



# Amazon's Prime Ambition



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## AMAZON'S PRIME AMBITION:

# WHY AMAZON'S NEW LOGISTICS REVOLUTION COULD SAVE IT \$3BN A YEAR AND TAKE IT HEAD-TO-HEAD WITH TRADITIONAL CARRIERS

How the internet giant will use logistics to become the 'pipe through which everything you buy flows'.

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### EXECUTIVE SUMMARY

The global internet retailer Amazon introduced its Amazon Logistics service in the UK in 2012 as a test-bed for its eventual role out across Europe and the US, and a precursor to some significant changes in its customer offering, particularly in its Prime service. There are a number of key reasons behind the e-commerce giant's move into logistics:

1. Amazon claims its new logistics arm is simply to 'complement' existing delivery companies and support its key strategy of strengthening its Prime service to encourage customer loyalty. However, to support the scale of such a logistics operation, a number of industry experts believe it may well become a logistics provider in its own right, competing with established companies such as UPS and Yodel.
2. Amazon stands to save \$3bn globally and £122 million in the UK alone this year by cutting down on the use of external delivery companies, and could look to its logistics arm becoming a net income source rather than a \$5.13bn yearly expense.
3. Amazon Logistics' introduction means it is not beholden to traditional mailing services such as the Royal Mail, and can support its Prime service actively by boosting lucrative Sunday deliveries and Same-Day Delivery services.
4. Long term, business analysts believe everything, starting with weekly groceries and home services, could be delivered through a pipe called Amazon.
5. Looking further into the future, the company is even considering using its new logistics service to manufacture items, using 3D printers, while *en route* to customers – the patent has already been filed.
6. In March 2015 Amazon is staging trials with Audi delivering items directly into customers' cars. This service could be rolled out across Germany this year if tests are successful.
7. Should the 'great Amazon Logistics experiment' ultimately prove successful it could kick-start a radical change in the entire supply chain industry, as global rivals such as Alibaba, and large-scale companies such as Tesco.com, consider whether to make their own fleet available for third party deliveries.

## Introduction

At the end of 2014 Amazon had earned a cumulative net profit of just \$1.9 billion in its entire twenty year history as a public company, despite more than \$400 billion in sales during that time. <sup>[1]</sup> Yet it continued pouring money into developing its own logistics operation, Amazon Logistics, and its Prime service, which loses revenue by offering free shipping and unlimited streaming video. Acquiring the rights to movies and TV shows isn't cheap. <sup>[2]</sup>

What are Amazon's goals in continuing to expand its logistics and Prime services, and is there a connection between the two? Is Scott Galloway, Professor of Marketing at New York University's Stern School of Business, correct in prophesying that Amazon will become the 'pipe through which everything you buy flows'? <sup>[3]</sup>

Amazon's technology chief, Werner Vogels, recently described the firm as 'a 20-year-old start-up', <sup>[4]</sup> and Amazon's growth policy has clearly puzzled investors, leading to a 27% slump in shares last year. However, as the small rise in its shares in early 2015 indicates, there is good reason to believe the company is quietly pursuing a transformation that will become clearer in the course of this year.

Amazon's new logistics service is at the heart of its consolidation plans, acting as a bedrock to many of its key initiatives. Prime Now Same-Day deliveries, free two day service and Sunday pick-up and delivery options have helped drive an astonishing 50% rise in Amazon's lucrative Prime membership in 2014. This logistics operation combines with other products, such as Amazon Prime TV, to drive further customer loyalty and retention – the ultimate aim of Amazon's Prime Membership project.

In addition, the creation of Amazon Logistics will create significant savings for the retailer, whose delivery costs have grown significantly in recent years. This report will show that, in the UK alone Amazon stands to recoup £122 million a year on its logistics operations, and once rolled out globally, \$3bn dollars in transportation costs. That will enable Amazon to be in a better shape to face the oncoming threat from Alibaba and others.

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## ESTABLISHING AMAZON LOGISTICS

Amazon might already be said to be a significant delivery provider. Last year 40% of its worldwide sales and deliveries were actually for third party retailers rather than Amazon itself. <sup>[5]</sup> It has been steadily developing its own logistics services across Europe and the US, a fact that caused the UK's national carrier, Royal Mail, to squeal last autumn as the loss of some of this business hit home.

An Amazon UK spokeswoman said in December 2014: 'Amazon Logistics is a technology and logistics platform that empowers local and regional delivery companies across the UK to deliver Amazon packages to customers seven days a week. This platform complements our current large, national delivery partners and provides additional capacity as more and more customers enjoy Amazon Prime's next day delivery benefits.' <sup>[6]</sup>

It's a strategy that could leave rivals struggling. Not least in the delivery market. Amazon's UK boss, Christopher North, says it is not in competition with other logistics providers: 'Amazon Logistics is not about replacing a carrier, it is about complementing'. <sup>[7]</sup>

However, Joel Ray, an analyst at Transport Intelligence says: ‘Some companies are starting to ask whether Amazon is now an e-retailer or a logistics company’<sup>[8]</sup>, and the *Wall Street Journal* reports: ‘Ultimately, a delivery network could transform Amazon from an online retailer into a full-service logistics company that delivers packages for others, according to former Amazon executives.’<sup>[9]</sup>



Will Amazon soon be delivering packages for other companies as well as its own business? Courtesy: Amazon.com

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## THE NUMBERS

Globally Amazon shipped an incredible 5 billion items worldwide in 2014, and 40% of these items were for third party sellers, according to figures from *The Guardian*. Amazon’s UK arm shipped 140 million items in 2014.<sup>[10]</sup>

In terms of profits in 2012 it was reported Amazon in the US achieved \$61bn in gross sales, with an average product price of around \$47 according to Whartons<sup>[11]</sup>. Citi estimates the company overall will generate nearly \$102 billion in revenue in 2015, rising to \$119 billion in 2016.<sup>[12]</sup>

Its growth rate is simply staggering, illustrated by its UK sales that have risen from £1.87bn in 2009<sup>[13]</sup> to £4.5bn in 2013.<sup>[14]</sup>

