

Strategic analysis of amazon.com essay sample

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I would like to express my sincere gratitude and special thank to my lecturer of Applied Strategic Management & Understanding Strategic Management module, Mr. G. V. Nathan for guiding me through the conduct of this project. His insightful knowledge and useful advices are invaluable for me in completing this project on time.

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Applied Strategic Management

Project Outline

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Selected company: Amazon. com, Inc.

Brief of company: Amazon. com, Inc. (NASDAQ: AMZN) is a US-based multinational electronic commerce company founded by Jeff Bezos in 1994. Started as an online bookstore, Amazon soon diversified into selling other kinds of products and offering Amazon Web Services (AWS). As of 2010, Amazon's turnover was US\$ 1. 152 billion and number of employees was 33, 700. Reasons for selecting Amazon. com: Despite Bezos's unusual initial business plan in which the company did not expect profit for four to five years, Amazon has now seen its remarkable business and financial success. The company's breakthrough in e-commerce, relentless effort in innovation and customer-centric philosophy are successful strategies that should be studied by every Strategic Management student. Main strategic issues facing the company:

1) A number of states, as well as the U. S Congress, have been considering the imposition of sales & use taxes upon e-commerce, which could result in substantial tax liabilities for past sales and decrease Amazon's future sales.

2) Since its beginning, Amazon has been facing a number of complaints and lawsuits regarding patent infringement which have a damaging impact on the company's reputation and negatively affect its business operations and financial positions.

Company's contribution to the National Economy: The recent years have seen the increasing trend in the U. S e-commerce spending with revenue of \$165. 791 billion in 2010, increased by 15%, and was 7. 2% of the whole retailing, which is a major sector in the U. S economy, accounts for roughly 70% of the National GDP. Amazon. com is the largest US online retailer, reaching 2010 revenue of \$34. 204 billion

Company's contribution to the global economy: Amazon. com has offices, customer service, software development and fulfillment centers across North America, Latin America, Europe and Asia, which has created 33, 700 full-time jobs and thousands of seasonal jobs. Company's recent strategic choice:

1) Amazon has been rapidly and significantly expanding into new technologies, product & service offerings and international market. 2) Amazon continues to make aggressive investment decisions in light of long-term market leadership consideration and take steps to expand globally.

Executive Summary

It can be clearly seen from the PESTEL analysis that the macro environment in the U. S is having both the negative and positive impact on the future business of Amazon. Porter's Five Force analysis shows that the e-commerce

industry is growing rapidly and competition level is high. It can be realized from the Appraisal of company's resources that Amazon possesses many of the Key Success Factors for any e-commerce firm to be successful in the industry. In terms of financial resources, Amazon has been performing well in terms of sales revenues and efficiency of operation. However, it is not the case for the company's net margin even though some upward trend has been spotted. It is clearly evident that Amazon has been pursuing the Generic Strategy of cost-leadership with broad market coverage.

However, in the face of intense competition and threats from future legislation, Amazon needs to consider product/market development coupled with expansion options including acquisitions, joint venture or strategic alliances. Some of the recommendations for international expansion strategy to be implemented successfully have been spelled out. First is the usage of organizational Matrix structure. Second, reward system should be attractive enough to hire and retain talented staff but at the same time must remain suitable with the company's strategic objectives. Last, international hiring policy should place emphasis on hiring and motivating talented staff from Parent Country Nationals (PCN) as well as Host Country Nationals (HCN) and Third Country Nationals (TCN).

Introduction

This report has been written to serve the purpose of the Applied Strategic Management (ASM) module which aims at helping Business & Management students develop knowledge, understanding and analytical thinking through undertaking an in-depth strategic analysis of a specific company and at the

same time, learn to integrate the knowledge and skills gained from other modules such as: Financial Accounting, Human Resources Management to form a complete Strategic Analysis. By selecting Amazon. com, Inc. as the subject company, all the theories and models of Strategic Management will be illustrated and applied to identify the strategic options available to the company to achieve its goals. The content of the report consists of two main parts: Strategic Analysis & Strategy Development.

