

How Amazon Achieves and Sustains Record Growth

IE White Paper

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Contents

Overview	3
Multi-Pronged Approach	4
Market Growth	4
Geographic Expansion	5
Technology Growth	6
Partnerships and Acquisitions	8
Product and Service Development	8
Summary	9
Implications.....	10
End Notes.....	11

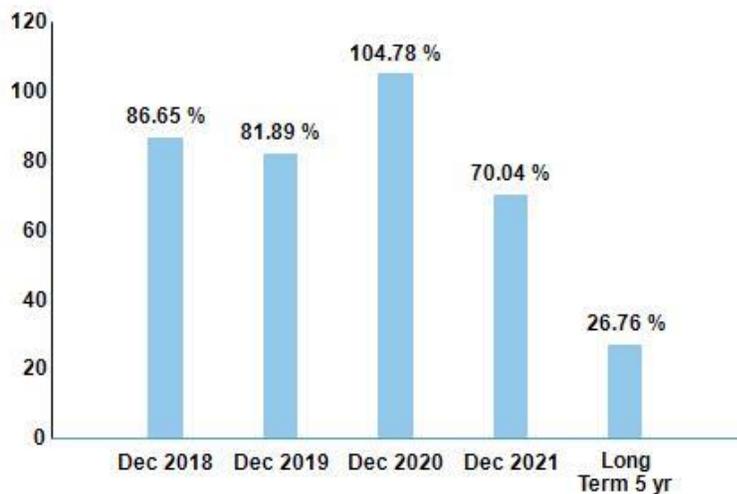
Overview

What began as 'Earth's biggest bookstore' in 1994 is now the largest electronic commerce retailer in the United States.

Amazon's 20-year record of double-digit revenue growth is unmatched in industry. In 2017 alone, net sales increased 31% to \$177.9 billion compared with \$136 billion in 2016ⁱ. It bought Whole Foods for \$13.7 billion, set a record for sales during its Prime Day event, and saw its stock rise 53.55% to cross \$1,000 for the first timeⁱⁱ. These are just a few of the highlights; the list of 2017 accomplishments in Amazon's investor relationsⁱⁱⁱ report is extensive.

CEO Jeff Bezos' focus on growth over net income is a major reason why Amazon has grown and continues to grow at more than 25% a year^{iv}. Bezos is not afraid of risk; he continually reinvests money from operating cash flow into new areas that keep Amazon ahead of its competitors. Examples include Amazon Prime, Amazon Web Services, the Alexa voice computing platform, and now Ring, one of the largest deals in Amazon's 24-year history^v. Bezos behaves almost as a growth investor does, diversifying and spreading risk across multiple areas. While some investments have been flops, the blockbuster returns from others have more than offset the losses.

Over the next five years, analysts expect Amazon to grow earnings at an average annual rate of 26.76%.



Data provided by Zacks Investment Research^{vi}

This paper explores the strategies and approaches that Amazon uses to generate its exceptional top line growth year after year.

Multi-Pronged Approach

One of Amazon's unique strengths is its ability to expand on multiple fronts simultaneously. **Innovationedge** groups Amazon's dimensions of growth in five categories:

1. **Market Growth:** New industries, new customers, increased sales to existing customers, leveraging its seller network and marketplace.
2. **Geographic Expansion:** Replicating its most successful products and services around the world, tailoring to different countries' interests.
3. **Technology Growth:** Investment in new technology and content, new applications for older technologies.
4. **Partnerships and Acquisitions:** Accelerating new market entry, providing more comprehensive value to customers.
5. **Product and Service Development:** Increasing sales and margins through homegrown offerings, including private label.

In each of these categories, Amazon takes a bold stance. Bets are big, though tests are relatively small. Bezos' view is long term and Amazon goes where he believes customers will be -- or want to be -- in the future. Amazon knows how to combine and leverage its strengths in powerful ways that not only create innovative customer experiences, but rapidly compound growth. A recent example is its new 2-hour food delivery service, in select cities to start. Amazon is combining its shipping/delivery and online ordering systems with its own line of fresh food and acquired Whole Foods brands. The concept will roll out quickly if successful, stopped if not.

Because Amazon already possesses vast amounts of customer data, it knows what people want. Since customers also tend to trust Amazon, they turn there first to buy. As a result, Amazon can dominate markets where it is established and overtake markets where it is not. Like a startup, Amazon is unafraid to disrupt itself and does so regularly. Unlike a startup, however, the company has massive resources to develop winning concepts and optimize quickly.

