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GORILLA MODE
**What Amazon Means for
the Rest of Us**



“There’s no rest.

We can’t rest on our laurels. Over the last twenty years, there has never been a time when we looked into the future and thought it was clear sailing. We look into the future, and we see always an intensely competitive environment, a world awash with high rates of change and new technologies, all kinds of disruptive influences. It never looks like smooth seas to us from the inside, no matter what it might appear from the outside.”

- Jeff Bezos at the Amazon shareholder meeting
on May 23rd, 2017



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WHAT THE HECK IS THIS?

Our intent is to provide an overview of the 800-pound gorilla that is Amazon for small- to mid-sized business operators. Our ambition is to support operators' knowledge of and strategic approach to an Amazon-dominant marketplace. This is not investment advice, nor is it a how-to manual of any kind.

To be clear, no one on the [adventur.es](#) team has ever worked for Amazon. We do own equity positions in private companies that sell products through Amazon and companies who have digital assets based on Amazon Web Services, and I'm fairly certain everyone on our team has an individual Prime subscription.

As investors we have a unique vantage point. It's rare that Amazon doesn't come up in discussions. And rightfully so, as we'll lay out.

Happy reading. We enjoy engaging in discussions about this content, too. Ping us on Twitter or send us an email:

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INTRODUCTION

THE UPSTART GETS DISRUPTED

In 1965, 24-year-old Len Riggio invested \$5,000 to open the Student Book Exchange, a single bookstore near New York University. Six years later, he had the opportunity to expand his business by buying a reputable bookstore at Fifth Avenue & 18th Street. That bookstore was Barnes & Noble.

Throughout the seventies, Riggio refined his company's approach to selling books. They offered 40 percent off best sellers. They encouraged customers to buy lesser known, full-price titles. They marketed heavily, including television commercials - the first bookseller to do so. They built a 40,000 sq. ft. Sales Annex across from the flagship store on 5th Avenue. Then, Riggio's team spent the next two decades building Barnes & Noble into the top bookseller in America through every method imaginable at the time: acquisitions, mail order, merchandising, and new store concepts.

By the mid-1990s, Barnes & Noble superstores had put small shops out of business and created a dedicated company for college campuses called Barnes & Noble College Bookstores. The college business alone was estimated to be worth more than \$1 billion at the time.

While the brick-and-mortar business thrived, brothers and Barnes & Noble executives Len and Steve Riggio did begin to look at the Web in the nineties, as detailed in a revealing 1999 retrospective by Warren St. John in Wired. They recruited younger employees to work on a website. But, the initiative wasn't considered a high priority.

They'd heard about this guy selling books online. He was 30 with no industry experience except for a four-day lecture at the American Bookseller Association. He had a website too - but this was in the mid-1990s - and had raised \$1 million. Who was Jeff Bezos? A competitor or a curiosity?

In 1996, The Wall Street Journal published an article about Amazon: "Wall Street Whiz Finds Niche Selling Books Online." That caught the Riggios' attention. The \$16 million in sales Amazon did that year was fairly inconsequential compared to Barnes & Noble's \$2 billion, but the Riggios requested dinner with Bezos in Seattle anyway. He said yes.

As an ironic aside, when Jeff Bezos started Amazon in the early 1990s, he, his wife MacKenzie (a novelist who studied under Toni Morrison at Princeton University) and the only outside employee, Shel Kaphan, would conduct meetings at the local Barnes & Noble.

As Brad Stone explained in The Everything Store, the Riggios met Bezos and Tom Alberg, an Amazon investor and board member, at the Dahlia Lounge in downtown Seattle.

"They told Bezos and Alberg they were going to launch a website soon and crush Amazon. But they said they admired what Bezos had done and suggested a number of possible collaborations, such as licensing Amazon's technology or opening a joint website..."

As we all now know, the confident Riggios of 1996 didn't predict the future for themselves, or Bezos' enterprise. Apparently Len Riggio wanted to call Barnes & Noble's website Book Predator. In the 1999 Wired article, one former Barnes & Noble employee is quoted as saying that the team

believed that because of “the deep pockets of Barnes & Noble... we could outlast... and out-discount [Amazon].” What they undervalued in calculations, along with the difficulty of selling online, is that Barnes & Noble had physical bookstores, mostly very large ones, scattered throughout the country on prime pieces of real estate. With thousands of employees and expensive rents, overhead was a far greater consideration in their strategy than in Bezos’.