Strategic Analysis comprises of the company's environmental scanning using PESTEL analysis and Industry Analysis using Porter's Five Forces analysis and Key Success Factors analysis. Strategic Analysis also looks internally into the company's resources & capabilities as well as its current financial performance. The second part focuses on Strategy Development by reviewing the Amazon's current Generic Strategies choice. Several Strategic Management Models for Future Growth and Expansion such as the Ansoff Product/Market Matrix and the Expansion Method Matrix will be constructed based on the above findings. Recommendations on Structure, Systems and Policies to implement those strategies successfully are also given towards the end of the report's content.

PESTEL Analysis

PESTEL analysis, as described by Lynch (2009, p. 115) is " the study of Political, Economic, Socio-cultural, Technological, Environmental and Legal factors-provides a useful starting point to any analysis of the general environment surrounding an organization". Political future: One of the important variables under Political Future that is going to have a remarkable

impact on the e-commerce industry is legislation on taxation. Currently, a number of States Government, as well as the U. S Congress have been proposing on the imposition of Internet sales tax (Laudon, 2010). If that is the case, financial and administrative burden would be placed upon Amazon and their future sales would be negatively affected. Economic future: The Internet infrastructure enables e-tailers, including Amazon to reach the global market and execute business transactions worldwide.

This subjects Amazon to certain economic constraints such as foreign exchange risks. “ If the U. S Dollar strengthens compared to these currencies, cash equivalents and market securities balances, when translated, may be materially less than expected and vice versa” (Amazon. com, 2010, p. 11). Social/Cultural future: The modern lifestyle nowadays has been so much influenced by the dominance of the Internet. In that context, online shopping, which is cheap, convenient and time-saving has gained rising popularity because it suits the increasingly fast-paced modern lifestyle. “ The demographic profile of online shoppers continued to broaden while at the same time significant generational differences in purchase patterns have emerged” (eMarketer, Inc., 2008a as cited in Laudon, 2010, p. 1-5).

Technological Future: “ The Internet technology base gained greater depth and power, as around 80. 5 million households (about 66. 5% of all U. S households) have broadband cable or DSL access to the Internet and 74 million people access the Internet via mobile devices” (eMarketer, Inc., 2009d, e as cited in Laudon, 2010, p. 1-5) Environmental future: Increasing

number of natural disasters in recent years has caused increased agenda on environmental awareness in business practices worldwide. E-commerce in consideration with environmental issues will have an impact on the business of e-commerce firms. Some of green effects of e-commerce are:

dematerialization, energy-saving aspect, reduced package hence less waste.

In contrast, it also represents some negative effects on the environment such as increased shipping and transportation activities leads to extra consumption of fuel and emission of vehicle smoke (Tiwari, 2010) Legal future: Cyber law enforcement has received increasing special attention from the U. S Government and its legal bodies & pressure groups (Turban, et al, 2010). This presents concerns about various compliance issues such as: privacy, competition, content, copyrights... to e-commerce companies, including Amazon. Therefore, the company will need to adopt a stringent code of conduct for online business, creating extra administrative and financial burden. Porter's Five Forces Analysis

The bargaining power of suppliers is low. Increased number of dropshipping and third-party merchants has acted as indirect suppliers to e-commerce companies. E-procurement has also given e-commerce buyers access to a huge number of suppliers. Since buyers have a large pool of suppliers to select from, bargaining power of suppliers is low. The bargaining power of buyers is high. Price competition leads to e-commerce buyers constantly seek for cheaper, better supplier offerings and there are many existing suppliers for buyers to select from. Therefore, bargaining power of buyers is relatively high. The threat of potential entrants is high. Most of the business

transactions take place via the virtual markets of e-commerce websites. Due to the removal of physical assets, sales forces and distribution channels, it is relatively easier to set up an online business rather than a traditional retailer.

