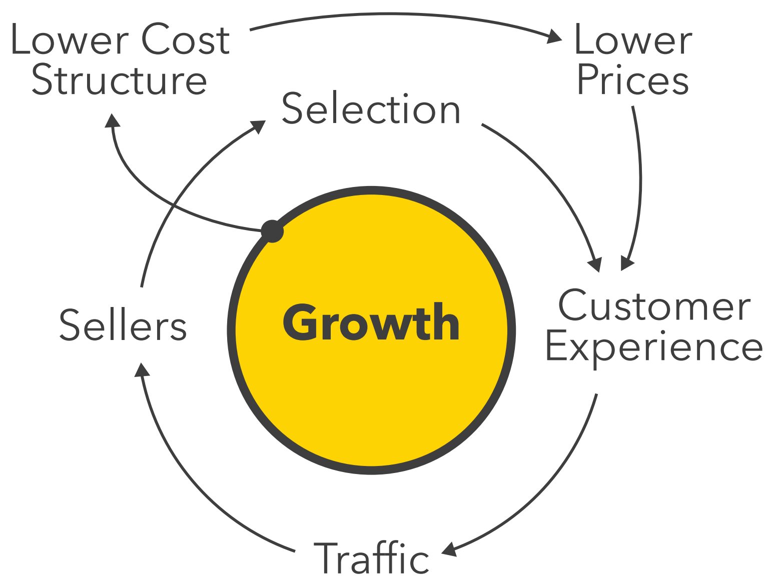
Radial

Is there Grit in Amazon's Flywheel?

Implications and What Retailers Need to Know to Survive

Over the past 22 years, Amazon has achieved enviable levels of growth through a simple yet strategic business concept: the flywheel. It has guided the company's core principles and driven its rapid ascent since its founding in 1994. The idea behind it is this: once core components are in place, the flywheel is activated, builds continuous momentum and grows more powerful over time. Throughout the cycle, each component has an energy of its own that is then used to drive other positive energies in the system.

In a nutshell, Amazon believes that by offering the largest selection of products and the best customer experience, it will drive hordes of consumers to its site and incentivize more sellers to join its marketplace, thereby expanding its selection. This ultimately allows Amazon to drive prices down through competition and its ability to spread out its costs over a wider base. Amazon's flywheel is a great model and has delivered tremendous value to consumers. It has raised the bar for all eCommerce companies around the world.



However, the problem with a flywheel is that when one part breaks down, the overall system can suffer rapid and catastrophic failure. ProPublica recently reported that at least one of the core pieces of Amazon's flywheel is already under pressure: the customer experience.

While there are profound implications for Amazon, there are potentially larger effects for the rest of the eCommerce ecosystem. Let's take a closer look.

Wobbles in the Flywheel

Amazon pioneered a superior customer experience, making it easier for tens of millions of shoppers to migrate their purchases online by removing fear and friction, and by offering convenience of returns and competent customer service. Amazon also instilled a sense of confidence in consumers that the prices across its site were—quite simply—the best. Amazon promoted price comparisons of products, as seen in its mobile app that allowed consumers to simply scan a barcode on a shelf and see Amazon's price while walking through a store.

Now, it appears that Amazon is focusing its efforts on increasing profitability—and it's coming at the expense of the consumer's trust.

What's Happening?

Much like Google, it appears that Amazon's algorithms aren't truly blind to acting in self-interest. ProPublica's report analyzed 250 bestselling products and found that Amazon promoted its own listings—ahead of lower-priced listings from other sellers on its platform—using the "Buy Box."

In "The Black Box Society," Frank Pasquale highlights how these algorithms are far from the benevolent agents gently steering us away from suboptimal outcomes in our lives. Rather, Pasquale posits that today's algorithms are often themselves flawed because "at present, algorithms are ripe for manipulation and corruption."

In the end, algorithms need something to optimize; they need to understand how to come to a conclusion. There needs to be a way to weigh the various inputs being thrown at them so that they can resolve a mass of data into a coherent answer.

