amazon

amazon

amazon

The Amazon Disruption

BY RONALD SOLOMON
MAPP Trap/The Creditors Network

Imagine for a moment that the year is 1875. You make a very comfortable living by running your own Western Union store. You send thousands of telegrams for people and businesses. Then along comes this gentleman named Alexander Graham Bell with a new fangled invention called the telephone. You, just like the owners of Western Union, scoff and pay it no mind. Now let's flash forward to 1904. There are over 3,000,000 telephones in the United States and you are out of business because of what Western Union's President deemed "a toy".

Let's imagine again. The year is 1985. You and your family have a booming business running a small chain of record stores. Your customers range in age from young to old and you sell everything from classical to rock and roll. Then along comes this thing called the internet. And something — a service called Napster — figures out how to let individuals record their music and share it with others for free through a peer-to-peer data exchange. And, if that wasn't bad enough, Apple comes along and introduces the iPod. Look around. When's the last time you saw a record or a video rental store?

These are examples of what's called "disruptive technology." The term was first described by Clayton Christensen in his 1997 book titled, "The Innovator's Dilemma: When New Technologies Cause Great Firms to Fail." In that book, Christensen defined a disruptive innovation as "an innovation that creates a new market and value network that will eventually disrupt an already existing market and replace an existing product." For the purposes of this article, the value market is ecommerce. The existing market being replaced is brick-and-mortar retail, mail-order catalogs and others.

As a prime example of the disruption caused by electric commerce (aka ecommerce) Amazon has lowered the barriers and costs to entry for retailers. Before Amazon and eBay's 3rd party marketplaces came along, at least online sellers were compelled to make investments in technology. They had to buy shopping cart systems, stock inventory, and fulfill orders. They even, to varying degrees, had to charge, collect and report sales tax. Not so with Amazon. For a fee, these functions can be 100% outsourced. Many online merchants never even see or touch the products they sell.

On its surface, one would assume that this disruption has only affected the brick-and-mortar retailers of the world. After all, with the lower cost models currently enjoyed by online sellers, the physical stores live on the bottom edge of an unbalanced playing field. Their costs are comparatively much higher — the costs for retail rent, sales fixtures, inventory, insurance, POS systems, sales people and more have not gone away. So because online sellers enjoy lower costs of doing business, they can charge less money for products they've purchased for the same wholesale price and still make similar profits.

Some manufacturers have looked at these market changes and declared themselves immune from any negative effects. They believe that as long as they still get the same wholesale price for their product then retailers (on or offline) can do whatever they please. Unfortunately for them, many of the brick-and-mortar retailers are fighting back. Like their customers, they look at the online prices of products as well. And, clinging to what is perhaps an obsolete model called "key-stoning" (the practice of doubling a product's wholesale cost to determine retail price), they demand a lower wholesale price. If extended to its logical end, this hints at a deflationary future.

Savvy manufacturers realize the disruption is not only affecting their brick-and-mortar customers. It is having a direct impact on their businesses, too. Because of the unfettered and uncontrolled distribution of their products online, they no longer know who is selling them. (There are over 2 million third party sellers on Amazon.com.) They no longer have control of brand messaging, image, or product descriptions.

Additionally, and perhaps most importantly, because the only true distinguishing factor of a product online is price, brands are suffering intense degradation to perceived value. This disrupted MSRP model is causing brand erosion, decreased profits, upside down sales channels and more.

So does this all mean that today's specialty retailers are going the way of the local video rental store? Perhaps, but not necessarily. In 2015, online sales only accounted for about 10% of all U.S. retail

sales (online marketplaces did over $300 million in sales, one-third of online sales, in 2015). That means brick-and-mortar is still alive, albeit struggling and scared because that percentage is growing rapidly. The retailers that want to survive are adapting.

Brick-and-mortar retailers are employing omni-channel practices that incorporate and enhance their physical locations with their ecommerce stores. They are learning how to use mobile technology to pull customers into their stores from the internet. They are learning that a hybrid model is the best and only chance they have to not only remain in business, but to thrive due to getting unparalleled access to millions of consumers (over 41 million consumers , 38% of U.S. households, subscribe to Amazon Prime).

Manufacturers are adopting new business practices as well. What those are depends largely on their objectives. Companies that want to get a better handle on their distribution are bringing that aspect of their business in-house. To help them create a more level playing field, and gain some control over counterfeiting, hyper-discounting, over-distribution and an eroding brick-and-mortar population, they have created new kinds of policies.

Some are letting go of their distributors and selling directly to their retail customers. This helps them to know where online sellers actually got their products. Some are creating authorized reseller agreements and strict buy-back policies. Some have even gone as far as to open online stores themselves and go into direct competition with their retail customers. There are over 365 million SKUs listed on Amazon.com.

Those that are more concerned with the decline in their brand's perceived value due to hyper discounting, are adopting and enforcing policies that include authorized use of intellectual property such as copyrighted images and product descriptions. Still, others

Savvy manufacturers realize the disruption is not only affecting their brick-and-mortar customers. It is having a direct impact on their businesses, too.

are employing a somewhat controversial strategy known as MAPP (minimum-advertised-pricing-policy). Not to be confused with the anti-trust practice known as price-fixing, a MAPP imposes restrictions on the price at which a product or service may be "advertised." It does not restrict the actual sale price.

And, contrary to what some may believe, MAPP is not an illegal practice. In 2007 the U.S. Supreme Court addressed the issue of MAPP in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* (127 S. Ct. 2705 (2007)). In that case, the court overturned a nearly century-old rule automatically prohibiting as unlawful all "vertical" price fixing arrangements in favor of a "Rule of Reason" test. MAPP is not a contract that must be signed, it is a company policy. With MAPP there is no negotiation whatsoever. They are unilateral statements that treat each retailer equally and set forth the rules under which a retailer may purchase their products.

No matter who you are, or what your business is, there will continue to be more market disruptions as time goes on. It's a certainty. It's Darwinian. And, as the theory of evolution states, it's all about the survival of the fittest. In the case of the Amazon Disruption, the fittest will be those businesses that take the disruption seriously, study it, understand it then adopt whatever new business practices are necessary to stay alive. ■

RON SOLOMON started The Creditors Network, a unique, online system that helps vendors to exchange credit information on their shared customers in 2006. Six years later the company added MAPP Trap to its portfolio in order to help companies keep track of how their brands are being represented by online merchants. The company helps manufacturers to identify online channel challenges, and then to implement, monitor and enforce policies that help them stay healthy. For more information visit, www.mapptrap.com.