The threat of substitutes is high. There are many e-tailer competitors within the industry: general vs. specialized virtual stores (amazon. com vs. barnesandnoble. com); pure virtual stores vs. click-and-mortar stores (Buy. com vs. Wal-Mart with walmart. com) (Turban, 2010), all of which play their part to increase the level of competition. Customers can also go for a huge number of substitutes from traditional retailers (brick-and-mortar stores) since traditional retail shopping still have their own advantages over online shopping in terms of providing customers with opportunities to clearly see, touch, try and test the products. The extent of competitive rivalry is high. The industry is growing. The number of new entrants is increasing hence the intensity of competition is high. Products being sold to customers are primarily undifferentiated leading to e-commerce firms enjoying little customer loyalty and competition is primarily based on price. Key Success Factors

According to Lynch (2009, p. 94) “ Key Success Factors in an industry are those resources, skills and attributes of the organization in an industry that are essential to deliver success in the market place”. The first key success factor of the e-commerce industry is low price. Since most of the products being sold at e-commerce websites are undifferentiated, customers are more concerned about pricing and prone to brand switching to get the best deal.

Strong brand name is the second success factor. Many have argued that low price is the most essential success factor for any e-commerce company because Internet consumers have access to global price comparison. “ However, even the most price-conscious online shoppers are willing to pay premiums for brands they trust”. (Turban, et al., 2009, p. 193) This is because the concern of trust and overall shopping experience are no less important than pricing for online shoppers.

One of the main concerns that make people shy away from online shopping is the issues of security, trust and privacy. Any e-commerce company which fails to protect their customers from the hazard of internet fraud, identity theft and personal data misuse will lose their customers to its competitors. Therefore, in order to succeed, any e-commerce company should be able to address the issue of Internet security, trust and privacy. One of the biggest advantages of e-commerce is that it brings the business people together and benefits all parties through its online platform. Relationship with suppliers has a remarkable impact on business activities of any e-commerce company. Affiliation with other business partners can be particularly lucrative in the context of e-commerce business practice. Therefore, good and extensive B2B partnership is crucial to the success of any e-commerce company.

“ Personalization (the ability to treat people based on their personal qualities and prior history with your site) and Customization (the ability to change the product to better fit the needs of the customers) are two key elements of e-commerce that potentially can make it nearly as powerful as a traditional marketplace, and perhaps even more powerful than direct mail or shopping

at an anonymous suburban shopping mall” (Laudon, 2010, p. 4-45).

Technology Innovation is another critical success factor because everything in the e-commerce world is built upon technology. Technology innovation has served as a source of competitive advantage to firms such as Amazon, Google. com, eBay, allow such firms to expand its business models and enhance online customer experience. Appraisal of Company Resources

Tangible resources: Although being a pure e-commerce company, Amazon has physical locations including offices, software development centers, fulfillment centers dispersed across the U. S, Europe, Asia and Latin America.

Intangible resources: Amazon has a strong brand name, which serves as the company’s sustainable competitive advantage. “ The company was ranked 43rd on the list of Best 100 Global Brands for 2009 by the Business Week” (DataMonitor, 2010, p. 6). The Interbrand Design Forum placed Amazon as number 10th most valuable US retail brand (DataMonitor, 2010).

Three distinctive capabilities:

Architecture: Amazon. com has a very wide network of relationships with other business partners, be it the company’s suppliers, third-party sellers or corporate customers of Amazon Web Services. “ By 2006, the company had more than 2 million partners worldwide that refer customers to Amazon. com”. (BusinessWire & Internetretailer. com, 2006 cited in Turban, 2009, p. 127) Currently, Amazon. com operates retail websites for a number of retail giants such as Marks & Spencer, Lacoste, Mothercare and Target.

Reputation: Amazon. com has been widely considered the pioneer in online-retailing as well as market leader in the industry. This makes Amazon. com

one of the most popular and trusted brand names in online-retailing which is particularly important for Amazon to attract and retain its customers.