Market Growth

When Amazon launched, its mission was to offer *Earth's biggest selection* and to be *Earth's most customer-centric company*. Amazon is now the dominant cloud services provider with Amazon Web Services (AWS), the number 2 video streamer, a major online and brick-and-mortar grocery with its acquisition of Whole Foods, and a leader in digital personal assistant devices with its Alexa and Echo product line. Amazon's new forays into healthcare, delivery/fulfillment ('Shipping with Amazon'), smart home appliances (Ring), and other endeavors demonstrate its limitless ambition and wide horizons.

Its current mission adds: *'Amazon's customers are worldwide now and have grown to include millions of Consumers, Sellers, Content Creators, Developers, and Enterprises. Each of*

these groups has different needs, and we always work to meet those needs by innovating new solutions to make things easier, faster, better, and more cost-effective.'

- **Broadening its base, including B2B, while staying true to its customer-centricity** is one of Amazon's keys to exponential growth. Its open platform and support of consumers, inventors, developers, and providers spreads market reach rapidly and cost-effectively. For example, Bezos quickly recognized the opportunity to leverage Alexa through its outside developers as well as its consumers. *"Our 2017 projections for Alexa were very optimistic, and we far exceeded them. We don't see positive surprises of this magnitude very often — expect us to double down...we've reached an important point where other companies and developers are accelerating adoption of Alexa. There are now over 30,000 skills from outside developers, customers can control more than 4,000 smart home devices from 1,200 unique brands with Alexa, and we're seeing strong response to our new far-field voice kit for manufacturers"*^{vii}
- **Expanding consumer offerings to businesses has proven to be another effective growth avenue.** Alexa, for example, is a product with many benefits for businesses as well as consumers. In addition to the far-field voice kit for manufacturers referenced above, Amazon just announced **Alexa for Business** which brings voice assistance to both large and small businesses. WeWork, CapitalOne, and Wynn hotels are among the early businesses using voice in their workplaces, and Alexa is by no means the only example. Amazon frequently leverages successful consumer products and technologies by tailoring them for sellers, suppliers, and manufacturers.^{viii}
- **Because Amazon makes it easy for third parties to join in,** the effect is almost like a multi-level-marketing program. Sellers bring in millions of new customers and dollars while Amazon provides the infrastructure to enable them. Thus, customers beget customers in Bezos' world.
- **Amazon also makes it exceptionally easy for consumers to buy -- and buy often.** One-click shopping, targeted reminders, free shipping, lower prices, free returns, helpful customer reviews, and many other well-executed benefits have made Amazon the de facto retail channel. In the past year, 84% of all consumers purchased from Amazon. Of these, 55% were Prime members.^{ix} By owning the channel, Amazon has enormous influence on how brands are discovered which makes it very attractive to sellers. Amazon itself is now rolling out private label brands (Amazon Basics, Amazon Elements, etc.) to gain higher margins on the types of products it already sells.

Again, Amazon accelerates growth by quickly capitalizing on its successes and combining its advantages for even further advantage.

Geographic Expansion

Amazon now operates e-commerce websites in more than 10 countries, including Canada, the UK, China, and India. The company continues to expand aggressively, growing its Prime subscriber base at a rapid pace, investing heavily in content and hardware devices. In India, which represents a \$1.1 trillion retail opportunity, it said earlier this year it would spend another \$3 billion, bringing its total investment to \$5 billion. Amazon recently introduced

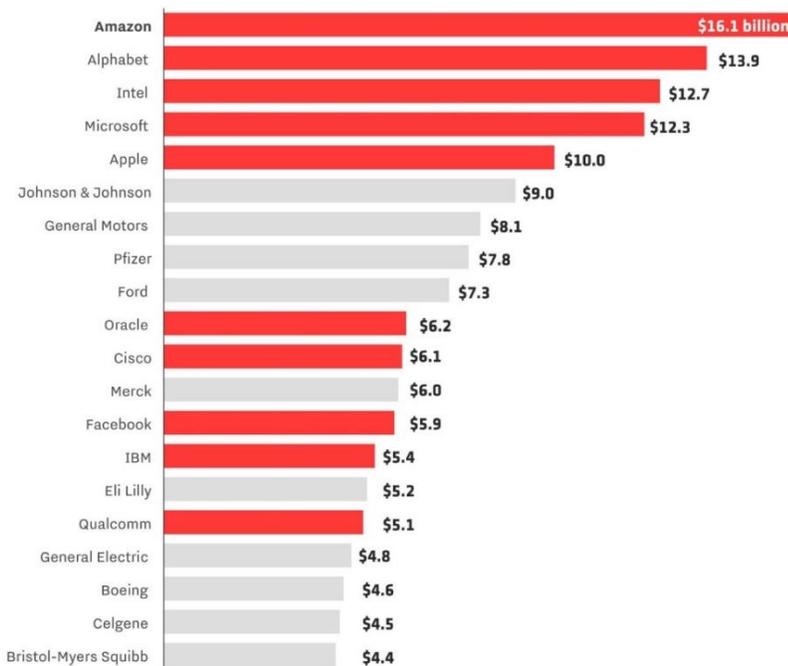
its Prime membership service in India – it is now adding Prime Video to its subscription package to give consumers access to more original content featuring Indian filmmakers and actors.^x

