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Amazon: Lessons from the US for Australian retail

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Amazon[1] is finally here!

The e-commerce giant's entry into the Australian market has been a constant source of discussion for several months, and the likelihood of a large disruption for our local retailers appears to have already been priced in.

In reality, Amazon has been in Australia for more than 20 years, just without a local Marketplace (its third-party retail platform) or Amazon Fresh (its on-line food offering) presence.

I believe that is it not too late for Australian retailers in all segments to learn from the global counterparts who have survived or even thrived in the face of Amazon, and I outline some of these lessons in this paper.

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In late September, I travelled to the US to attend a large Global Retail Conference and see first-hand the experience of retailers, particularly those operating in the supermarket and consumer electronics spaces, meeting various companies all along the supply chain.

Companies I met included supermarket and general merchandise players Walmart, Walmex, Sprouts, Macy's, Dollar Tree, Carrefour, and Sainsbury's, and sporting goods retailers Hibbert Sports and Lowes. I also spoke to ex-employees of both consumer electronics retailer Best Buy and Amazon itself.[2]

While Amazon will impact the Australian retail landscape, based on these discussions I remain positive for Australian retailers. My trip has helped me to see a different trend for each segment – the supermarket sector is less likely to suffer; however, parts of the consumer electronics industry is going to face increased competition.

CONSUMER ELECTRONICS CAN COMPETE, BUT IT WILL BE HARDER

Consumer electronics are at the heart of Amazon's commercial offering. Despite concern regarding Amazon's impact on the Australian market, my trip to the US has made me confident that large Australian electronic retailers can compete with Amazon. Although, it may be at the expense of the second-tier operators that can't keep up.

On my trip I met with several ex-employees of **Best Buy**[2], a company that has survived, and even thrived in this space, despite initially struggling to compete with Amazon in the US in the early years. In fact, its earnings per share, and share price are now at a record high.

See below for six tools incumbent retailers can make use of to battle Amazon:

Price perception is key

I learnt that one of the key reasons that Best Buy initially struggled was that it didn't react quickly enough to normalise the large price gaps between itself and Amazon. Amazon's algorithms mean that prices can change multiple times per day, whereas Best Buy's pricing was less flexible.

Some bulky or high-end categories, like televisions, furniture and white goods, are more likely to continue to be sold from physical stores, whereas Amazon is focused on smaller, low-end items.

But while Best Buy had only a small overlap in the lower-end space, it was the price 'perception' that led to consumers losing confidence in Best Buy in the higher-end space.

Now, Best Buy offer a blanket 'price match' guarantee no matter the segment, and this has helped to restore the perception of price leadership across the board.

Putting power back in the hands of suppliers

A key insight gained by retailers was how they could put pressure back onto their suppliers in terms of enforcing recommended retail prices across all distribution channels (including Amazon), thus levelling the playing field in terms of price and hinder Amazon's ability to undercut them.

While this may be somewhat more difficult in Australia due to Australian Competition and Consumer Commission (ACCC) rulings on the subject, companies such as Apple appear to have been successful in controlling price across channels.

Understanding customer data

Australian companies, on the whole, already have a firm grasp on the benefits of data analytics. Best Buy was late to the party, but found that the eventual investment in understanding its customer data better (i.e. credit card data, loyalty programs, web traffic) allowed it to improve targeting clients and increase customer loyalty.

Enhancing the 'offline' experience and service

Best Buy deliberately added value that could only be accessed in-store, such as its Geek Squad (a subsidiary of Best Buy offering support services); 'store in store' installations, where part of the retail space is used by a different speciality company; and delivery and installation.

Making the most of infrastructure

Existing scale is also a very significant advantage. Incumbents like Best Buy were able to use their own store network for home delivery, rather than from distribution centres, and this helps to shorten the 'last mile' (the movement of goods from a fulfilment centre to their destination). The ongoing development of new stores and distribution centres will therefore only strengthen the supply chain.

Innovating with Innovation

The proliferation of the 'connected home' trend bodes well for companies that sell innovative home products like Best Buy. This is because for newer, more innovative products, customers prefer to have direct interaction with sales advisors over the use of these new products. Combine this with the the 'price match' concept above, and bricks and mortar can compete.

Best Buy's experience shows that companies willing to invest, and think laterally in their product offering and business models, have the ability to not only withstand Amazon's presence, but retain and extend their customer base. In contrast, in the US, it has been the smaller players that have taken the Amazon hit.