However one of the big problems for Amazon is that its outbound shipping costs were an incredible \$5.13bn, in other words 8.4% of sales, according to its 2012 annual report.<sup>[15]</sup> Amazon typically pays between about \$2 and \$8 to ship each package in the US, according to shipping-industry analysts, with the cheapest option through the Postal Service and the most expensive via UPS or FedEx.<sup>[16]</sup> In the first quarter of 2014 alone, the company reported that its shipping costs had increased by an eye-watering 31%.<sup>[17]</sup>

Of course the company also gained \$2.28bn or 3.7% of its total sales through shipping cost income in 2012, but that still left it with net shipping costs of \$2.85bn, or 4.7% of sales.<sup>[18]</sup>

In the period since 2012 Amazon has offered increased free mailing – an essential feature of Amazon Prime – so its costs rose and income from shipping costs fell further in this period.

If Amazon could cut its pure logistics costs from its current figure (which experts predict will be at the very least 9% of sales today), by around one third it would create significant savings. In the UK, from likely sales of £4.8bn in 2014, Amazon probably spent £367 million if it mirrors the US 9% of income. Even at 2012's *net* shipping cost rate of 4.7% of sales that's £191 million. However, if it could work out a way of reducing its shipping costs by one third then its mailing expenditure would be reduced by £122 million, from £367 to £245 million.

And the same sum works for Amazon's entire global operations. If Citi's prediction of Amazon's revenue of \$102bn for 2014 is correct, then, at 9% of sales, its shipping costs globally have probably risen from \$5.1bn in 2012 to \$9.1bn last year. By reducing its shipping costs by a third it could save an incredible \$3 billion dollars.

Is a saving of a third possible? In Britain, UK Mail makes 60% of its profit and 40% of its revenue from parcels. It delivered 29 million parcels in 2012 (significantly less than Amazon's total of 70 million <sup>[19]</sup>) and made £22.5million in 2014, of which £13.5 million was generated from parcels. <sup>[20]</sup> It's a lucrative area. City Sprint delivers 5 million parcels per year, has revenues of £112m annually and makes £12m EBTA on this, nearly 11%. <sup>[21]</sup> Companies such as Amazon are looking closely at this and questioning their delivery costs.

In the US, UPS delivered 15,322 million domestic parcels a day in 2014, 12,893 by surface mail. It saw an income of \$35.8 billion from its domestic parcels operation. Its revenue per package was \$9.25, Ground \$7.85. Its (adjusted) operating expenses on domestic parcels business was \$31.3bn leaving an (adjusted) operating profit of \$4.5 bn. <sup>[22]</sup> In short, it makes a 12.5% profit on its US domestic parcel operations.

Even more revealingly Amazon pays around \$7-\$8 for ground mail parcels delivery to UPS and FedEx. <sup>[23]</sup> As the *Wall Street Journal* reported in late August, FedEx then place 2.2 million packages a day, or about 30% of its express mail, straight into the United States post office system! That's because the US Postal Service is geared up for deliveries of smaller items into private homes, rather than bulk deliveries into businesses, and can do this cheaper than a large carrier ever could.

Amazon has not been blind to this industry ruse, however. The *Wall Street Journal* report reveals Amazon has finally cut out the middleman – FedEx – and has started taking most of its packages to the Postal Service. The result is that FedEx Smartpost volumes have dropped by 8% while Amazon now pays just \$2, rather than its previous \$7-\$8, for delivery.

That means Amazon achieved a 75% saving by avoiding using third-party package delivery companies. It now works directly with door to door postal services who are geared up specifically for delivering to residential addresses. At that rate our 33% saving begins to look a conservative estimate.

But how does Amazon begin to achieve the economies of scale a postal operator can achieve? The Royal Mail can deliver a letter for just 50p. Amazon is geared up for home deliveries, just like a postal operator and unlike an international parcels company. Savings of a third begin to look entirely achievable in this light.

How can it do this? By learning the lesson of FedEx Smartpost and cutting out the middleman. Ideally by introducing a delivery company of its own.

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## AMAZON LOGISTICS

Amazon began to trial its own logistics operations in the UK in 2012. By the end of 2014 Amazon Logistics had 13 delivery hubs and two sorting centres, in Hemel Hempstead and Manchester. These sites organise Amazon's packages and then pass them to vans to deliver to their destination.



Amazon's extensive Hemel Hempstead fulfilment centre is one of the largest in the UK. Courtesy: Amazon.co.uk

The difference between Amazon Logistics and typical industry models, such as the Royal Mail, is that the staff and delivery vans belong to local and regional businesses, not Amazon. Amazon provides the technology and logistics, as the name of the business suggests, and acts as a platform for other delivery firms. As the *Daily Telegraph* reported in November 2014, the problem for Royal Mail is that in the past these delivery firms, some of which only employ a handful of people, would never have been able to work with Amazon. <sup>[24]</sup>

The Amazon Logistics branded deliveries are fulfilled by businesses ranging from small companies like SAB Couriers and CTC Express to national carriers such as APLE. <sup>[25]</sup>

And the maths is already beginning to go the right way for Amazon. By November 2014 the Royal Mail was blaming Amazon's introduction of its own delivery network on its drop in its own profits. The *Financial Times* reported that Amazon had 'already grabbed more than 3 per cent of the UK parcels market, accounting for about 70m parcels annually'. It said 'Amazon had been Royal Mail's largest customer, accounting for 6 per cent of its parcels, or about 60m of 1bn parcels annually.' <sup>[26]</sup>

Amazon was swift to respond that it was no threat to the Royal Mail. Christopher North, the head of Amazon in the UK, insisted it has no intention of killing Royal Mail with its own delivery business. At the end of November 2014 he told the *Daily Telegraph*:

"Amazon Logistics is not about replacing a carrier, it is about complementing. It is about expanding the total capacity in the UK for fast delivery. It is also about meeting the challenge of the peaks in our business. At this time of year, our business is doing many, many multiples of what we do in the rest of the year. That is something that no one carrier can meet. No one carrier can go from handling x volume to 20x volume over a period of just a month." <sup>[27]</sup>

Christopher North's comments may have soothed Royal Mail's concerns for the immediate term, but they didn't stop analysts predicting the model could be extended further in the UK, and across Europe. We've already seen the scale of savings possible, and the potential profits even after all the operating costs have been taken into account.