Amazon will expand similarly into other opportune countries such as Mexico and Australia that are still largely untapped.

Technology Growth

Amazon is the biggest investor in R&D among the top technology companies in the US, although the company does not actually report ‘R&D spending.’ It has a line item under operating expenses for ‘technology and content.’

Tech companies lead in R&D spending



Includes latest fiscal year data for reporting S&P 500 companies.
Source: FactSet

recode xi

Technology and content are indeed instrumental to Amazon's growth.

Technology: Its highest margin and fastest growing service, AWS Global, began as an inhouse project – it is now responsible for half of Amazon's market value and on track to contribute more than \$15 billion in revenue and \$4 billion in operating income in 2018.^{xii}

Many analysts believe Amazon's **cloud-based service** is its biggest and best innovation to date and that it could see a compound annual growth rate of 26% through 2023.

The other big technology for Amazon to capitalize on is Alexa, its **AI-powered, voice-activated personal assistant**. One in five (19%) have made voice purchase through Echo or similar device and another third 33% plan to do so in next year. Amazon's Alexa users, on average, already spend more on Amazon.com when purchasing than standard Amazon Prime customers -- \$1,700 versus \$1,400.^{xiii}

Voice is an industry game-changer, and Amazon is well-poised to own the retail commerce segment. A Walker Sands study^{xiv} reveals that the “connected consumer and voice-controlled devices are the future ...and as retailers struggle to stay ahead of consumer desires, their biggest challenge will be evolving at scale as technology continues to disrupt the industry.” Amazon is ahead of the game.

Search is yet another area where Amazon could dominate. According to ComScore^{xv}, 50% of all searches will be voice searches by 2020. By 2019, the voice recognition market will be a \$601 million industry, according to a report from Technavio^{xvi}. When people are looking for products they might want to buy, they typically go to Amazon.com already. With the Alexa/Echo line of products, voice search is a natural. Given its number of retail customers, Amazon could easily rival or overtake Google in voice search. It will likely gain significant market share of the \$601 million industry by 2019.

Content: Amazon is expected to spend more than four billion this year in content, almost double what they've spent thus far. Amazon Prime Video, its streaming TV service^{xvii}, will likely offer new bundles and more original content going forward. Streaming media is growing like wildfire, and as a key component of Prime, Amazon needs to provide more than its many competitors.

Overall, Amazon's **technology and content strategy** is to invest heavily and move quickly. With AWS, Amazon was first to market 11 years ago, ahead of its biggest competitors (Microsoft and Google) in cloud computing. It still leads the pack according to Gartner's measure of its strategic vision, “based on the services it plans to provide over time—and its ability to actually deliver those services.”^{xviii} Amazon is likely to have similar first mover advantage in voice commerce and search with Alexa.

Partnerships and Acquisitions

Amazon has mastered the art of make, buy, or partner decisions and the balance of organic with inorganic growth. Where the company is already dominant (i.e. warehouse, distribution, delivery), it acquires companies that can quickly add new products to its channel. For instance, by acquiring Audible, a producer of audiobooks, Amazon was able to add products and expand its influence in a new market segment.

Amazon is now acquiring Ring, a startup that makes a popular line of video-camera doorbells, in \$1 billion deal that could help it “enmesh further into consumers' homes and lay the framework for a high-tech pipeline that delivers retail goods and groceries straight to them.” (Business Insider^{xix})

The Whole Foods acquisition^{xx} is more symbiotic, but potentially Amazon’s most disruptive one to date. Amazon has the channel for online buying and delivery while Whole Foods has the brick-and-mortar stores that give Amazon direct human connection. Customer experience, cross-selling, and spin-off opportunities abound. The food industry landscape has been irrevocably changed.

