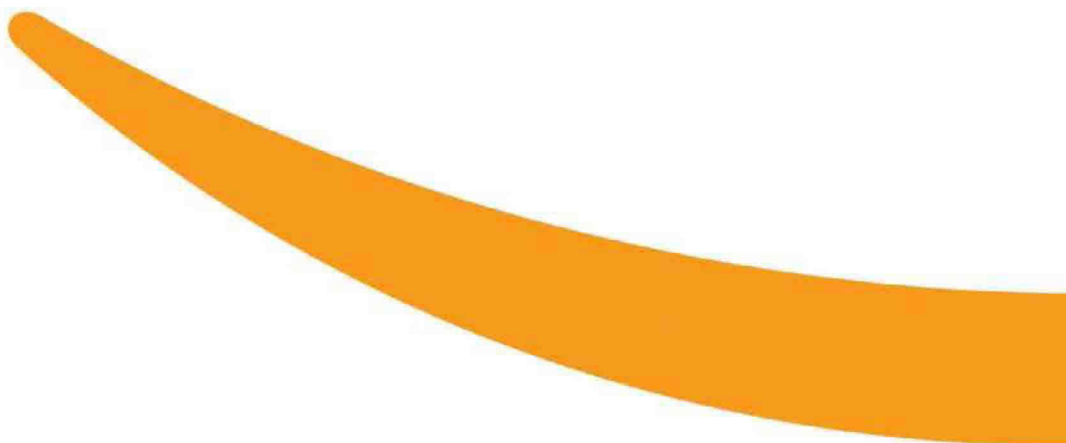
Amazon's Botto



Corporate America is running scared

Amazon makes no sense. It's the most befuddling, illogically sprawling, and—to a growing sea of competitors—flat-out terrifying company in the world.

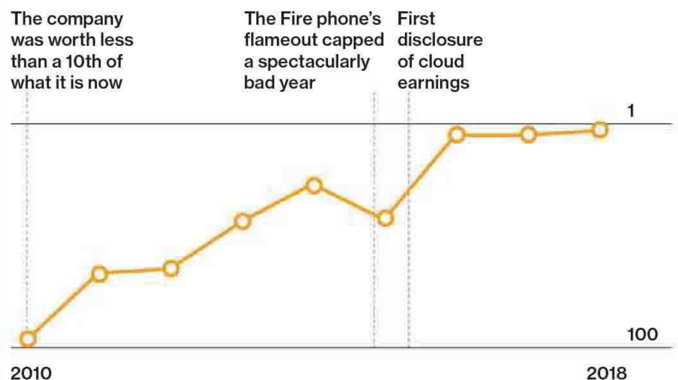
It sells soap and produces televised soap operas. It sells complex computing horsepower to the U.S. government and will dispatch a courier to deliver cold medicine on Christmas Eve. It's the third-most-valuable company on Earth, with smaller annual profits than Southwest Airlines Co., which as of this writing ranks 426th. Chief Executive Officer Jeff Bezos is the world's richest person, his fortune built on labor conditions that critics say resemble a Dickens novel with robots, yet he has enough mainstream appeal to play himself in a Super Bowl commercial. Amazon was born in cyberspace, but it occupies warehouses, grocery stores, and other physical real estate equivalent to 90 Empire State Buildings, with a little left over.

Investors have grown to love Amazon.com Inc. despite, or perhaps because of, its contradictions. Shareholders pushed its value above Microsoft Corp.'s for the first time on Valentine's Day and to an all-time high of $774 billion on March 12. Only Apple Inc. and Google parent Alphabet Inc. remain more valuable, and unlike them, Amazon breaks all the rules of the modern corporation. It's also wielding its power against an unprecedented range of other businesses.