Adding further nuance was the issue of taxes. Barnes & Noble had physical real estate in each state and paid taxes in each state - even for online orders. By contrast, Amazon only charged sales tax for Washington and Nevada orders. To compete on price, Barnes & Noble had to offer deeper discounts.

In 1997, Amazon posted \$148 million in revenue, and Jeff Bezos drafted his first - and still often quoted - shareholder letter. That year, Barnes & Noble filed a lawsuit against Amazon over slogans; Amazon countersued. As St. John wrote in his Wired article, “[The lawsuit] reinforced the view of Barnes & Noble as an old, tired, unhip giant – exactly the wrong image to project to the burgeoning Web audience.”

By the end of 1998, Barnes & Noble’s position was painfully clear. The company had spent over \$100 million on its own online efforts, but Amazon was clearly winning. Steve Riggio left his executive role by the end of the year, and an executive from AOL UK was brought in to try to improve the company’s competitive position, particularly online.

In the 1999 Wired piece, Len Riggio is quoted:

“At this point in time anyone who has a strategy that requires them ‘winning it’ is somewhat delusional. A much more appropriate strategy would be making it.”

In 2000, U.S. Patent No. 5,960,411 caused Barnesandnoble.com to have to intentionally complicate its online checkout process. The patent owner? Amazon.

Looking at today’s stock data, Barnes & Noble (\$BKS) has a market cap of \$530.19 million. Amazon (\$AMZN) has a market cap of \$478.94 billion.

DEFINING A GORILLA

Barnes & Noble, and the book industry more broadly were Amazon’s first target. Many others overestimated their position, and underestimated Amazon’s goals and strategies.

Today, Amazon is a topic of conversation in virtually every sector of North American-based business. Reuters reported earlier this year that out of over 700 quarterly earnings calls so far in the season, one out of ten mentioned Amazon; that represents more than double the mentions of Google and more than three times that of Apple. Perhaps more telling, none of the retailers had held their calls when the article was published. It’s not just retail who’s concerned.

Amazon is the 800-pound gorilla, or as we stated in our last essay on Amazon, “the Borg.” While some youngsters in our office had to look up the reference, it is undeniably fitting. Without diving into Star Trek storylines, the Borg stands for the idea that, “Resistance is futile.”

To illustrate the sheer scale of its operation, a few recent data points on Amazon include:

- Employ 7.5 percent of Seattle's working age population (seems like a good reason to open a dual headquarters, right?).
- Operate \$1 billion media budget.
- Ship more than 1.6 million packages per day.
- 45,000 robots work across its 20 fulfillment centers in the U.S.
- Own thousands of 53-foot trailers and lease at least twenty Boeing 767s, among other transportation and logistics assets.
- Report over \$11 billion in shipping expenses.
- 52 percent of American consumers start their online buying process at Amazon (over Google, etc.).
- 43 percent of all U.S. 2016 online retail sales took place on Amazon, accounting for 53 percent of the growth in all U.S. e-commerce sales for the year.
- Accounted for 27 percent of \$128 billion increase in total U.S. retail market in 2016, according to U.S. Commerce Department.
- Amazon's Prime Day was attributed as a considerable reason for July 2017 retail sales growth going up from the previous month and year over year by the U.S. government.
- Amazon Web Services on its own would be a mid-sized Fortune 500 company.
- A Death By Amazon Stock Index was created by Bespoke Investment Group.

Still, haters are going to hate. Here's a sampling of articles speculating on whether Amazon has already peaked or is in a downward spiral:

- Amazon.toast (1997 - this one started a multi-year trend, but seems to have disappeared from the Internet)
- Amazon.con (1997)
- Amazon.bomb (1999)
- Amazon.bomb (2000)
- Can Amazon Make It? (2000)
- Back to Being Amazon.Bomb (2000)
- Scathing Report of Amazon is a Must-Read for Stock Owners (2000)
- Revisiting Amazon's Liquidity Issues (2001)
- Amazon: When Will This Bubble Burst? (2003)
- A Retail Revolution Turns 10 (2005)
- Dueling Fools: Amazon Bear (2007)
- Worst Stock for 2008: Amazon.com (2008)
- What Amazon Fears Most: Diapers (2010)
- The Walmart of the Web (2011)
- Amazon Is Toast (2011)
- Why Amazon Is A Lousy Business (2013)
- Is Amazon's Stock Bubble Bursting? (2014)
- Amazon Prime Was Too Good To Be True After All (2014)
- Everyone Is Underestimating Walmart's Ability To Crush Amazon (2015)
- Is Amazon Prime Nearing Its Peak? (2016)
- Why Macy's CEO Thinks Amazon Threat is Overrated (2016)

Noise is a persistent pest.

