Who can beat Amazon?

A winning model in e-commerce against Amazon

by

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Founded in 1994, Amazon has experienced strong growth of over 20% per year since then; its revenue now exceeds $100Bn. Its geographical locations have developed at a robust pace and its product offering has expanded as far as to fresh groceries in the US. Its success has been based on technological leadership, competitive prices and outstanding service. Consequently, is there a strategy to bypass Amazon for an Internet player selling products to consumers? What are the possible strategies for Internet players?

Reminder of the competitive levers of e-commerce

Like in all distribution businesses, there is a strong value to leadership in e-commerce. Profitability is linked to national market share first and to overall size second (Table 1).

It is therefore necessary to be the leader in one's segment at a national level to be profitable and to grow. Eventually, distant challengers will not be able to keep up. Another requirement is to first focus the approach on competitive models and on specific geographies and then to roll out these models country by country like offline commerce did historically.

Three possible strategies on the Internet

1. Mass strategy

This is the strategy led by Amazon. It spans all consumer products (without complex service and with high value added), either directly or indirectly through market exchanges. This requires a strong and unmissable staple brand which only Amazon really has (in most countries), strong price competitiveness and an unrivalled service. It is impossible today to beat Amazon on this ground. The lead taken by the Internet giant in this field as well as its desire for hegemony and thus growth are such that a challenger, even as competitive and as unconventional as Cdiscount, will not make a return on its investment.

2. Niche strategy without differentiation

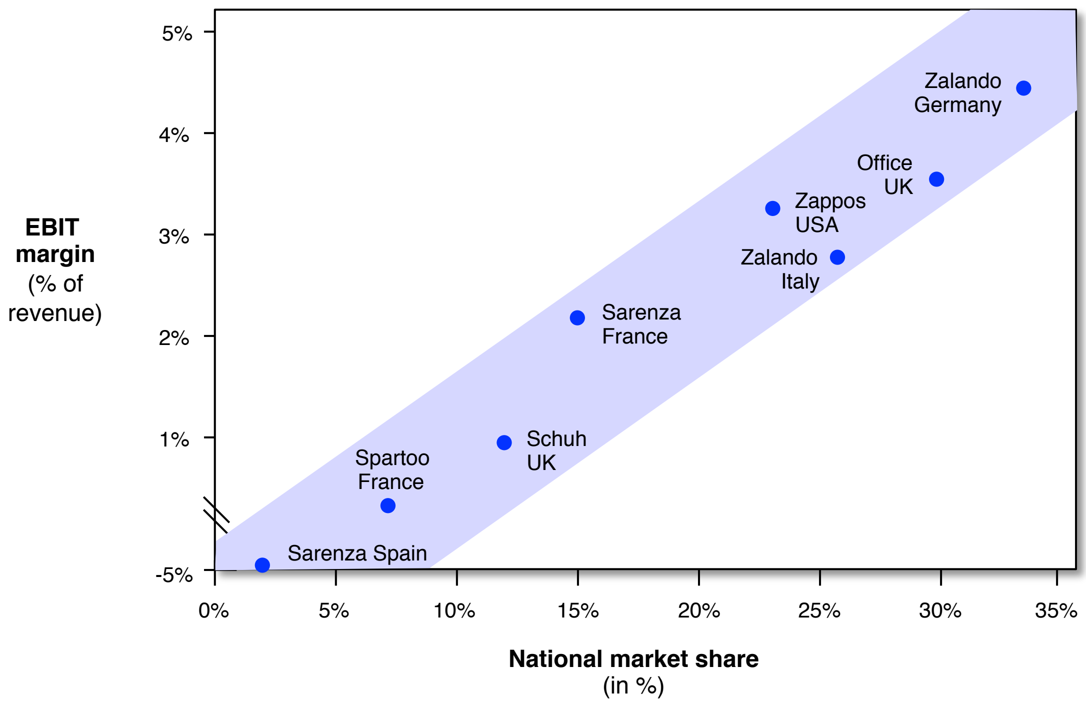
This is the strategy led by many players on some product categories where Amazon's leadership as a generalist is less relevant. This niche strategy is only possible on categories with specific characteristics: products that are complex to manage like shoes (Sarenza, Zalendo, etc.) or fashion apparel (Yoox, Asos), technical specialized products such as jewelry (Blue Nile, etc.) or commodities like pet food (Zooplus, Directpetfood, etc.). The levers of competitiveness are the same as those of mass models but the differentiating characteristics protect them from Amazon.

The cost of growth for these models remains high (one must become the leader by investing more and faster than the others). As a result, margins are low during the phase of leadership build-up. However, it is likely that in time, when the market is mature and concentrated, margins will go up and reward those who continued to invest successfully. There is a risk however that Amazon benefits from its investment wherewithal to buy the leaders or competitive (but less profitable) challengers and then become a serious competitor, jeopardizing the strategy built during these long previous years.

- Table 1 -

In e-commerce, profitability is linked to national market share

- Example of the online distribution of shoes -



Sources: Estin & Co analyses and estimates

3. Niche strategy with differentiation

This is the strategy which is the most appropriate and which creates most value against Amazon. It is also the most complex to the extent that it must be based on a business model which is not merely the improvement of an existing model. The first two strategies are based on new channels using new technologies. At the utmost, it is the development of long-distance sales with and advantage in terms of reactivity (compared to a catalogue) and an advantage in terms of breadth of offering (because there is no physical constraint for product display).

This third strategy incorporates a new dimension that did not exist in the physical world.

