs are an unsustainable strategy that can actually constitute a threat. It therefore needs to be checked.

Figure 1: Amazon's Financial Performance Indices



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CRITICAL ASSESSMENT OF AMAZON'S NON-FINANCIAL RESOURCES

The resource-based view (RBV) has been intensively explored (see for example, Zhuang and Lederer, 2006; Teece *et al*., 1997; Penrose, 1995; Barney, 1991a; Porter, 1979; Bain, 1968). This might be why Kraaijenbrink *et al*. (2010) argued that it remains one of the most cited theories in the history of management theorizing. The theory largely holds that organizations that possess inimitable, rare and valuable resources are likely to perform better than their rivals. This implies that achieving sustainable competitive advantage (SCA) is a function of how inimitable, rare and valuable an organization's resources are in relation to competition. Although academics vary in their conceptualization of the RBV, we refrain from advancing the views of these authors because that lies outside the scope of this report. We rather tried to strengthen our view by critically examining those rare, inimitable and valuable resources that have contributed immensely to Amazon's success.

The criticality of resources cannot be underestimated. In fact, Zhuang and Lederer (2006) bluntly stated "that resources foster organizational success" (p. 251). Amazon seems to be a perfect case in point. It can be argued that the company's unique team of employees and Bezos' visionary leadership has been very instrumental to Amazon's success (Annual report, 2013). Hargrave (2014) argue that Jeff Bezos is Amazon's greatest asset due to his long-term vision and consistent expansion strategy. This view appears tenable because every business is a going concern. The staffs within Bezos executive team are genius in their respective fields. In fact, each have years of experience in multinational corporations that compete with Amazon and from time to time Bezos has continued to strengthen this team. For instance, the former Vice President of Wal-Mart was recruited into Bezos team in 1997 as the Chief Information Officer whilst Jimmy Wright, former senior manager in Wal-Mart with over 25 years' experience joined as the Vice President, Chief Logistics Officer in December 1998 (Stockport, 2004). A former General Manager of Apple Computer, Diego Piacentini with over 13 years' experience in international operations was equally recruited in 2000 as one of the Senior Vice Presidents of Amazon (Annual Report, 2000). Looking at the experience and expertise of Amazon's top executive officers, one will quickly visualize an organization that is strongly placed to initiate and execute sound managerial policies and strategies. This team of experts are highly valuable, rare to find in competing firms and completely inimitable. Consequently, it creates SCA for Amazon. Besides, several studies underscored the importance of human resources in attaining SCA (Carlson and Carlson, 2013; Ployhart and Moliterno, 2011); although this view was counter argued by Zhuang and Lederer (2006) who found that human resource is not a good predictors of e-commerce performance. Nonetheless, the problem with Zhuang and Lederer's research was that they tested human resource as having a direct impact on e-commerce performance. Testing human resources as a mediator in the relationship between e-commerce performance and firms' performance would have confirmed the criticality of human resources in firms' competiveness. Moreover, it takes human beings to invent technologies which provide the platform for e-commerce and the best technologies cannot function until humans act on them.

Consistent innovative thinking is another resource that Amazon has exploited advantageously. Amazon disruptively rules the market by continuously adding unique products and services to its already existing lines (Malczewski, 2011); thereby, constantly keeping competitors at the defence side of the market fence and creating blue ocean markets (Lindic *et al*., 2012). Continuously finding new territories is one of the facets of Bezos genius (Gassee, 2013). It takes a great deal to be innovative and firms who establish themselves as innovators will always

stay ahead of competition (Lindic *et al*., 2012) especially when product range is constantly expanded to meet the growing needs of customers. Although consistent innovative thinking and unique team of employees whose interests are strongly aligned with those of the enterprise are intangible and very difficult to explicitly notice, they are critical assets that do not appear in any company's balance sheet. Whilst the agency cost theory holds that there is always a conflict of interest between managers and shareholders as both pursue their individualistic interests (Margaritis and Psillaki, 2010; Jensen and Meckling, 1976); Amazon's case is different. Managers are committed to the interest of the organization to the extent that they believe that their success is based on the success of the organization (Annual Report, 2013). As such, commitment to the success of the organization has never been in doubt. Another unique thing about the top ranking executive officers of Amazon is that they are in the same age bracket (ranging from 42 – 53) and are likely to think the same way (Annual Report, 2012). Drawing from the 2012 annual report, their average age is roughly 49 years. This unique team is the brain behind all Amazon's innovative products and services.