Hendrik Bessembinder, a finance professor at Arizona State University said in The New York Times, “[Amazon is] one of the greatest wealth creators since 1926, and it’s reached that status in a very short period of time... [with an] annualized return through 2016 [of] 37.4 percent.”

Before you’re inundated by more information on Amazon, we want to share some encouraging words. The reason adventur.es still invests in small to mid-size private companies and doesn’t just buy \$AMZN was nicely summarized by the founder himself in an interview with Charlie Rose last year:

“Think about what are the things you know will be true even ten years from now... Your competitive set will change, the technologies you have available to you will change, but the customer needs, if you find the right ones, will tend to be stable in time... [They] won’t ever go out of style.”

... And then go read, “My Advice To Anyone Starting A Business Is To Remember That One Someday I Will Crush You” to even things out.



THE FOUNDATION

Jeff Bezos, who undoubtedly has a great public relations team, asserts in almost every interview that Amazon currently has three pillars: Amazon Marketplace, Amazon Prime, and Amazon Web Services. While these pillars are useful in categorizing revenue, we've found it helpful to explore the foundational cornerstones of what enables Amazon to compete in almost any industry it chooses.

Some of these cornerstones are tangible, some revenue-oriented, and some are more philosophical. All contribute to the company's operational heft and market dominance.

CUSTOMER-OBSESSED

Bezos has talked at length about Amazon's strategic vision. It all centers around the customer's needs. The company mission statement starts, "We seek to be Earth's most customer-centric company..." This approach may sound fairly intuitive on the surface (who doesn't put customers first?), but few companies could claim to take the prioritization as far as Amazon does. And it admittedly sometimes makes others involved (i.e. third party retailers, employees) unhappy in the process. If it's right for the customer, though, it seems to be right for Amazon, and the loyalty data suggests it pays off for them in spades.

Bezos focused on customers before the first line of code was written. He recalled a tale told by one of his instructors, Richard Howorth, owner of one of the largest bookstores in the country at the time, from the four-day book-selling seminar. A person in Howorth's bookshop was unhappy and a lower-level employee came to get him to help smooth things over. The woman's car had been parked outside the bookshop, and mud had somehow gotten on her car. She wanted to know who was going to clean it. He offered to take her to the car wash. When the car wash turned out to be closed, he took her to his house, got a bucket, and washed the car himself. As Bezos puts it, "That day I realized how far you have to go to please a customer. And then I decided to make sure Amazon was customer centric."

Being customer-obsessed means constantly analyzing feedback loops. Bezos gave Charlie Rose this example for expanding product categories on Amazon:

"I sent an email message out to the customer base, actually a thousand randomly selected customers, and I said, besides books, music and video, what would you like to see us sell? And the list came back incredibly long. It was basically just whatever the person had on their mind right now. One of customers said, I wish you sold windshield wipers because I need windshield wipers for my car. A light kind of went on in my head. You know, people -- people will want to use this new fangled e-commerce way of shopping for everything. Because people are very convenience-motivated."

Being customer-obsessed also means constantly advancing the customer experience and benefits, never claiming it is "good enough," even if changes make it harder for those on the supply and sales side of the equation. One example from this summer is changing the company's promise of "Hassle-Free Returns." Prior to October 2017, the "hassle-free" part applied to any item sold by Amazon, but not necessarily those sold through the Amazon Marketplace. The Amazon Marketplace is a major contributor towards Amazon's scale of offerings and price competitiveness, and therefore an important partnership population for the company.

After October 2, 2017, third party sellers in the Marketplace are required to offer hassle-free returns. If you've ever reviewed an income statement for a retailer, you know returns are costly. The fact that Amazon is requiring third party sellers to accept returns, and in some cases without a physical return of the product, is a cringe-inducing change for third party sellers, but will undoubtedly please customers.

What's important to Amazon is how all this customer obsession pays off. The continuous annual revenue growth is one indicator, but perhaps Amazon Prime is the most pointed. At \$99 per year, it's a quantitative commitment from an estimated 64 percent of American households, 75 percent of households earning \$112,000 per year or more. For many, being Prime has become as much a utility as a smartphone and more of a utility than cable.