When Amazon needs other strengths to make an impact, it partners. Its healthcare partnership with Berkshire Hathaway and JP Morgan Chase, the details of which are still unknown, exemplifies this. Following the announcement, New York Times said, “That weakness [of the current healthcare system] reflects the strength of the new entrants. The partnership brings together Amazon, the online retail giant known for disrupting major industries; Berkshire Hathaway, the holding company led by the billionaire investor Warren E. Buffett; and JPMorgan Chase, the largest bank in the United States by assets.”^{xxi}

Finally, when Amazon possesses the channel, technology, and customer base, it develops internally.

Product and Service Development

Amazon is increasingly developing its own products to accelerate growth and gain higher margins. AWS is its biggest contributor on this front, but not its only one.

Amazon.com Inc.’s recent push into offering more private-label goods is also paying off and driving sales. It is estimated that Amazon has sold roughly \$300 million worth of its private label goods so far this year, a 12% increase compared with last year. While its private-label business represents a very small amount of total sales on its platforms, and 12% growth is slower than total sales on Amazon, it is still quite respectable.^{xxii}

AmazonBasics is its biggest private-label brand and accounts for the bulk of sales, or \$250 million so far this year. AmazonBasics was launched in 2009 primarily as an electronics brand, selling items like HDMI cables and batteries, but it has since branched out to include such home necessities as bed sheets, bath towels and knife sets.^{xxiii}

Amazon has the customer data to identify which products will sell, the ability to deliver, and built-in prominent “shelf space.”

Sanjay Parthasarathy, founder and CEO of Indix Corp., a technology company that provides a comprehensive product intelligence platform points out, "Typically what they do when entering a new business is they start out with a marketplace and then figure out which one of those products are the right products to go and build themselves. Amazon can harness the power of its algorithms to enhance the overall customer experience and combine products and services, such as buying luggage when booking flights," he adds.^{xxiv}

Summary

Amazon is unique in many ways that cannot be replicated easily.

- First, it is in more diverse businesses than most companies. Usually companies that spread themselves beyond their primary business don't succeed. While Amazon has had its share of failures, its successes far outweigh them. Its business truly is to offer Earth's biggest selection and be Earth's most customer-centric company.
- Amazon has an expansive view of its customer base and understands the unique needs of its consumers, developers, suppliers, and more – both locally and globally. It successfully transformed itself from B2C only to B2B, profiting greatly from such offerings as Amazon Web Services and Alexa. Amazon is now moving into healthcare and banking and is certain to tap other industries and markets as well.
- Amazon is known for disrupting established businesses and traditional players. Bezos has keen instincts coupled with a wealth of data to spot opportunities and gaps. He does not hesitate to jump on them.
- His affinity for big bets is different from many companies' pursuit of "home runs." Bezos is in it for the long term, recognizing that disruptive moves with potentially significant impact will not be immediately understood. He stands behind his vision and makes sure big bets are fully resourced.
- Amazon invests heavily in R&D, acquires or partners strategically when needed, and has built a culture of customer-first innovation. Technology is instrumental to ensure operational excellence as well as superior products and experiences.
- Amazon makes it easy for third parties to join in the growth, compounding and accelerating both its market size and revenue.
- Amazon combines and leverage its assets and strengths in powerful ways, so advantages create further advantages.
- Amazon never rests on its laurels.

Implications

This white paper examined Amazon's growth strategy from the market, technology, and product development perspective. The scope of Amazon's success factors is wider and includes management practices, leadership, and organizational culture.

For those that seek to adopt some of Amazon's best practices as applied to R&D, **Innovationedge** recommends that companies focus first on their own unique strengths and assets. Having a clear mission is essential. Once strengths and missions are defined, the following strategies are effective regardless of size, industry, stage of growth, or market position:

- Identify the areas where your company can provide exceptional customer value
- Understand which emerging technologies and macro trends will be germane to customer happiness
- Be willing and unafraid to fail – go big, test small
- Find partners to accelerate new market entry and faster product development; make sure partnerships and acquisitions are complementary
- Be open to third parties to share in your growth; their success expands yours with minimal investment
- Place customer needs and desires above all else
- Make sure resources are sufficient to support growth

In terms of future growth areas, Amazon's actions indicate that voice-enabled technology, artificial intelligence, health care, original content, and instant gratification delivery are ripe.

Growth comes from believing that what you do will make a difference. Companies can learn from Amazon's example as well as take advantage of its willingness to share with third parties.

End Notes

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