In Amazon's case, it appears the decisions being made in algorithm design are resulting in consumers often not being shown the best offer for their product search. When consumers begin to realize this, the customer experience component of the flywheel will degrade, and the power of the very momentum that built Amazon into the impressive company it is today will exert the same awesome power—but this time in reverse.

When the customer experience falls, traffic to Amazon could falter as users, upset by having to work harder to find the best value, go elsewhere for better prices and more trustworthy experiences.

When traffic falls, fewer sellers stay on the platform as paying a sizable portion of their revenue to Amazon for a chance at those customer eyeballs looks much less attractive.

When sellers abandon, both selection and pricing could suffer as a result of fewer items being on the site and fewer sellers selling the same item, a reality that today often serves to keep pricing low. Higher prices, less selection—this further erodes the customer experience, and the downward cycle continues.

Finally, Amazon's considerable cost base—driven higher in recent years by mass hiring and billions of dollars in capital expenditures and research and development spending—must be spread across a smaller foundation, driving fees for merchants even higher.

Is this plausible? An extreme collapse seems unlikely, but even a tempering of products, sellers or traffic can (and will) have dramatic effects on Amazon's flywheel and everyone who relies on it.

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The Results

There are two troubling considerations for retailers that use Amazon as their eCommerce partner. Both considerations revolve around the same core question: how much should retailers rely on Amazon for their future success?

First, with the pricing box algorithm becoming increasingly opaque (and apparently leaning more in favor of Amazon), do retailers have confidence that future changes will be made in their favor? Google's history provides harrowing lessons. Entire companies like Demand Media and Mahalo nearly collapsed when Google's "Panda" algorithm change (done, much like Amazon claims, to benefit users) decimated traffic to their sites.

Second, even if retailers are confident that they'll always be able to win through great pricing and service against the other sellers competing on Amazon, if the flywheel truly does begin to dissemble, where does it leave the business if it relies on Amazon for traffic and conversions? It's no fun being the last person selling typewriters.

Your Move

Just how worried should retailers be?

Certainly there are plenty of history lessons for companies that have managed rapid growth on the back of a flywheel only to one day wake up to find their business no longer their own (Meerkat and Zynga are two recently hobbled harbingers).

1. Using Amazon to build product awareness and consumer loyalty is great—but once retailers have their own flywheel of devoted, repeat customers making recommendations to their friends, it's time to head for the exit. From the retailer's perspective, Amazon is like a drug: though it provides such a rush of consumers and conversions, and though it's common knowledge that piracy, copycats and expenses are grounds for quitting, retailers just can't follow through. Soon the retailer is hooked on a majority of its direct business coming from Amazon, and by then it's too late—they can't move away.
2. If retailers can't transition fully from Amazon, they must investigate strategies and partners that will allow them to still take advantage of Amazon's traffic while protecting the brand and business from a capricious algorithm. The goal is to intelligently market certain items on Amazon while allowing for building and retaining a real brand experience.
3. Reimagine what the business could look like without the deluge of traffic that comes from Amazon's funnel. The reality of the online commerce ecosystem is that retailers have the potential to be more differentiated and personalized than ever before. Today's customers have come to expect a certain level of personalization that has historically been missing or impossible to achieve. Those customers are drawn to (and, importantly, return to) the retailers who personalize their products/services, demonstrate they know the individual, and make the overall experience as seamless and enjoyable as possible. Amazon's strength is also its weakness—while consumers always know what they are going to get when going to the Amazon site, the lack of personal or brand-centric experiences treats every purchase roughly the same. Consumers appreciate tuned end-to-end journeys that differ depending on whether they're buying pumps or a leaf blower.

The Promise of Challenge

All is not lost: ecommerce is growing at 16 percent annually and has grown nearly 400 percent over the past 10 years. The pie is getting bigger and it's not a zero-sum game. The challenge for retailers is how to position themselves to capture their fair share without relying on the hacks (like Amazon marketplace) that got us where we are today.