And Primers are telling their friends and sticking around. Consumer Intelligence Research Partners (CIRP) estimates that there has been a 38 percent growth in the number of Prime accounts just between spring 2016 and 2017. CIRP also estimates that 73 percent of 30-day trial subscribers convert for the first year of membership, 91 percent renew for a second year, and 96 percent renew for a third year. That's astounding.

Most notably (and hardest to copy) is that the obsession is based on developing a long-term relationship with the customer. Amazon isn't concerned about you specifically buying your next two books from them, although they will most certainly make recommendations. They want to be your default purchasing engine for decades to come.

SEARCH ENGINE

Why do over half of Americans (62 percent among 18- to 29-year-olds) start their online purchase searches on Amazon? Convenience and inventory.

If you're looking for a product, you already know where to find it. Amazon knows your credit card, address, browsing history, and purchases. This is the data that makes one-click buying possible. This is the data that makes imitation impossible.

What enables Amazon to offer so much is the Amazon Marketplace. Over half of product offerings come from third party sellers. Meaning, Amazon is a monstrous distributor. In the same way department stores and superstores curate products from multiple brands in physical locations, even, for example, two visually identical white shirts at different price points, Amazon has done so online for the last two decades. As Andreessen Horowitz's Benedict Evans put it,

"Half of their business is actually is taking margin on something someone else is selling - that they don't even set the price on."

Beyond the estimated 398 million products is all the supporting information. Customers can make a better informed decision online than in a store, talking to a salesperson. Of course the price is listed, as well as any known cautions on available inventory. There are also product specs, descriptions, pictures and video, and frequently asked questions.

Then there's social proof. Ratings and reviews are a fascinating subject unto themselves, but Amazon has normalized the peer-to-peer process for everyday items. Amazon has equipped the customer with as much information as possible.

Think back a decade. Most retailers with an online presence did not list reviews on their website. You could see the product and price, but why in the world would a brand let someone say something negative about their product for other potential customers to read in their own real estate (even if the real estate is digital)? Well, it turns out that trust is more valuable than missed sales.

Now even brands like Lululemon, which have avoided assimilating into the Amazon shopping experience, know that reviews are standard. And it's why most of the sale selection in such websites is stocked with lower-rated items.

But what makes Amazon dominant, even if every retailer were to copy their product page design, is the scale. More customers. More options. More inventory. More reviews. More everything. When you start a search, you generally want options.

DISTRIBUTION

Perhaps one of the more under-the-radar cornerstones of Amazon's empire is their distribution influence and resources. As mentioned earlier, the company is spending many billions on shipping. The company has more than 100 million square feet of distribution center space just in the U.S., and a coordinated program for third party sellers called Fulfillment by Amazon. But let's begin with the transportation component.

One of the most entertaining topics to hear Bezos speak on is shipping. As he told Recode's Walt Mossberg in 2016,

*"No [we're not aiming to take over the last mile]...
We're aiming to supplement it in any way we can...
We are driven to supplement their capacity...
We will take all the capacity the U.S. Postal Service and UPS [can provide], and still we're supplementing as long as you guys keep shopping.
[Turning to the audience] Thank you."*

In essence, Bezos is saying they use everything available, but still need more.

Within the U.S., it is estimated that Amazon ships about 40 percent of its packages through the U.S. Postal Service (USPS). Boxes now make up roughly 25 percent of USPS revenue, a dramatic increase that trends alongside growth in online shopping. But the USPS gives Amazon a major discount for funneling the volume. It's so significant that it's questionable whether it even covers the costs. A Citigroup analysis in April 2017 said that if package costs were to cover their "fair share" of USPS system costs, each delivered box would cost approximately \$1.46 more.

But volume is volume. USPS wanted it so much that in 2013 they offered to start delivering packages on Sundays. These days, it's pretty normal to see postal trucks in neighborhoods on Sundays. One arrives at my house almost every Sunday.

For their part, Amazon stated, "Our partnership with USPS is reviewed annually by the Postal Regulatory Commission... The Postal Regulatory Commission has consistently found that Amazon's contracts with the USPS are profitable. Amazon has invested hundreds of millions of dollars in a network of more than 20 package sortation facilities that inject directly into the USPS

last mile network bypassing most of USPS network. This investment resulted in more efficient processes as well as thousands of jobs and related economic benefits in local communities.”

So let’s just say there’s mutual dependency in the Amazon-USPS relationship. The same is true with UPS, the largest package delivery company in the world, which delivers 19.1 million packages per day.