Bezos' brainchild has been fast-growing, influential, and anomalous for most of its 24 years, but it's entered a new phase. Its dominance can't be contained to a few areas such as books, electronics, or even computer networks. Remember my colleague Brad Stone's book *The Everything Store*? That title may have undersold Bezos' ambitions. He seems to want to establish his place in every industry. Parcel delivery, supermarkets and packaged foods, apparel, trucking, auto parts, pharmaceuticals, real estate brokerages, makeup, concert ticketing, swimming pool supplies, and banking are just a sampling of the fields battered at various points in the past year because of Amazon's encroachment or even rumors of its interest in entering them. Amazon declined to comment for this story.

The company has grown so large and difficult to comprehend that it's worth taking stock of why and how it's left corporate America so thoroughly freaked out. Executives at the biggest U.S. companies mentioned Amazon thousands of times during investor calls last year, according to transcripts—more than President Trump and almost as often as taxes. Other companies become verbs because of their products: to Google or to

Amazon's global market value ranking



DATA: AS OF JANUARY OF EACH YEAR. COMPILED BY BLOOMBERG

omless Appetite

By Shira Ovide

Xerox. Amazon became a verb because of the damage it can inflict on other companies. To be Amazoned means to have your business crushed because the company got into your industry. And fear of being Amazoned has become such a defining feature of commerce, it's easy to forget the phenomenon has arisen mostly in about three years.

In 2014 everything was going wrong. Amazon introduced the Fire smartphone, one of the bigger flops in the history of consumer electronics. It posted its steepest quarterly loss before taxes and interest—an ignominious milestone for a company with a history of slim or no profits. Revenue growth in the 2014 holiday season was the second-worst since 2001, and executives started to sound downright pessimistic, as if the business was starting to mature or even stall. They promised the company would be more discerning about spending on projects that might not pay off for years or decades. At one point, Amazon's top finance executive even tried to blame disappointing sales on students trying to save money by renting textbooks. It was a lame excuse befitting a stodgy company struggling to adapt, not a rising technology superpower.

Investors lost patience. Over the course of 2014, Amazon's stock price fell more than 20 percent, making the company much less valuable than Walmart Inc. or China's Alibaba Group Holding Ltd., an Amazon look-alike that went public that September.

A year later, however, Amazon had leapfrogged to No. 6 on the list of most valuable companies. Since the end of 2014, its market value has quintupled. This was a case of preparation meeting opportunity. As the company started to clear key thresholds in several of its important businesses, it also revealed that it was sitting on a gold mine made of clouds.

In April 2015, Amazon had what technology analyst Ben Thompson called a second initial public offering. It disclosed for the first time the staggering profitability of Amazon Web Services, which started in 2006 as an experiment to rent out computing horsepower to companies that needed it. It proved to be a big idea that allowed young businesses to get off the ground more quickly and cheaply than before. Large companies, notably Netflix Inc., also started using AWS—first for side projects, then eventually to support essential operations.

Amazon had always been the clear market leader in this kind of cloud computing service, but few outside the company were prepared for just how valuable AWS had become. Inside Amazon was a division with the muscular profit margins of Starbucks Corp. and higher annual sales than the entire Chipotle Mexican Grill restaurant chain.

The AWS disclosure changed the way investors and stock watchers valued Amazon. Suddenly there was evidence the company could be consistently and nicely profitable if it chose that route. It was also among the biggest signs that Amazon's head-scratching investments could pay off in a huge way. In 2015, AWS was responsible for two-thirds of total ▶

◀ operating profit. Last year it was more than 100 percent.

Two other long-gestating Amazon businesses also found their groove in 2015. The company tested the loyalty of its 10-year-old Amazon Prime program by holding its first Prime Day, a fake shopping holiday during the summer retail doldrums. The program, which delivers fast, free shipping and other benefits to members, gave Amazon not only a predictable stream of membership fees but also a psychological advantage with shoppers. Once they pay their annual dues, they have an incentive to buy as much as possible from Amazon. A year later, on the second Prime Day, total orders rose 60 percent above the first outing. Like Costco Wholesale Corp., Amazon had found a way to compel customers to pay them for the privilege of buying more stuff.