This differentiation may be based on three elements (which may be combined):

- *Technological differentiation:* technological developments (specific algorithms, data analysis...) should enable the development of new models which do not exist to date in the physical world. E-commerce is expected to scale these models and reduce the access cost. This way, eSalon has developed a technology to customize color shades for hair, depending on the hair structure. Each customer can choose the color as desired with the advice of a remote specialist. Internet can get some of the work done for you.
- *The simplification of the experience*: e-commerce simplifies customer experience and reduces significantly certain value steps. This will result in a compression of costs and increased competitiveness of a product. Warby Parker has developed in eyewear industry a model based on a strong brand, mid-range prices and a limited number of references with good quality frames and lenses.

  Similarly, Blue Apron has strongly developed in the delivery at home of ingredients to cook quality dishes. On a subscription basis, customers can select recipes and ingredients needed for this recipe. The ingredients are kept cool in isolated boxes. Each client, novice or expert, can make these recipes easily.
- *The relational proximity or communitarianism*: model combining a strong physical relationship and a strong virtual relationship can combine the benefits of both worlds. Hence, Ritani allows customers to design a wedding or engagement ring, to test it in nearby jewelry stores and modify if necessary. Created in 2002, this concept is doubling every year and should reach a revenue of over €150 million this year. Similarly, J. Hilburn offers bespoke clothes with the help of personal stylists who meet customers at home for their first order. These models, however, raise the question of the duration of growth and therefore size in the long run.

These models have a double feature: they create significant barriers to entry and they generate significant returns which fund profitable and significant growth.

The first two models are a race to the top where the leader takes it all after a period of significant investments and heavy losses.

The third model generates margins and builds strong positions. To that extent, they are similar to models like Zara, H & M, Ikea, Hermes, etc., which have EBIT margins above 15% and ROCE higher than 35%.

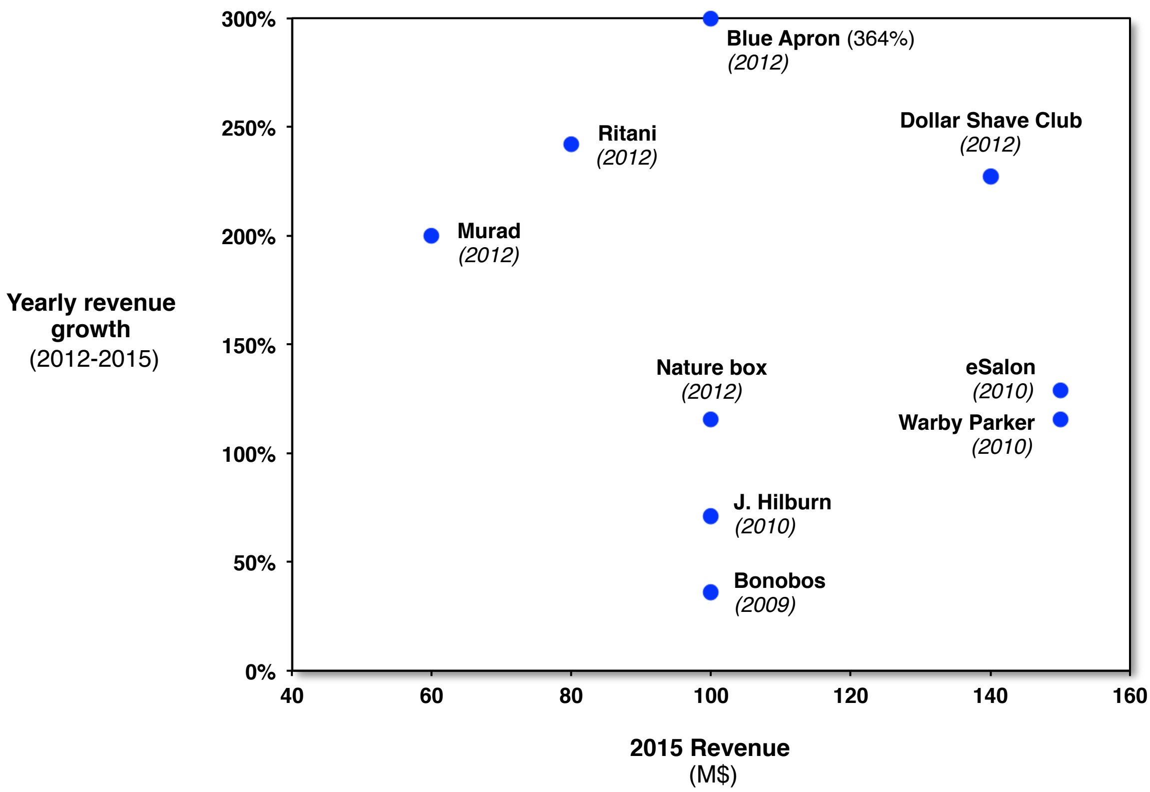
What to conclude?

With emerging markets, e-commerce is a source of significant growth in distribution. Amazon will capture a significant share of the value of mass models. Only niche models with strong differentiation will resist this tidal wave (Table 2). These models, well defined and based on strong characteristics, can grow and generate strong margins immediately *despite* strong growth.

It is on this ground that we must invest in distribution models on the Internet. It is the only option to beat and bypass Amazon.

- Table 2 -

Example of niche concepts with strong differentiation



Sources: Estin & Co analyses and estimates

October 2016

Estin & Co is an international strategy consulting firm based in Paris, London, Zurich, New York and Shanghai. The firm assists CEOs and senior executives of European, North American and Asian corporations in the formulation and implementation of growth strategies, as well as managers of private equity funds in the analysis and valuation of their investments.

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