One of the more interesting recent developments in regard to UPS is the company’s 2017 introduction of holiday surcharges. While the fees themselves are nominal, they occur around two important online shopping periods: Black Friday and Christmas. Amazon will pay surcharges alongside every other retailer, but as Motley Fool’s Rich Duprey put it in his article, “Because of Amazon’s size and scope, it has the financial wherewithal to absorb the fee increases, whereas small and medium-sized businesses trying to compete with the e-commerce king do not. If they absorb the fees, these smaller rivals risk their profitability; if they pass them on to customers, they risk losing sales.”

It’s between a rock and a hard place for the average retailer, while Amazon has scale, strategic agreements with USPS and UPS, along with it’s own, growing shipping network.

Bezos may not want to be a direct competitor in last mile delivery, but his company is certainly not going to stand by and let customers wait longer for their packages. That would be against the mission statement, remember?

Amazon has been stocking up in the logistics department. On the transportation side, they lease more than thirty Boeing 767s, own thousands of 53-foot trailers, and have a dedicated air hub based in Wilmington, Ohio.

Perhaps more important is the growing physical space from which they can organize and distribute products. On the customer-facing side, there are Amazon Lockers, Whole Foods, and Prime Fresh delivery trucks. Internally, they have millions of square feet in warehouse space, a luxury few can afford. Most of this space is in fulfillment centers, but they also have sortation centers and specific Prime Now warehouses to speed up delivery.

Amazon regularly experiments with distribution. As one example, an interesting concept being tested is the Treasure Truck. In some ways this seems like the return of the traveling salesman who arrives in town with a novelty everyone needs. The gist of the concept is that Amazon handpicks an item to sell at a deep discount, arrives in a city with a truckload of said item, and then invites subscribing Amazon customers via text message to buy one from their mobile device, and come pick it up. That’s right, the customers come to the truck. But Amazon of course makes it fun by turning it into a social event, complete with celebrities, food, and interactive experiences. It sounds like something from a hip SF-based startup and not a retailing giant. But, that’s what makes Amazon so special.

If early signs at Whole Foods are an indication, they will also be experimenting heavily with what 456 brick and mortar stores in higher income areas, along with other real estate, can mean for the company, while continuing to alter consumer expectations for items typically bought locally (i.e. produce). They’re also working to extend the physical use of space by accepting Amazon returns at both Whole Foods and Kohl’s.

Even with all the partnerships, acquisitions and installations in the marketplace, Amazon seems dedicated to perfecting at-home delivery. The newly announced Amazon Key program will allow Prime members to ensure that their packages are never stolen - by allowing delivery drivers to enter their home through an Amazon-powered security system.

We're not even going to get into speculation on drones and future distributions concepts.

Just in case you're wondering, Amazon does reportedly lose money on shipping with \$11 billion in costs and only \$6.5 billion in fees collected. They're not magicians, but scale is on their side; margin is made up elsewhere.

AMAZON WEB SERVICES

The most unique cornerstone of Amazon is also one of its biggest profit centers: Amazon Web Services (AWS). On it's own, AWS would be a mid-listing on the Fortune 500. And there's a strong likelihood your company is one of over a million using it. If not your company, definitely one with which you interact (think Netflix, General Electric, BMW, Ticketmaster, Yelp, etc.). Even the CIA awarded Amazon their cloud business. Most experts agree that AWS is the largest hosting company in operation.

Amazon Web Services was developed within Amazon to solve internal problems associated with collaborative deployment and scaling. It just turned out a lot of other people had the same problems.

How did AWS get so large? Let's go back to Bezos' interview with Charlie Rose from last year:

"One of the most unusual things that happened with Amazon Web Services is the amount of runway we got, which is a gift, before we faced like-minded competition... Typically, if you are lucky, you get about two years of runway before competitors copy your idea. And two years is actually a pretty long time in a fast-moving industry... For whatever reason, Amazon Web Services got seven years of runway."

"I think the reason that that happened is because the incumbents in technology for enterprises... thought what we were doing was just so damn weird it could never work. And so we just kept very quiet about it. And we knew it was working, you know?"

Without getting into the technical jargon, AWS offers hundreds of features and services beneficial to developing, hosting and analyzing data, websites, and systems. This pillar of the corporation is supported on the backend by secretive data centers throughout the country, which the company established in 2006.