The year 2015 was also a milestone for the last of what Bezos calls his "three pillars," as Amazon topped $100 billion in sales for the first time. About half the merchandise sold on Amazon's vast online mall comes directly from the company. But the other half is sold by millions of independent shops that open mini-storefronts on the site, a panoply Amazon calls its Marketplace business. It's the equivalent of Walmart setting up swap meets in its parking lots and mixing stuff from its own shelves alongside the pickings of strangers' card tables. The independent merchants bear most of the costs of distributing orders, and Amazon collects about 15 percent of the price of their merchandise, plus more fees if they want to be, say, included in Prime. (That's another 15 percent.) Those rents amounted to $32 billion of revenue last year, or about half of Target Corp.'s yearly sales.

That holiday season, Amazon recorded its first quarterly operating profit of more than $1 billion, an achievement it's notched five more times since. Management theorist Jim Collins coined the term "flywheel" to describe a virtuous cycle that makes successful companies ever more successful. For Amazon, it took 20 years for the flywheel to kick in. Bezos now loves to explain how happy customers (who happen to be locked in) give Amazon the ammo to add products and cut prices, which in turn draws more customers, more merchants, and the efficiencies to lower prices further, including by squeezing more money from partners.

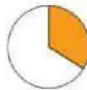
Insatiable Amazon

2nd
largest private U.S. employer after Walmart

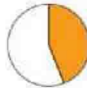
254m
square feet of real estate, equivalent to about 90 Empire State Buildings

55% of the total is new since 2014

34%
share of global cloud computing revenue



44%
of U.S. online spending



DATA: COMPANY REPORTS, SYNERGY RESEARCH GROUP, EMARKETER, COMPILED BY BLOOMBERG

No other company in Amazon's ballpark is growing as quickly. Its roughly $180 billion in annual sales remains dwarfed by Walmart's $500 billion, but sales at the big-box retailer inched up 3 percent in the year ended on Jan. 31. Amazon's revenue rose at least 25 percent in 2017, excluding sales from Whole Foods. That also means Amazon is growing faster than it did three years ago, when it was half its present size.

All the things Amazon did before 2015 seem hopelessly small compared with its more recent ambitions. In late 2014 it introduced Prime Now, an added Prime tier, in New York City, promising one- or two-hour deliveries of a small variety of consumer staples. Today, Prime Now operates in more than 30 U.S. cities and delivers a much wider range of goods, including electronics and restaurant meals. Three years ago, Amazon owned or leased about 100 million square feet of space around the world, including 109 distribution warehouses and 19 U.S. package-sorting facilities. Now the square footage tops 250 million, and it has 150 warehouses.

In the past few years, Amazon has also started leasing its own cargo planes, obtained a license to handle ocean freight, and committed billions of dollars to developing India's nascent e-commerce market. Its Hollywood studio collected an Academy Award, and its Echo smart speaker basically invented a whole new product category, becoming the envy of Apple and Google. Oh, and last summer, Amazon paid $14 billion to buy a supermarket chain.

A few years ago, Amazon's getting into supermarkets would have seemed like evidence that its corporate strategy was scatterbrained and profit-averse. After all, the company spent a decade laboring over a grocery delivery service with little success. But the deal for Whole Foods was hailed as a coup. That's the story of Amazon in its new, terrifying phase: Outsiders look at the same sorts of facts that used to prompt derision, and tremble.

For many companies, perhaps what's scariest is that Amazon has lots of room to grow, even in retail. In the U.S., more than 90 percent of all retail sales still happen in physical stores. In some big categories, including home furnishings, personal-care products, toys, and food, the brick-and-mortar numbers are even higher. As the share of online shopping continues to increase, Amazon seems likely to benefit the most. It's responsible for roughly 44¢ of every dollar Americans spend online, and it's now mixing in retail stores.