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SUPERMARKETS WELL PLACED TO COMPETE

While I was in the US, I also attended a conference where I was able to speak to executives from US supermarkets, and many of the global chains. In particular, the insights gained from **Sainsbury** (UK), **Walmex** (Mexico) and **Carrefour** (France)[3] were beneficial.

See below for the five key insights I gained on the competitive positioning of supermarkets against Amazon:

Importance of convenience in the mix

A key unexpected takeaway from these discussions was the importance of the 'convenience store' and fuel station-type offerings to the supermarket play book.

Everyone I spoke to said that this was the best part of their business, and that it was immune from Amazon's Wholefood business, which is a full-line supermarket with a limited footprint.

Online not that big a deal for groceries

While there is a lot of industry fuss around online grocery delivery services, it appears there is actually little consumer interest.

In fact, Goldman Sachs state that less than 3% of groceries and consumer packaged goods are bought online in the US.

For example, Carrefour, which is in 30+ countries, also told me that there has only been real interest in online food in the UK, China and Korea. In all other countries, it is only a small percentage of its business even though it has been developing it for 20 years. In Australia too, online grocery shopping is said to be in the low-single digits.

Recent news articles also indicate that Amazon's existing 'Amazon Fresh' grocery delivery service was closing in certain US states later this month.

Physical stores required for click-and-collect

We expect limited growth in online sales for the foreseeable future, and the 'click-and-collect' will continue to dominate those sales. For Carrefour, this has been around 60% of its online business. Its data also shows that 40% of these customers go on to buy something else instore.

It believes that click-and-collect will continue to be preferred for food orders due to the difficulties in getting deliveries to the customer in a timely manner. You can't leave perishables on a doorstep, traffic can cause havoc with scheduled deliveries etc.

This reinforces the need for bricks-and-mortar premises. Amazon's purchase of Whole Foods provides it with some physical locales. However, the insight I gained was that Amazon will face the same problems as the incumbent supermarkets in terms of fulfilment costs.

Fulfil with a combination

While it appears that online will be a small part of supermarket food sales, the biggest issue for online is fulfilment. From the supermarkets I met with, there was no clear consensus on how to fulfil online orders.

Sainsbury and Walmex are currently using in-store picking to leverage existing capital, while Carrefour have moved to dark stores (warehouses containing produce for online customers) for more efficient pick costs.

Physical stores are advantaged in the 'last mile' (speed/cost) and access to click-and-collect, but are disadvantaged in product range and higher pick cost. Dark stores and distribution centres are much slower on the last mile. A combination of the two seems to be working best.

The Australian incumbents should have strong advantages in their existing scale and supply chain:

- Online orders can be met through a combination of their existing stores, distribution centres and convenience stores;
- They have prime locations all over Australia with very short delivery distances and high 'drop densities', given most customers live nearby a store.

General merchandise will find it harder to compete

General merchandise sales for supermarkets, however, appears tougher, with Amazon's marketplace the biggest competition.

Unlike Australia, supermarket chains such as Walmart and Sainsbury's have a large amount of general merchandise embedded within their supermarket stores. Industry sources told me that stores with less exposure to general merchandise, such as Walmex are doing a lot better.

In Australia, general merchandise has been separated into standalone offerings outside of the supermarket. These general merchandise stores have their own competitive advantages and issues outside of Amazon.

Amazon's move to purchase American grocery chain Whole Foods in June, put supermarkets around the world on notice of increased online competition on the horizon. While the transaction sets up Amazon to have a US footprint, most of the key grocery players I spoke to were relatively unperturbed in terms of Amazon's immediate competitive threat.

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SUMMARY

Amazon has been a very successful retailer over a number of years, and its model to sell and distribute both its own and third-party products has worked in most of the markets it has entered. China is an exception, due to the strength of the local competitor, **Alibaba**[4].

Its key advantage is that its strategy is driven by data, not gut feel, and the key source of this data is the Marketplace.

For Amazon's Marketplace to be successful in Australia, Amazon will need to have a good product range, including local specialty suppliers. I think this may prove difficult.

We recognise that Amazon's entry will, of course, have an impact on the Australian retail landscape, but we view the current price weakness in Australian retail stocks as an over-reaction, given the strengths of major shopping malls, and their leverage to Australia's employment and population growth.

Amazon has done well in the US and UK against inefficient players, but efficient bricks-and-mortar retailers can compete if they can use their existing scale and supply chain to lower 'last-mile' delivery costs and time. However, they need to react quickly.

It is likely that small independent retailers and discount department stores will find it very difficult to compete. However, we see that the good-quality large retailers are likely to survive or even thrive in the face of Amazon.

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