AWS is important not just because of its revenue generation for the corporation and symbolic representation of their technical sophistication, but also because other companies are incredibly reliant upon their network. If AWS has an outage, a lot of services come to a screeching halt.



THE ENGINE

In our earlier essay, we discussed Bezos' "Day One" mentality for Amazon's culture. In brief, "It is always Day One." But where does the momentum come from?

ACTIVE DATA

If you have an Amazon account, the company may know quite a bit about you, including any information collected through:

- Your User Profile
- Your Order History
- Your List(s)
- Your Stored Data, such as photos you store on Amazon
- Your Browsing History, including how much time you spend on any given page, your IP address, buttons you click and more
- Your Search Queries, including the terms you entered and what products you ended up viewing and later purchasing
- Your Ratings & Reviews on products and services
- Your Responses to surveys, contests, and any other response-oriented prompt
- Your Geographic Location when using the mobile application
- Your Uses of and preferences within Prime Video, Prime Music, Audible, Kindle, and any other content-oriented service
- Your Alexa prompts, but note that apparently Alexa only records up to 60 seconds of audio and only after prompted to protect your in-home privacy

As consumers, we don't seem to care that the company knows this. Privacy is exchanged for convenient service. We like Amazon's use of the information to improve our experience, giving us better product recommendations, allowing us to purchase without re-entering information, and notifying us when there are price changes on items we've said we want to buy. The data collection seems to be for the benefit of the consumer.

"We [are always making] personal recommendations for people... Of course, [we] have to keep your purchase history to do that... One of the reasons we always greet you by name when you visit our site... [is so] you know you're not anonymous on our site... To the degree you can combine transparency with what the consumer benefit is... [the better]," is how Jeff Bezos explained it.

But data collection also has value for Amazon as a company. Think about what Amazon knows about the bulk of consumers. On the merchandising side, they don't just know which products sell, in what volume and at what price point. They know how many people have a given product in their wish list, how many times and in what ways they interacted with the product page before buying, how long it sat in their cart, the percentage of people who considered it but ultimately didn't buy, and what people thought about the product after purchase.

This information translates into a deep understanding of products, inventory, and market size. It's a company's dream but it's Amazon's reality. In imperceptible ways, Amazon incrementally improves the user experience.

More daunting for competitors, though, is what Amazon knows demographically and psychographically about its customer base. It would be fascinating to hear an Amazon insider explain how many customer profiles the company caters to. The segmentation of populations from pet lovers to new moms is something most companies have to narrow down to a handful or less; Amazon likely caters to thousands, if not tens of thousands, of niche target audiences and has the inventory ready to fulfill their specific desires.

Amazon knows when its Amazon Marketplace sellers are struggling to fulfill demand or, by contrast, selling at scale with great margins. If you were them, what would such data suggest? Opportunity.

This creates a highly customized shopping experience for consumers. Amazon can anticipate needs, wants, trends, fascinations, and frustrations. Where others ask, Amazon knows. Where others guess, Amazon has data. Where others survey their users, Amazon checks their shopping carts. In a world where people lie, this info is priceless.

R&D

It is estimated that in the fourth quarter of 2016 Amazon became the largest known corporate spender on research & development in the world on a trailing twelve month basis (TTM), a position previously held by Volkswagen AG. According to Q1 2017 financial reports, the company spent \$4.8 billion on R&D just in that quarter, putting them at \$17.4 billion in TTM spend. Who can compete with that?

All this spending is funneled into their public financial reporting through a vague heading: "Technology & Content," which is described in their reporting as:

"Technology costs consist principally of research and development activities including payroll and related expenses for employees involved in application, production, maintenance, operation, and development of new and existing products and services, as well as AWS and other technology infrastructure costs. Content costs consist principally of payroll and related expenses for employees involved in category expansion, editorial content, buying, and merchandising selection."

Reading between the lines, this is a big umbrella for continued experimentation and growth. R&D dollars matter because there's inherently higher risk. As Bezos phrased it in the 1997 shareholder letter,

"Given a 10 percent chance of a 100-times payout, you should take that bet every time. Failure and invention are inseparable twins. To invent you have to experiment, and if you know in advance that it's going to work, it's not an experiment."

Dollars spent are not the only metric, and certainly not a guarantee of success. Although Bezos admits there have been billions of dollars in failures, the data, creativity, and technical sophistication likely play large roles in contributing to Amazon's effectiveness in R&D.