Besides the 470-odd Whole Foods locations, since 2015 Amazon has opened more than a dozen bookshops and dozens of mall kiosks that sell Kindles and other branded gadgets. There are also 30 Amazon outposts on or near college campuses, offering snacks, phone chargers, other impulse items, and a central point to pick up packages. Some 238 cities entered bids for Amazon's second North American headquarters. And the company is experimenting with a cashier-less convenience store as well as drive-through locations where people can grab groceries they purchased online.

Just as it was difficult to predict that Amazon would buy upscale supermarkets, it's tricky to be certain which industries the company might torch next. On Feb. 27, it bought Ring, a maker of home security cameras, and shook the rest of that industry. On March 12, Bloomberg News reported that Amazon plans to team up with a bank to offer a credit card to U.S. small businesses, an area dominated by American Express Co. Shares of AmEx dipped about 1.4 percent.

When Amazon announces an expansion or new business, rivals and investors tend to panic

Biggest intraday drop in share price ▼

One-day loss of market value:

Industry:
Automotive
Food
Health
Industrial distribution & package delivery
Real estate
Retail & apparel
Tech

At one point, United Natural Foods lost about 26 percent of its value

United Natural Foods
Supervalu
-20%
Kroger
-15
Sprouts Farmers Market
Shutterfly
Target
Blue Apron
Express Scripts
TrueCar
Foot Locker
Alkermes
Ahold Delhaize
-10
Best Buy
Costco
Kroger
CVS Health
Rite Aid
Cigna
LogMeIn
Wayfair
Just Eat
Walmart
Lowe's
Teva
AutoZone
Brixmor
-5
Walgreens
Advance Auto Parts
Ocado
CVS Health
Kellogg
UnitedHealth Group
Netflix
O'Reilly Automotive
Costco
Centene
Cigna
Inditex
PayPal
FedEx
0

6/9/16 Expands grocery business into U.K.

11/17/16 Prime video expands

1/23/17 Reported expansion of auto parts sales

6/16/17 Whole Foods purchase

10/5/17 Package delivery test

1/30/18 Amazon health-care joint venture

Company milestones ▲

There are more hints in the smoke. Amazon has shown interest in other categories of physical stores, including custom-made clothing, furniture, and home appliances. Like groceries, those are big retail areas that remain stubbornly offline. Amazon has also spent much of the last several years assembling the pieces of a delivery operation that analysts say might allow it to directly challenge FedEx Corp. and United Parcel Service Inc., companies with combined sales of about $126 billion. And health-care companies have been wringing their hands about Amazon's potential foray into drug distribution or the possibility of its becoming a middleman for health-care benefits. Walgreens Boots Alliance Inc., the drugstore retailer, recently began negotiating a full takeover of AmerisourceBergen Corp., one of the largest distributors of prescription drugs. One major motivation is the desire to outpace a possible Amazon entry into the pharmacy business.

Amazon is far from invulnerable. All the same old red flags are there—a puny 2.7 percent e-commerce profit in North America, massive outlays to establish delivery routes abroad—but few are paying attention. Anyone buying a share of Amazon stock today is agreeing to pay upfront for the next 180 years of profit. By one measure, it's generating far less cash than investors believe. And its biggest risk may be the fear of its power in Washington, New York, and Brussels, a possible prelude to regulatory crackdown.

Few tech companies manage to stay this kind of dominant for long, and Amazon can't sneak up on anyone anymore. It has more outside threats than ever, and there remains a very real risk that it will choke on its own ambition. For now, however, little is being done to contain its or Bezos' power or aims, and it's difficult to imagine the company lacking a seat at any table it wants. On March 7, Amazon fixed a bug that left its voice-assistant software, Alexa, cackling aloud, unprompted. Shame—that summed things up nicely. Ⓑ —*Ovide is a columnist for Bloomberg Gadfly.*

DATA: COMPILED BY BLOOMBERG