ORDER PLACED  
5 Dec 2013  
Order Details | Printable Order Summary

ORDER: [REDACTED]

TOTAL £459.99

**Delivered**

Tracking Information:

STATUS: **Delivered**  
LOCATION: **Resident**  
SIGNED FOR BY: [REDACTED]  
SHIP CARRIER: Amazon Logistics  
TRACKING ID: [REDACTED]  
LATEST EVENT: **Wembley Delivered**

See Complete Tracking History

Sony PlayStation 4 Mega Pack (PS4)  
Sold by Amazon EU S.a.r.l.

Track Package  
Return or Replace Items  
Leave Package/Delivery Feedback  
Write a Product Review

'Amazon Logistics' is already a familiar name to Amazon's UK customers.

## AMAZON LOGISTICS EUROPE-WIDE

In December Reuters said: 'Analysts expect Amazon, and potentially others too, to start rolling out similar services across Europe's 30 billion euros-a-year parcels and express delivery market, leading many investors to flee traditional postal firms. Shares in PostNL, TNT Express and UK Mail -- as well as Royal Mail -- have fallen 20-30 percent this year.'<sup>[28]</sup>

Edmund Shing, Global Equity Fund Manager at BCS Asset Management, told Reuters that traditional postal firms could soon face a new type of competition. "It's a very competitive market, growth prospects are limited and the barrier to entry is not very high. The danger for the market is that Amazon might replicate its experiment across Europe and other online companies such as eBay also launch their own delivery services to cut costs."

Amazon's European operation is significant. The company has increased its distribution space in Europe by more than 1000% in the last 10 years and by the end of October 2012 the company occupied more than 1.3 million square metres. The vast majority of this space has been delivered by Goodman, who spotted the potential of the e-commerce sector early and has delivered customised warehousing solutions not only for Amazon, but also for the rising star of the German online market, Zalando.<sup>[29]</sup>

Little wonder that Amazon seems to be gearing up for greater logistics involvement across Europe. The company created 6,000 new full-time positions across the Continent in 2014. It now employs 32,000 permanent staff in the European Union, with the new jobs created in logistics centres, customer service, software development, supply chain management and design.

'We are still in a phase of investment and look forward to being able to fill more positions in 2015,' said Xavier Garambois, Amazon Vice President for EU retail this January; adding that customer demand in Europe was bigger than ever.

Amazon says around 1,200 of the new jobs were in Germany, its second-biggest market after the United States where it employs 10,000 warehouse staff plus more than 10,000 seasonal workers. Britain had the next most new positions with the rest spread around other countries.<sup>[30]</sup>

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## AMAZON LOGISTICS IN THE US

The 2012 launch of Amazon Logistics in the UK acted as the blueprint not only for Europe, but for the key US market as well. In 2014 *The Wall Street Journal* reported that:

‘As a prelude to the US moves, Amazon has been testing a delivery network in the U.K. "We've created our own fast, last-mile delivery networks in the UK, where commercial carriers couldn't support our peak volumes," Chief Executive Jeff Bezos said in his annual letter to shareholders. "There is more invention to come." As a prelude to the US moves, Amazon has been testing a delivery network in the UK. Typically using small couriers, Amazon delivers packages under the "Amazon Logistics" moniker and recently acquired an option to invest in Yodel, a UK-based parcel-delivery service.’<sup>[31]</sup>

There is small wonder that Amazon felt the need to develop its own logistics services following a disastrous Christmas 2013, when it believed it was badly let down by its regular distribution companies in the US.

*The Wall Street Journal* reported in 2014 that: ‘Planning for the delivery network began several years ago, but the project took on added urgency last winter after UPS and FedEx failed to deliver Amazon packages to some customers by Christmas, according to two people familiar with the matter. Amazon blamed the carriers, but offered \$20 credits to many affected customers.

““What happened during Christmas cost a huge amount of money” for Amazon, UPS and FedEx, said Marc Wulfraat, president of logistics consulting firm MWPVL International.’<sup>[32]</sup>

Looking beyond capacity concerns, there is a strong financial reason for Amazon developing its own logistics operation in the US. Analysts Sanford C. Bernstein & Co estimates that Amazon shipped about 608 million U.S. packages in 2013. The Postal Service handled 35%, UPS 30%, regional shippers 18% and FedEx about 17%. The distribution hasn't changed much in recent years.<sup>[33]</sup>

By April 2014 *Business Insider* reported: ‘Amazon could be rolling out its own private delivery network to make more same-day deliveries and have more control over shipping expenses (which grew 29% last year)’.

It said: ‘The company is currently testing the use of Amazon trucks driven by Amazon-supervised contractors to bring customers' packages "the last mile" to their doorsteps in San Francisco, Los Angeles, and New York.’

The report continued: ‘Right now, UPS, FedEx, and the US Postal Service deliver an overwhelming majority of Amazon's packages. Last Christmas, shipping delays caused Amazon to have to offer many affected consumers \$20 credits. With its own trucks, Amazon would have much more control, like offering deliveries late at night or early in the morning when traffic is lighter.

‘Amazon apparently began to roll out its delivery network late last year, with packages labelled "AMZL" and "AMZN\_US," codes designating the company's in-house delivery network.’<sup>[34]</sup>

Amazon itself took no pains to hide its plans. It published a job advertisement saying:

‘Amazon is growing at a faster speed than UPS and FedEx, who are responsible for shipping the majority of our packages. At this rate Amazon cannot continue to rely solely on the solutions provided through traditional logistics providers. To do so will limit our growth, increase costs and impede innovation in delivery capabilities. Last Mile is the solution to this. It is a program which is going to revolutionize how shipments are delivered to millions of customers.’