It's hard to speculate on what Amazon is working on behind-the-scenes at any given time. Apparently they worked on Echo and Alexa for four years before any product announcement was made. Now, Bezos has said over a thousand people are working on artificial intelligence (AI)

projects just related to Echo and Alexa. The scale is hard to fathom. Just that division alone would be one of the largest AI companies in the world.

What may be most remarkable is how they continue to build these technically advanced projects, while also working on seemingly boring advancements like the Treasure Truck, private label fashion brands, auto parts, and physical Amazon Books stores.

At first glance, the Amazon Books stores seem counterintuitive to Amazon's original premise. They are small shops in highly trafficked cities with only around 5,000 book titles on the shelves, all facing outwards to encourage exploration (and also taking up expensive physical real estate). How are the titles chosen? Amazon.com data. Why add overhead and expense of physical operations? Bezos put it this way:

"It's about satisfying a very different need. It's about browsing. It's about discovery... there are many discovery methods online... Tons of serendipity... Wandering around is a unique opportunity for serendipity."

The stores are, of course, differentiated in meaningful ways. For one, they don't accept cash. Customers pay with a credit card or, of course, charge it to their Amazon Prime account.

It turns out people have a seemingly endless supply of needs and wants. Amazon's R&D programs are attempting to understand and satisfy all of them.

MARKET INTEGRATION

For most companies, an opportunity to gain dominance is through either vertical or horizontal integration. Most companies can only execute on one or the other relatively well, if they can set aside capital to invest in either. Amazon, though, has successfully done both, and in impressively strategic fashion.

Can you imagine how nimble, large, and efficient a company would have to be to acquire new products daily, while continuing to manage inventory and logistics to fulfill its existing promises to customers? Well, what if you could deputize thousands of other people to do it for you? Oh, and by the way, those people share the risk (a.k.a. inventory costs). This is Amazon Marketplace, Amazon's primary and somewhat self-functioning horizontal integration strategy.

Today, "there are a hundred-thousand businesses on Amazon where the businesses make \$100,000 or more a year." Amazon also helps support these businesses operationally, including doling out \$1 billion in small business loans between June 2016 and June 2017. What would be the funding, valuation, and expectations of this finance division if it was a stand-alone business?

When you own the customer relationship, everyone needs you. Amazon has been able to leverage this with third party sellers in such a way that proves to be a win-win for those that select the right products and fulfill on Amazon's promise to its customers. That said, their partnerships can include so many rules and guidelines that some companies feel like they can't control their own brand. And pricing is always a battle.

When you own the customer relationship, you can also set the terms. For Amazon, this means that they are both your enabler and your competitor. Enter private label goods, strategic sourcing, and services they know their customers value.

Starting with Amazon Prime, you can view a list of benefits that speaks to all the Amazon-owned and operated things you will benefit from as part of the relationship, including streaming of free music, free movies, and free television series. These benefits strengthen Amazon's relationship with the customer.

Meanwhile, Amazon is also constantly analyzing ways in which a perceived middle man - even if that's the brand of a third party seller on Amazon Marketplace - can be cut out for the benefit of the customer, namely through a reduction in price and/or better fulfillment (e.g. faster delivery, bigger quantity).

This customer-first approach has led to the creation of dozens of Amazon private label brands. AmazonBasics sells things like batteries and iPhone chargers. There's Happy Belly for non-perishable foods like trail mix and nuts. There's Amazon Elements for nutrition supplements and baby wipes. There's Pinzon for bed and bath linens and other needs. There's Presto! for household cleaning products. And there are also more than a dozen Amazon clothing labels covering everything from basic t-shirts to high-end menswear.

Journalist Jeff Jones described Amazon's primary target for going direct well in a 2013 Fortune article:

"Amazon's sales skew heavily towards 'hard-lines,' things like media, electronics, home and garden, and toys. Most best-selling hard-line products are produced by large manufacturers that market them heavily and distribute them broadly through multiple retail channels. They are essentially commodities, identified by a standardized Universal Product Code (aka, U.P.C.). An example is a Canon digital camera; once Canon's ads convince you that you might want a Canon camera, you know you can shop for it pretty much anywhere. And for most commodities, price is the key differentiator. Consumers know that Amazon almost always has the lowest prices, along with free and fast shipping."

If it is a basic, undifferentiated product in which you rely on the brand for some sort of perceived increase in value, Amazon can change things in a big way. In the process, your margins likely get close to zero.