However, even though Amazon's top executive officers are invaluable and well catered to, there are evidences suggesting that warehouse staffs are completely disgruntled with the stringent labour conditions under which they work. Most of the disappointing work conditions which the warehouse staffs find themselves are job insecurity, overtime, strict monitoring and failure to compensate for times spent outside the warehouse working for the company and so on (Young, 2013). This therefore becomes a weakness that Amazon must try to address before it becomes too obvious and grow into a big threat. Global companies such as Nike, Adidas and so on are heavily investing in PR to redeem the bad reputation arising from the grievances of disgruntled employees (Nike, 2013; Adidas, 2013). Such expenditures can actually constitute a drain on any company's revenue.

Additionally, although Bezos expansion initiative reflects a long-term attractive strategy, Amazon will encounter greater competitive threats. According to Kotler and Armstrong (2010), several click-and-mortar firms are becoming more successful online than their pure-click competitors. It could also be argued that the strategic moves of key competitors like Apple, eBay, Neflix, Wal-Mart and so on are potential threats to Amazon especially as many of the key players in the retail sector are now complementing their physical stores with websites. With such competitive moves, Amazon may likely enter into price wars with these competitors as a result of its aggressive expansion strategy. Such price wars present threats since it can affect profit margins negatively. Overall, competition will get tougher because despite the initial predictions at the dawn of the internet era, cannibalizing the brick and mortar stores is far from current market realities (Doherty and Ellis-Chadwick, 2010).

Strong corporate vision and good technologies have also accounted for Amazon's success. Amazon's vision is to become the earth's most customer-centric organization by enhancing customer experience via offering the widest available product selection, low prices and convenient shopping (Annual Report, 2013). According to Gassee (2013), "Amazon Web Services is one area where the company is now larger than all of its competitors combined, and shows no sign of slowing down or of approaching saturation". Although this typically evinces how the company's corporate vision is driving it towards success, the use of its web technology services are yet to be optimized because customer profiling is still far from optimal (see the second paragraph of 'Amazon business model and strategy section).

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PULLING IT TOGETHER: SWOT DIAGNOSIS

In this section, effort was made to pull our views together through SWOT diagnostics. Figure 2 captures the summary of Amazon's strength, weaknesses, opportunities and threats as has been discussed in previous sections.

Figure 2: Amazon's SWOT Analysis

	Strengths	Weaknesses
Internal	• Customer-centric • Unique team of employees • Wide product range • Low/competitive prices • Continuous product/process innovation • Strong corporate vision • Good technologies	• Poor customer profiling despite good technology • Poor working conditions in the company's warehouses • Low profit margins • Debt financing • Rising operational costs
	Opportunities	**Threats**
External	• Growing markets • Expanding into new markets that offer better profits because of growing e-commerce market • Better customer profiling	• Intense competition • Financial losses • Price wars

CONCLUDING REMARKS

Although Amazon generates astounding revenue on yearly basis, the proportion of these revenues that actually translates to profits is very infinitesimal. Our findings show that Amazon's debt financing, poor customer profiling, intense competition, rising operational costs and expansion strategy might have accounted for this. Whilst as the abovementioned presents a bleak picture for Amazon, the firm's potential of sustaining its current success is not in doubt if it can concentrate on vigorously pursuing its corporate vision more efficiently. This is because industry forecasts depict that e-commerce will continue to grow at an incredible rate and it is quite impressive that Amazon has been investing heavily on its supply chain to enable it take advantage of this growth and gain better market consolidation. The company's customer-centric philosophy, corporate vision, unique team of employees, broad product range and competitive prices are great success factors if sustained. Amazon's Web Services and technologies equally place the company ahead of its competitors.

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However, it is important that Amazon thread with caution if it wants to outlast its critiques. Good as Amazon's business strategy appears, its debt financing strategy constitute a threat even though its good side cannot be totally dismissed. Taking the gearing ratio analysis (see table 2) as a point of reference, there is an inverse relationship between excessive debt financing and profitability. It will make great business sense if Amazon can rethink its excessive debt financing by keeping it within reasonable limits. Although competitors are making some smart moves that may likely upset the e-commerce market, Amazon still stands a good chance of sustaining its current success if it continues its process/product innovations. Amazon can also leverage its good technologies to do better customer profiling. Tracking the profit returns of each customer will enable Amazon to build more profitable customer base and reduce rising operational costs. Finally, poor working conditions in the company's warehouses is equally a must watch.

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APPENDICES

$$Current\ ratio = \frac{Total\ current\ assets}{Total\ current\ liabilities}$$

$$Gearing\ ratio = \frac{Long - Term\ Liabilities}{Capital\ Employed}\ x\ 100$$

$$Capital\ employed = Total\ Assets - Current\ Liabilities$$

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