Given the fact that delivery charges rose 32% in one quarter, the shipping charges on its probable \$102bn revenue for 2014 were, at our earlier, very conservative, estimate at least \$9.1bn. Clearly Amazon Logistics makes as much sense in the US as in the UK. And remember that by cutting out FedEx Smartpost surface mail Amazon achieved savings of 75%. It’s not a lesson that it will forget in a hurry.

As we will see later, running a shipping company requires a huge investment, and requires a significant volume of business, to make profitable, as the demise of City Link, a UK top five UK courier, this Christmas shows all too clearly. Cost savings on their own may not have been a large enough reason for Amazon to take such a significant step.

However, there are a number of strategic reasons why the introduction of Amazon Logistics makes serious business sense, above and beyond transport costs alone. Amazon has wider plans about how it delivers goods and services, and Amazon Logistics is at the heart of these.

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## AMAZON AS A 3PL

As we have seen Amazon has stated several times that it is not in competition with its delivery partners. An Amazon spokeswoman told the *Financial Times* in December 2014 that the rapid growth was simply because ‘We needed more capacity to deliver on time and in excellent condition and to complement our existing carrier partners.’<sup>[35]</sup>

However, the *Wall Street Journal*’s Greg Bernsinger reported recently: ‘Ultimately, a delivery network could transform Amazon from an online retailer into a full-service logistics company that delivers packages for others, according to former Amazon executives.’<sup>[36]</sup>

What is the evidence that Amazon is trying to become a ‘full-service logistics company’ or, in industry terminology, a Third Party Logistics provider (3PL)? A 3PL is a company that fulfils logistics on behalf of another organisation, such as a retailer or manufacturer. In some ways Amazon is already a 3PL, in that third party sellers accounted for more than 40% of all items sold on Amazon in 2014, and in many cases Amazon looks after the entire delivery process of these goods. There are currently more than two million vendors on the online retail site, who sold more than two billion items worldwide last year, including books, clothing and other products.<sup>[37]</sup>



Amazon already acts as a 3PL fulfilment company for third party sellers. Courtesy: Amazon.com

Amazon's US operation has three types of sellers:

**Sold by Amazon:** This is merchandise in Amazon's inventory that ships from Amazon's warehouses. For warranty purposes, Amazon is the seller.

**Fulfilled by Amazon:** This is merchandise that third-party sellers purchase and ship to Amazon for storage in one of their warehouses. Sellers pay monthly fees for storage, as well as fees for handling the package and to have Amazon's workers pick and pack the orders when one of these items sells. The advantage of this is that the seller doesn't need to keep inventory on hand or employ their own order pickers. Amazon handles returns, but the third-party vendor is the company that sold the item for warranty purposes.

**Fulfilled by seller:** The seller stores their own inventory, picking, packing, and shipping their own orders. This could be a one-person business or a store with dozens of employees. Returns go back to the seller, and for warranty purposes, the third-party vendor is the company that sold the item for warranty purposes. It is this type of seller that Amazon is looking to incorporate more in its own logistic operations.

In keeping with its goal, this year Amazon.com has sought to tie-in the external sellers with its overall fulfilment offering in the US. Orders fulfilled by sellers are now included in super saver free shipping offers. In America non-Prime customers get free shipping for orders over \$35. Previously third party sellers' items did not count as part of this offer. From January 2015 they have been included, providing the item was sold with free shipment. As *Consumerist.com* explains: 'Let's say, for example, that you're buying two toys: one is shipped from Amazon and costs \$9, and the other is shipped directly from the seller's warehouse and costs \$27. Even though Amazon isn't involved in shipping the more expensive item, it still counts toward your total for free shipping.'<sup>[38]</sup>

However *Supply Chain Quarterly's* autumn 2014 issue states there is more to Amazon's plans than simply bringing its sellers further into its own supply chain:

'The company has an enormous fulfilment and distribution infrastructure in place that provides its customers with a full range of logistics services, including order management, warehousing, inventory management, fulfilment, distribution, and returns management. Smaller companies can rely upon Amazon to provide a virtual supply chain for them.

'The actions Amazon has taken to develop its own transportation capabilities may be a forerunner of a move into the realm of for-hire transportation in selected markets. At the same time, Amazon Supply has now targeted the business-to-business market in an aggressive, strategic move that is likely to pull customers away from traditional 3PLs'.<sup>[39]</sup>

So might Amazon become less of a retailer and more of a delivery company that makes it easier to buy anything from anyone at any time?

Certainly many analysts think so. Business journalist Nathaniel Mott, who specialises in start-ups and new technology, wrote recently on Pando.com:

'Amazon's current iteration is based on a group of warehouses from which consumers can purchase goods that will be shipped to their doors within just a few days or hours. But the warehouses aren't the important part in that process — the ability to order an item, pay for it without having to enter credit card information, and have it appear a while later is the reason why people shop Amazon. Warehouses are a means to an end. So why should Amazon expand its infrastructure when it can focus on everything else?'<sup>[40]</sup>

Discussing a new venture in which Amazon delivers food ordered from over 100 Seattle restaurants, Nathaniel said this could lead to a wider range of logistics services: 'It can partner with restaurants to get people what they want, when they want it, without having to offer their payment information to another company. Amazon has their credit card, it has their address, and it has the perception of being the company that sells, or at least delivers, anything. Amazon could decide that this program isn't worth pursuing. Maybe it really wants to be the one making, selling, and delivering everything instead of merely acting as the conduit between a consumer's desires and the businesses that can fulfil them. But if I were running a delivery company, I would be very, very worried about this program.'