Innovative capability: Amazon has been relentlessly focusing on innovation, especially on technology R&D. Some of Amazon's outstanding innovations are the series of Kindle e-books and Simple Storage Service (S3) which come under Amazon Web Services (Turban, et. al, 2010). One of Amazon's successfully acquired patents is the one-click purchase system. Amazon regards its trademarks, service markets, patents, copyrights, domain names, proprietary technologies and intellectual property as critical to its success (Amazon. com, 2010). Assessment of Company's financial resources

Petty, et al. (2000, p. 109) said about financial ratios " Financial ratios give the analyst a way of making meaningful comparisons of a firm's financial data at different points in time and with other firms". In assessing Amazon. com financial performance, three groups of financial ratios are being used and analyzed: Profitability Ratios, Efficiency Ratios and Gearing Ratios. Profitability Ratios are used to measure the company's profitability and assess its effectiveness in using resources to generate profit, according to Petty, et al. (2000). Some profitability ratios of Amazon for the financial year (F. Y) 2010 are Gross margin: 22. 35%; Net Margin: 3. 37%, Return on Equity (ROE): 4. 75%; Return on Investment (ROI): 3. 53%; Return on Total Assets: 6. 13%. There is a great disparity between Gross Margin and Net Margin, indicating that Amazon was not successful in controlling and minimizing its operating expenses.

This pattern of high Gross Margin in contrast with low Operating Margin could be attributed to Amazon's free shipping policy which started in 2005

Efficiency Ratios of Amazon. com F. Y 2010 are as follow: Inventory turnover: 11 days; Creditors turnover ratio: 72 days. This means Amazon has been able to turn inventory quickly and has a cash-generating operating cycle.

According to Brigham & Ehrhardt (2005), Gearing Ratios measures the firm's degree of financial leverage. As of F. Y 2010, Amazon's Debt Ratio is 63.

48%, meaning that 63. 48% of the company's assets are financed with debt, rather than equity. Another Gearing Ratio is the Times Interest Earned ratio,

which " measures the extent to which operating income can decline before the firm is unable to meet its annual interest costs" (Brigham & Ehrhardt,

2005, p. 450). Amazon's Times Interest Earned ratio for F. Y 2010 is higher at 36 times compared to that of F. Y 2009 (33 times) and F. Y 2008 (11. 86

times), meaning to say Amazon has got a better financial position in terms of short-term solvency. Review of options available to the company &

recommendations for future direction Porter's Generic Strategies

Low-cost leadership

In the case of Amazon. com, the company has been pursuing the Generic Strategy of cost leadership with broad market coverage since its beginning in 1995. In the company's vision & mission statement " Our vision is to be earth's most customer centric company; to build a place where people can come to find and discover anything they might want to buy online" (Amazon. com, 1997), Jeff Bezos made it very clear about Amazon's broad target market aiming to reach customers worldwide. Amazon's strategic philosophy has remained consistent for many years with the emphasis placing on

lowering cost to offer customers the lowest price possible. To reduce variable costs per unit, Amazon seeks to increase its direct sourcing, increase purchase discounts from suppliers and minimize defects in the process. On the other hand, to leverage on fixed cost, the company seeks to “ improve process efficiencies and maintain a lean culture” (Amazon. com, 2010, p. 20).

Ansoff Product/Market Matrix

Market Penetration: The simplest option in the APM is focusing on Market Penetration. Market Penetration deployed by the company aims at attracting more customers from the existing market (Lynch, 2010, p. 315). Among Amazon’s 12 sales item major categories, revenues from electronics and other general merchandise have been growing rapidly within the last 3 years. Net sales from electronics and other general merchandise increased by 41%, 43% and 74% in 2008, 2009 and 2010 (Amazon. com, 2010), indicating Amazon should consider capture sales growth from electronics and other general merchandise by using market penetration strategy.

Market Development

The second option that should be considered by any company for future growth is Market Development, which is “ identifying and developing new markets for its current products”, as stated by Kotler (2005, p. 40). Amazon can leverage on its existing sophisticated online platform to expand its B2B activities with third-party sellers from not only North America but also other parts of the world such as Europe, Latin America and Asia. Amazon can also seek to increase sales revenue from their fastest-selling Kindle e-readers by

selling the products in other parts of the world such as: Asia, United Arabic Emirates (UAE) and Latin America. Product Development

The third option that comes under business-level strategy for future growth is Product Development, indicating the company “ offering modified or new products to current markets” (Kotler, 2005, p. 40). Due to the proliferation of smart phones, especially within the last two years 2010 and 2011, Amazon have started to venture into mobile shopping and other smart-phone related application products, “ launching a shopping app for the iPhone in December 2008, the BlackBerry in April 2009, and the Android in August 2009” (Laudon, 2010, p. 9-22). The Expansion Method Matrix