Strategies that focus on delivering an "Amazon-like" customer experience without having to surrender the brand to Amazon itself offer some of the highest ROI spend one can undertake. Looking past this year's peak holiday season and into 2017, the time is now for retailers to start nailing down the basics.

While there is no end of companies promising improvements through amazing in-store experiences, customer marketing techniques, or clever and more beautiful websites, the reality is that job No. 1 is simply allowing a friction-free and reliable transaction with the customer in moving off Amazon and into owned operations. To nail what consumers want requires getting the "post-checkout" experience nearly perfect. That means retailers must answer critical questions across key areas:

Order Management: where should I ship this order from to maximize whatever variable I want—profit, time-in-transit, markdown prevention?

Payment Management: how do I make taking someone's money super simple?

Tax Management: how do I handle the 14,000 tax codes across the US? What about international customers? How do I handle international duties?

Fraud Management: am I declining good orders for fear of fraud? Am I taking too many fraud losses?

Picking & Packing: how do I get the order shipped as quickly as required to meet my customer promise?

Transportation: how do I choose the right shipping method to get it to the customer when I said I would without paying too much?

Returns: how do I make it easy on both the consumer and on me? How can I be smart about integrating returns back into my saleable network?

Customer Support: how do consumers talk to me in a way that they want—again, without bankrupting me?

For each of the above, there are dozens of vendors clamoring for retailer's money, hundreds of connection points, inconsistent integration taxonomies—and they all must come together in real time, every time, to make every retail interaction the best retail interaction for the customer.

Retailers can choose to take on the integration task themselves, but clearly this level of technical sophistication is not something most midmarket retailers desire to master—after all, this isn't their core business. Luckily, companies like Radial—the one I work for—and others like Kibo, are emerging with the necessary technical and physical assets to turbocharge a retailer's operations to help them profitably deliver that exceptional customer experience at a price they can afford—all while building *their* own brand.

The Road Ahead

There will be a time and place when it will make sense for retailers to go out and support other marketplaces that have unique value propositions—Jet.com was a nice example. However, as a rule of thumb, for a mid-market brand with any shred of customer affinity, take control of the situation and don't succumb to Amazon's siren song. History is littered with companies that have, with a promise of scale and skill, found initial business success on the back of a mega-partner, only to awake one day to find the grand bargain was corrosive to their long-term viability.

Just as eCommerce customers are getting more diverse, tomorrow's retail winners will not thrive using any single channel. The challenge and opportunities for the leaders is to partner with companies that can help them meet these differentiated and escalating customer demands, where the interests of all partners are aligned around growth. Never before has there been such a time where retailers and brands are able to build experiences that customers crave—understanding how to build them durably is job No. 1 for progressive companies in 2017.

About Radial

Radial is the leader in omnichannel commerce technology and operations, enabling brands and retailers to profitably exceed retail customer expectations. Radial's technical, powerful omnichannel solutions connect supply and demand through efficient fulfillment and transportation options, intelligent fraud, payments, and tax systems and personalized customer care services.

Hundreds of retailers and brands confidently partner with Radial to simplify their post-click commerce and improve their customer experiences. Radial brings flexibility and scalability to their supply chains and optimizes how, when and where orders go from desire to delivery. Learn how we work with you at www.radial.com.

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Stefan Weitz
Chief Product and Strategy Officer at Radial

Stefan is responsible for leading the planning and execution of Radial's overall corporate strategy, including defining the Company's portfolio of global products, product marketing, and inventing technologies to deliver the industry's best post-click commerce solutions. He also leads Radial's Payments, Tax and Fraud business, delivering fraud-free payment solutions to eCommerce merchants across the world. Prior to joining the Company, Stefan spent 17 years at Microsoft where he served in key engineering and strategic roles to help turn whitespace opportunities into viable business lines. He most recently was one of the founding members of the Bing search engine, helping to drive that product to 30% of search market share and billions in revenue. He began in eCommerce at Microsoft with the acquisition of eShop in 1997.

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