Given the numbers for Europe and the US, could Amazon Logistics really stand alone as a logistics company? In the UK we have seen that it already delivers 3% of the parcels market, 70 million parcels.<sup>[41]</sup> This is a viable number for an independent delivery company. Established UK delivery company UK Mail delivered 29 million parcels in 2012,<sup>[42]</sup> so Amazon already ships more than twice the number of packages of a major UK player. In the US Amazon sends 608m parcels a year,<sup>[43]</sup> and worldwide 5bn items globally.<sup>[44]</sup> The largest international companies, UPS and FedEx deliver 6.5bn items globally, so Amazon Logistics already has the volume necessary to be a profitable logistics provider worldwide, should it wish. Of course this is particularly the case if Amazon Logistics seeks to offer its logistics services to other parties, in head-on competition with the likes of Royal Mail and UPS.

A note of caution is struck by Rob Martinez, CEO of Shipware LLC. '...It will be more expensive and difficult than perhaps Amazon is currently envisioning. An old industry joke comes to mind. How do you make a million dollars in the shipping business? Start with \$2 million.'<sup>[45]</sup> However, even a sceptic such as Mr Martinez believes Amazon could supplant parcel delivery companies like UPS in a few densely populated markets.

Other industry insiders are not so cautious. To return to Greg Bersinger's conjecture in the *Wall Street Journal*: 'A delivery network could transform Amazon from an online retailer into a full-service logistics company that delivers packages for others'. Greg also reports that 'Next up for Amazon is Treasure Island, a man-made spit of land in San Francisco Bay. Amazon is reviewing a lease for a site on the island to house trailers and delivery trucks, according to a person familiar with the matter.'<sup>[46]</sup>

Could third party logistics indeed become Amazon's new Treasure Island? This year will probably reveal a lot more about Amazon's ultimate logistics plans.

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## HURT LOCKER

For Amazon to succeed in shaving 33% there is another strong reason why the company should look to developing its own logistics arm further, and perhaps contemplating becoming a 3PL. Amazon could save a considerable amount by delivering into more central points rather than individual addresses. And it can do this through ensuring its delivery network serves drop boxes and pick up points. Amazon has been surprisingly slow to develop its Locker services, and is potentially losing out on significant cost savings as a result.



Amazon Lockers could one day be found in every London Underground tube. Courtesy: Futurilla

Amazon has already dipped its toe into the market. By April 2014 it had 270 Amazon Lockers across the UK <sup>[47]</sup> in major towns and cities such as London, Basingstoke, Aberdeen, Exeter, Liverpool, Birmingham, Glasgow, Bath, Leicester, Southampton, Leeds, and Bristol.<sup>[48]</sup> It also investigated nearly doubling this number in London alone by using London Undergrounds ticket offices when they are replaced by automated machines. <sup>[49]</sup> Amazon Lockers are also available in a variety of locations across the US.<sup>[50]</sup>

In the UK the company has also tried to expand its pick up point capabilities by entering into some unusual partnerships. It recently created Pass My Parcel, in conjunction with newspaper and magazine wholesale deliverers Smiths News. Amazon deliveries can be delivered into local shops on Smiths' delivery network. In addition it has also done a deal to deliver into Post Offices as Royal Mail Local Collect, and a new partnership with Duddle to deliver into handy pick-up points across the UK's railway stations.<sup>[51]</sup>

Amazon also works with the now well-established CollectPlus network for one day or first class deliveries. CollectPlus, the UK's largest store-based parcel delivery and returns service, was founded in 2010 and made its first full year of profit in 2014.

The company made a profit of £1.8 million for the 52 weeks ending 31 March 2014, with record full year revenues of £34.1 million on a volume of 13.6 million parcels. <sup>[52]</sup> Given the economies of scale delivering into drop boxes, and Amazon's increasing willingness to cut out that middleman, it could be forgiven for eyeing up companies such as CollectPlus with interest.

In the US Amazon is also working with specific universities to establish Amazon-run pickup points where students can securely ship their orders. Amazon Prime members, including Amazon Student, see a 'Prime Campus' badge on all items available for Free One-Day Pickup at their college's pick-up point. Again we see that the Pick Up service can be used as yet another Prime incentive as there are also faster shipping benefits for Amazon Prime/Student members. And in the UK one day delivery is free to pick up points for Prime Members, but costs £1.99 for non-members.

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## PRIME NUMBERS

As we have already seen, as well as creating Amazon Logistics to reduce costs and generate income from sellers using its logistics services, Amazon has another significant reason for introducing a logistics arm, to support its highly innovative Prime offering.

Amazon's ten-year old Prime service looks at first to be an unaffordable operation. Prime is an expensive service for Amazon, which loses revenue by offering free shipping and unlimited streaming video. Acquiring the rights to movies and TV shows isn't cheap. As MSN remarked in a recent report 'The point of this bounty is to entice customers to buy more stuff from Amazon.com'. The company says this does happen—without giving too many details. <sup>[53]</sup>

However, in fact there are some strong commercial reasons for Amazon's push towards increasing Prime membership: As Consumer Intelligence Research Partners recently revealed: <sup>[54]</sup>

- Prime now has 40 million US members
- Prime members spend an average of \$1,500 a year on Amazon, compared to \$625 per year for non-members
- Prime members shop 50% more frequently than non-members
- 45% of Amazon customers are Prime members

Amazon ships more than twice as many items to members who use its Prime subscription service in the United States than to those shoppers who opt for free shipping. <sup>[55]</sup>



**Fig 1: 10 Years of Amazon Prime.** Source Amazon.com

One of the key drivers for consumers to sign up to its Prime service is the varied shipping options. And Amazon Logistics is key to this. Two of the most valued Prime options are made possible by Amazon Logistics: Same-Day Delivery (including Prime Now) and Sunday deliveries.