Acquisitions

In the case of Amazon, acquisitions should continue to be one of the strategic options to expand its retail categories and enhance selection of product & service offerings. The F. Y 2008, 2009 and 2010 has seen significant growth in consolidated sales revenue from the faster-growing retail categories of electronics and other general merchandise at 45%, 47% and 66% respectively (Amazon. com, 2011). This suggests that Amazon should consider acquiring some retailers of electronics and other general merchandise both inside and outside the U. S such as Argos (UK’s leading general merchandise), BestBuy (www. bestbuy. com) or JCPenney (www. jcpenney. com). Joint Venture & Strategic Alliance

Acquisitions could be an option for Amazon to fulfill its international expansion strategic choice. However, Jobber (2010, p. 752) suggested that “ mergers and acquisitions are sometimes not possible because of legal

restrictions or national sensitivities” which can become a great concern in international trading and expansion. On the other hand, “ a strategic alliance can be the initial stage to a merger or acquisition” (Jobber, 2010, p. 752).

Therefore it is arguable saying that Amazon should consider joining forces with overseas e-commerce portals, online shopping websites or general merchandise retailers from China, India or other Asian countries.

Recommendations for structures, systems & policies to implement these strategies successfully Amazon currently has a diversified business portfolio in terms of product/service offerings and geographical locations.

Therefore, the Matrix organization structure should be adopted to enable cooperation of business strategies and coordination of major decisions making from the separate divisions of products and geographical locations (Lynch, 2009). According to Lynch (2009, p. 479), “ capable and well-motivated people are essential to strategy implementation, especially at senior management level”. Reward system plays a very important role in motivating company’s staff. However, there should be an alignment between the company’s strategic objectives and its reward systems. Amazon’s strategic objective is to emphasize on long-term market leadership considerations rather than short-term profitability. As a result, Amazon adopts a cost-conscious culture, which places tension on the company’s reward system.

To conserve cash for future growth and expansion, Amazon should continue to cut down on short term incentives and compensation, instead reward employees significant stock ownership as Amazon’s CEO, Jeff Bezos believed

that to be successful in the long-term, each of company's employee " must think like, and therefore must actually be an owner" (Amazon. com, 2010) . In doing business overseas, Amazon should figure out the best international hiring policy with the optimal combination of PCN, HCN and TCN. Relocation assistance and reasonable Expatriate Compensation Package are essential to motivate PCN staff. Competent, HCN staff should be hired to incorporate knowledge about local business practices into the company's foreign division. Last, hiring talented TCN staff with lower labour cost would serve to satisfy headquarters' culture of frugality.

Usefulness of Strategic Management Models

PESTEL analysis provides a useful way to examine the macro environment of the U. S which can have a negative or positive impact on the future business of Amazon. The usefulness of Porter's Five Forces Analysis, according to Lynch (2009) is to help the company better understand and act upon the competitive forces influencing its business activities: to exploit opportunities and protect itself against competition and threats. It also helps the company decide which type of resources to use: peripheral or breakthrough resources according to the level of competition. Besanko, et al. (2010, p. 379) said about the usefulness of Porter's Generic Strategies model " A firm's generic strategy describes, in broad terms, how it positions itself to compete in the market it serves".

By reviewing the Generic Strategy adopted by Amazon, findings about the company's lean culture has been identified which serves as an important indicator to determine recommendations for structure, system and policy to

implement proposed strategies successfully. The Ansoff Product/Market Matrix “ identifies the product and market options available to the organization” (Lynch, 2009, p. 313) for future growth while The Expansion Matrix identifies the possible expansion methods available to the company to achieve these product/market development decisions.

Conclusion

The strategic analysis on Amazon. com has been completed using research method of literature review from text books and academic journals coupled with findings from the company’s annual report to give an inside, deep look into the application and usefulness of Strategic Management Models.

The principal conclusion which can be drawn from the report’s findings is that Amazon may need to rethink its strategy at the corporate level such as its strategic choice on diversification, in order to survive intense competition and protect its position as the market leader in the e-commerce industry.

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