## SUNDAY DELIVERY GROWTH

Amazon is open about the fact that it created Amazon Logistics in the UK partly to ensure Sunday delivery. A spokeswoman for Amazon UK said in 2014: 'Amazon Logistics is a technology and logistics platform that empowers local and regional delivery companies across the UK to deliver Amazon packages to customers seven days a week. This platform complements our current large, national delivery partners and provides additional capacity as more and more customers enjoy Amazon Prime's next day delivery benefits.'<sup>[56]</sup>

And the UK director for Amazon Logistics, Jamie Stephenson, clearly sees a healthy link between Sunday deliveries and the local companies that are collaborating to create Amazon Logistics. He said recently: ‘We’re excited that so many customers are taking advantage of Sunday delivery and that so many local and regional delivery companies continue to join the Amazon Logistics platform. And this is just the beginning – we recently opened a new delivery station in Glasgow and we hope to expand even further in the future.’ [57]

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## SAME-DAY SERVICE

Amazon offers same-day delivery in just over a dozen US cities, charging \$5.99 (£3.81) for members of its Prime programme while non-members pay \$8.99. In October, the company launched a same-day delivery service in the United Kingdom with newspaper delivery company Connect Group PLC. [58]



Amazon Fresh has introduced Same Day deliveries in a number of US cities. Courtesy: Mestro.us

Amazon sees its Same-Day Delivery service as an increasingly important part of its Prime offering. *The Wall Street Journal* reports of Amazon Logistics’ same-day operations: ‘The new delivery efforts will get Amazon closer to a holy grail of e-commerce: Delivering goods the same day they are purchased, offering shoppers one less reason to go to physical stores. With its own trucks, Amazon could offer deliveries late at night, or at more specific times.’ [59]

Amazon says: ‘Our long-term vision is that customers can order and receive a seller’s product the same day anywhere in the world.’ [60]

The reason why Amazon is putting so much emphasis on its Same-Day Delivery and Prime Now service may seem obscure at first. Only 4% of its customers used the service in 2014. [61] However, according to a September survey by RBC Capital Markets, its same day customers spent 15 per cent more than others.

The business press is in little doubt that same day services are lucrative for Amazon. Reuters’ Deepa Seetharaman says: ‘Amazon.com Inc is considering expanding its same-day delivery programme globally, recent job listings show, underlining the importance of fast shipping to its ability to compete with the instant gratification offered by brick-and-mortar stores.’

'The No. 1 US online retailer is also looking to add a same-day delivery option on all items sold by third-party merchants on its site, a move that some logistics experts said may help offset the high costs of speedy, last-mile delivery.'<sup>[62]</sup>

The Prime same-day service model can be rolled out easily to delivering groceries and other items, boosting Amazon's role as a one-stop purchase and delivery shop. In the US Prime Now initially rolled out in parts of Manhattan. It gave another way for Amazon to compete with brick-and-mortar stores by offering speedy delivery of household items.<sup>[63]</sup> Again the service was only available to Prime members. The new service delivers items such as shampoo, books, batteries and other products to Prime members in 60 minutes or less.

Amazon has already launched its Prime Now App in the US. With the Prime Now mobile app available in the iOS, Android and Amazon App stores, Prime members can order items from 6am to midnight, seven days a week. Two-hour delivery is free, or customers can pay \$7.99 to get their order in an hour or less.

The App works like any shopping app, allowing Prime members to search for and browse items and then add them to their shopping cart. After ordering an item, they can track its delivery via the App. Tens of thousands of products are available through Prime Now, according to Amazon.<sup>[64]</sup>

Prime is definitely a growth driver for Amazon. However, the logistics costs for the service are considerable. *Fortune* magazine recently revealed that Amazon's Prime service is a 'big money loser'. "On the one hand, Prime adds to their bottom line, but it's like a leech that sucks their blood," Forrester analyst Suchitra Mulpuru told *Fortune* in January, estimating that Amazon loses at least \$1 billion annually on Prime-related shipping expenses.<sup>[65]</sup>

By taking control of the logistics supporting its Prime service, Amazon can reduce its costs and control the quality of its operations.

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## PRIME DIRECTIVE

Technology journalist Don Reisinger recently wrote on CNet: 'The willingness of Prime members to spend more heavily perhaps suggests why Amazon is willing to throw so many different services into the offering. Prime started as a way for customers to save money on shipping while getting items more quickly. Over time, as Amazon brought on its instant video streaming, photo library, and Kindle Owners' Lending Library, which gives users free access to a limited number of books, it bundled them with its Prime service to make it more attractive'.<sup>[66]</sup>

Amazon also plans to support its Prime service through an entirely different form of delivery, streaming. Beyond the free two-day shipping and its new Prime Now feature, Amazon Prime offers a large library of Prime Instant streaming movies and TV shows, Prime Music and Prime Photos. The company is taking organisations such as Netflix head-on in a further effort to encourage Prime membership. This year its series *Transparent* Sunday ruled the Golden Globes. It also announced a deal for a new Prime Instant Video series written and directed by Woody Allen.<sup>[67]</sup>

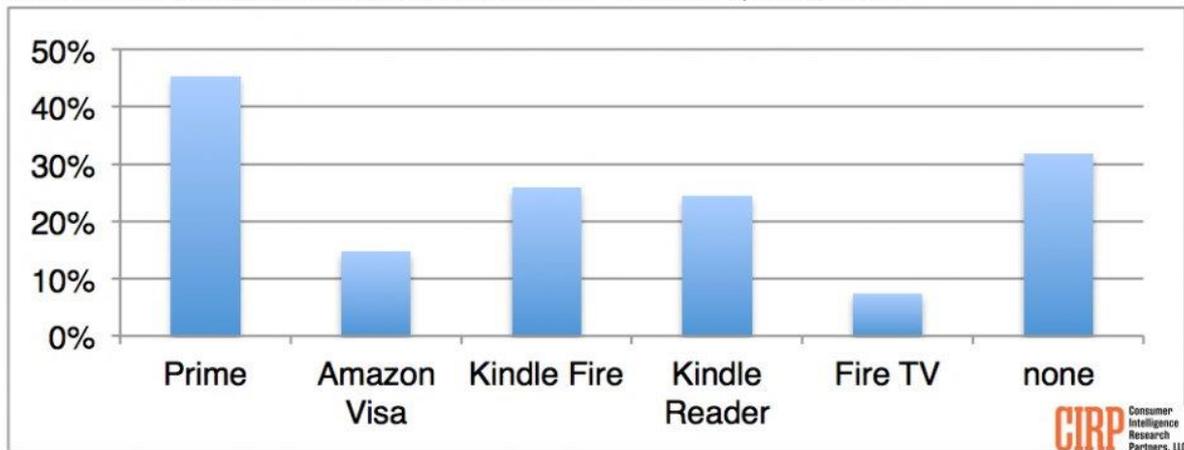


Amazon’s Prime service includes streaming services. Amazon can also supply the hardware, this is a Fire TV. Courtesy: Amazon.com

When combined with Amazon Prime’s physical logistics services it is a compelling proposition. To return to the prediction of Scott Galloway, Professor of Marketing at New York University’s Stern School of Business: “Everything you buy, starting with your weekly groceries, will be flowing through one pipe called Amazon. They’ll have your credit card purchase history, be able to do data-mining on your needs, offer massive selection with a reputation for low prices’ . [68]

In spring 2015 Amazon announced yet one more flow through this pipe. In the US it launched a new Home Services section, where customers can shop for professional help. *The Verge* reported that: ‘It’s launching with 700 different services, from the ordinary to the esoteric, everything from installing a garbage disposal to renting you a goat herd that will graze away the unwanted vegetation on your property.’ [69]

**Chart 1: US Amazon Customer Affiliations – Fourth Quarter 2014**



**Fig 2: how prime compares with other amazon loyalty initiatives.** Source: Consumer Intelligence Research Partners

Amazon does not work in a vacuum. As well as rival brick and mortar stores, it also faces growing opposition from sites such as eBay and the Chinese internet giant Alibaba, which is actually considerably larger than Amazon, though it is only now beginning to encroach on Amazon's traditional territories.

Alibaba has also seen the benefits of creating its own logistics operation to cut costs and control service. In 2013 it began to create its own shipping operation; on different lines than Amazon Logistics however. Alibaba has signed a framework co-operation agreement with China Shipping Container Lines (CSCL) and China Shipping Network Technology - two subsidiaries of CSG - to jointly establish a web platform serving container shippers across the logistics chain, specialising in full container load international logistics and transportation services.

Alibaba's new logistics operation is called China Smart Logistics Network. Alibaba is responsible for sourcing logistics demand from customers via its portals and establishing a professional team for online operations and products. As a carrier, CSCL will need to ensure freight space and provide offline customer services corresponding with online demand, among other operational resources. <sup>[70]</sup>

Alibaba's founder, Jack Ma, says the new logistics operation will become the backbone of the country's \$190 billion e-commerce market. The network, which will be able to deliver shipments to any city in China within 24 hours, is backed by 100 billion yuan (about \$16.3 bn) in funding and slated for completion in eight to ten years. Once finished, CSN will support 30 bn yuan (about \$4.9 billion) in daily online sales, says the Alibaba Group. <sup>[71]</sup>

Alibaba's move into logistics makes even more sense than Amazon's in its domestic market. Bloomberg reports that: 'The Chinese shipping industry is still fragmented into lots of small companies that ferociously compete to undercut each other on price, and timeliness and package care often suffer.'

The report continues: 'And the difficulties for logistics in China aren't confined to the shipping companies. The infrastructure the companies rely on to transport their goods is still uneven—the highway system isn't nearly as extensive as in the US, and it peters out in the country's rural reaches, while the rail system still focuses more on passengers than on freight. Many rural residents don't have formal addresses. And the country is woefully short of warehouse space. What warehouses it does have lack the sort of modern pick-and-pack systems and computer tracking that have been key to Amazon's success... Boston has more modern warehouses than all of China.' <sup>[72]</sup>

However, creating a logistics arm is not cheap, and some analysts say Alibaba may be taking on more than it realises in copying Amazon's move. Logistics industry analyst Steve Banker wrote in *Forbes* last summer: 'Currently, if you compare Alibaba to Amazon, Alibaba is far, far more profitable despite being a much smaller company. In part, this is because Amazon is aggressively building a network of distribution centres. But the China Smart Logistics build out, of which Alibaba is a 48 percent owner, could be hugely capital intensive. Alibaba is a fascinating company with terrific upside potential. But many investors might not be paying close enough attention to potential future logistics network expenditures.' <sup>[73]</sup>

However, Alibaba is bullish enough about its own logistics operation to extend it into Europe. Alibaba logistics partner ZTO Express is cooperating with the French post office, La Poste, to launch an express delivery service from China to Europe as part of the e-commerce giant's overseas expansion. ZTO Express is a partner of Alibaba's China Smart Logistics Network (CSN), also known as Cainiao, which is 48 per cent owned by Alibaba. <sup>[74]</sup>

Alibaba is also threatening to move into Amazon's own backyard. Logistics capacity might prove to be at the very heart of the fight. eBay and PayPal are ripe for acquisition after the two companies announced in September that they would separate. The most likely target to buy eBay may be Alibaba, which is preparing to enter the US market in a big way. That would give the company a strong foothold in America. But Amazon could also see a benefit in acquiring eBay. It would eliminate a hearty competitor - the companies are two of the largest in the US e-commerce market <sup>[75]</sup>. Amazon would require considerable more logistics capacity should it buy eBay, and control of its logistics operation would help considerably. And remember Edmund Shing, Global Equity Fund Manager at BCS Asset Management, has predicted that eBay itself may introduce its own logistics service to reduce costs. <sup>[76]</sup>

Amazon has already dipped its foot in the eBay market. In December Amazon.com quietly introduced Make an Offer. It is limited to 150,000 items that uniquely lend themselves to the barter-style process, including sports and entertainment collectibles, collectible coins, and fine art. That number might seem low considering the several hundred million products Amazon carries and the fact that Amazon Marketplace sellers currently account for 40% of all items sold on the website. However, this seems like a logical starting point for a widespread program should Make an Offer prove successful in this limited scope. <sup>[77]</sup> Again, the logistics operation behind such growth is better controlled 'in house'.

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## A GLIMPSE OF THE FUTURE

The recent collapse of electronics giant Radioshack in the US also led to one more interesting potential challenge for Amazon's logistics operations: performing a 180 degree turn and becoming a traditional high street retailer. In early February Amazon considered buying a number of Radioshack stores. <sup>[78]</sup> These could have become both a retail outlet, and a pick up and return point for deliveries

As we might expect by now, any such Amazon high street store may be rather different than traditional shops. US tech website *Recode* disclosed this April that Amazon is planning a new kind of retail establishment that would allow shoppers to pick items and leave without stopping at a cashier station or kiosk. <sup>[79]</sup>

*Recode* reports: 'Based around the idea of complete convenience, such a store would work using a system of cameras, sensors or RFID readers that would be able to identify shoppers and the items they've chosen, according to the application, which was filed in September and published in January. The technology would also potentially give Amazon a more cost-effective way to compete with traditional retailers by operating a store that doesn't require cashiers and could similarly serve as a place to pick up online orders.'

Again Amazon Logistics operations will be central to any future venture into brick and mortar retailing. It is almost ironic that Amazon Logistics could end up servicing a chain of brick and mortar stores, as well as delivering a leading edge internet shopping service. In addition we saw earlier the savings Amazon could make delivering to its own pick up points – something this new idea in high street stores could facilitate.

Amazon is also ready for the Internet of Things. For some time tech experts have been predicting fridges, washing machines, espresso coffee machines, etc. will send a message to replenish stocks automatically. Amazon's new Dash Button service, introduced this April, can be both a manual physical button stuck on your appliance, or equally the Dash Replenishment Services technology can be built into appliances to send a message entirely automatically. Whirlpool, Brita and Brother are amongst the companies about to launch products that send a message to Amazon. <sup>[80]</sup>

Again this level of delivery technology needs a dedicated and integrated logistics supply chain behind it, something possible now Amazon has its own logistics capability. And once again the new service has been introduced exclusively for Prime members, at least initially, as another way of offering greater convenience, and of course boosting repeat custom.

Amazon is also investigating radical new ways of delivering items exactly where its customers wants them. It is collaborating with DHL Parcel and Audi on A pilot project that will allow car owners to use their cars as mobile delivery addresses for their parcel shipments.

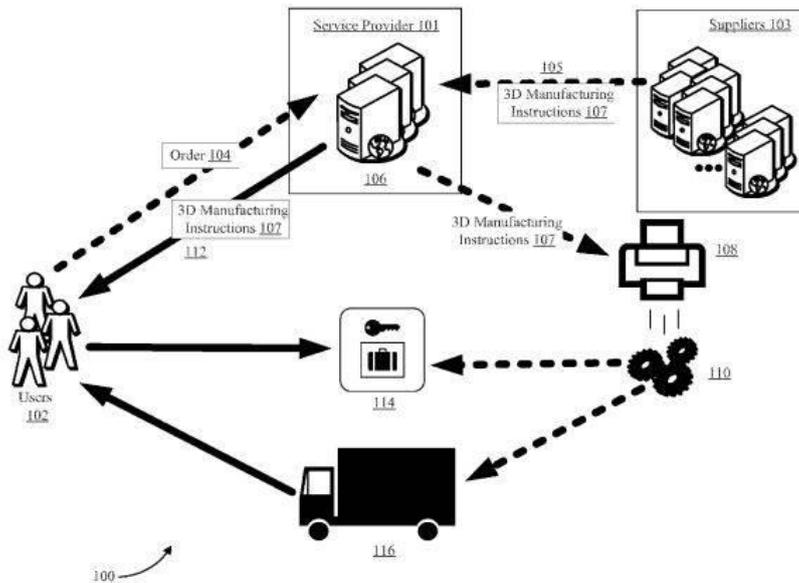
Amazon.de and its project partners start trials in May and will run them for several months. The plan is then to roll out system Germany-wide. For now Amazon is working closely with DHL on this project, but it could easily build it into its own logistics operation in the future. <sup>[81]</sup>

And there is one final fascinating option for the future that, if it takes shape, is a perfect fit with Amazon's new Logistics operation. Amazon is investigating the possibility of installing 3D printers in its distribution centres and even in its trucks. It's clearly not a short term plan, but *The Register* reports that Amazon has filed a US Patent on a service that would see the company offer 3D-printed stuff on demand.

Says *The Register*: 'The filing even suggests that 3D printers could be mounted within trucks or vans, which could then print customers' purchases on the fly and deliver them instantly.' <sup>[82]</sup>

And in its application Amazon elaborates on this: 'By 'mobile', we mean that the position of the 3D manufacturing apparatus changes because it is mounted within or contained within a moving vehicle or other structure'. <sup>[83]</sup>

One obvious advantage for Amazon would be the ability to cut back the amount of storage space needed. Amazon's patent request says printing products on demand would 'decrease the amount of warehouse or inventory storage space needed to maintain items, to reduce the time it takes for current systems to locate items requested in an order, or both.'



**Fig 3: How Amazon Logistics mobile 3D printing could work.** Source: Amazon/regmedia.co.uk

Clearly, by operating its own fleet of Amazon Logistics 3D printer-equipped vehicles, the company will be in control of the entire logistics process. This might ultimately be a more astute idea than delivery drones or other new technologies Amazon has been investigating.

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## LEADING THE WAY?

Where Amazon leads, we can be certain others will follow. For the past 20 years retailers and manufacturers have largely sought to outsource their logistics function, and concentrate on their core business. But, if the great Amazon Logistics experiment logistics works, other companies will be sure to follow. They too might see the benefits of developing logistics as part of their income stream, rather than as a necessary but unwelcome expense.

Industry expert professor Alan Braithwaite CMILT predicted in *The Financial Times* recently that other retailers will do the same: “Retailers are looking at how they can leverage their resources,” he says. “They are concerned that their own reputations are at risk. If Tesco is already delivering its own food, there’s no reason it couldn’t deliver other goods for a third party as well,” he says. “They already have the delivery network.” [84]

Amazon Logistics might be the launching point for a new revolution in the world of commerce.

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