Contemplating this, you may start think artisanal-level customization is the only alternative. Amazon's okay with that. But sell it through Amazon Handmade rather than Etsy; that's where you'll find "our hundreds of millions of customers worldwide."

You may also consider services a better bet. Well, Amazon also built a marketplace to compete with Angie's List, Zaarly, and brick and mortar retailers like Best Buy that try to sell the service market or added value through human touch points. It's called Amazon Home Services, and there you can find service providers for everything from house cleaning to ceiling fan installation to plumbing. Every provider listed has been through a six-point criminal background check, licensing has been evaluated where appropriate, and most of the pricing is upfront (rather than an estimate). Also, services are backed by the company's 100% Happiness Guarantee.

In short, if your target market includes individual consumers, there's a chance Amazon is or intends to have its hand in it. By the way, Amazon has dozens of other names trademarked, just waiting to be launched.

LIFESTYLE INTEGRATION

With the consumer, Amazon has pursued an immersive experience. They've sought to establish themselves as the source of lifestyle convenience, rather than just a provider of goods.

This is where so many of the Amazon Prime benefits come into play. Obviously the streamable content serves as a source of personal entertainment. One thing that differentiates Amazon is that they view their \$4 billion per year in spending on content and programming in the profitable context of their relationship with the customer, something HBO and Netflix can't do.

Perhaps more intriguing is the most recent introduction of artificial intelligence through Echo and Alexa. Back to Bezos' interview with Charlie Rose for a brief description of what Echo and Alexa are and do:

"Echo is a small black cylinder that... has seven microphones on the top and has a speaker inside and a digital signal processor and some other computer inside. It's WiFi-connected to the Cloud. And Alexa, the agent -- the artificially intelligent agent that lives in the Cloud will talk to you through Alexa -- through Echo.

"One of the interesting things about Echo, the device, is it uses those seven microphones to do something called beam forming. And so basically it can hear you very well even in a very loud kitchen environment. For example, you have the dishwasher running and you have the sink running water and maybe somebody is playing the television set in the living room. And Alexa can still hear you because of that digital signal processing.

"So you can say, Alexa, what time is it? Alexa, what is the weather today?... And people really -- it's just been a big hit."

What makes Amazon's entrance into AI concerning for other businesses is that it ties the company that much closer to the consumer's everyday existence. If Alexa is your personal assistant, she'll be the one to play you a song and order more soap... Amazon soap.

Like the company has done in so many sectors, they are miles ahead of the competition. Various sources estimate that Amazon Alexa-enabled devices own between 71 and 82 percent of the market share for smart speakers.

Alexa also has numerous extension and application opportunities. There are companies trying it out for warehouse inventory management and in secretarial roles within offices. Amazon internally is working on technology to integrate other formats like home security systems and smart glasses with Alexa.

BALANCE SHEET

Perhaps the biggest driver of the company's continued growth is that they never seem to show a profit. Between 2008 and 2016, Amazon paid \$1.6 billion in federal taxes, while Walmart paid \$64

billion; look to the stocks, though, and you'll see that Amazon stock has added more value than Walmart's entire market cap.

There is plenty of cash, but it gets reinvested. On a Q3 2016 earnings call, Amazon CFO Brian Olsavsky said the focus is on investing in areas where they see "significant customer traction." Fortunate for them, shareholders are willing to value the company based off of growth rates rather than posted profit.

To understand how the continual lack of profit, but ever-growing cash flow of Amazon compounds to drive the business forward, just look at some simple graphs of the company's top summary financials, like the ones in this Recode article.

Every year the company has more cash. And every year that cash gets invested into making the company even more competitive. I'm telling you, it's the Borg.



THE THREAT

It can be far too easy to fall into an underdog mentality, believing that since Amazon is the 800-pound gorilla, you're differentiated and competitive because you have a smaller, deeper focus and more personal relationship with customers. What makes Amazon a threat is that they are not just big. Amazon possesses more pricing power, data intelligence, and influence than any other enterprise.

DOMINANCE

You're likely familiar with the story of Quidsi, although you probably know it through the lens of its subsidiaries Diapers.com or Soap.com. Quidsi launched in 2005, and competed against Amazon in things like diapers and soap. Amazon knew diapers were a great business. Diapers.com was taking some of the market share, so Amazon sent someone to make an offer to acquire Quidsi.

Quidsi turned down Amazon's offer. So Amazon analyzed short-term and long-term gain, dropped prices by 30 percent, and effectively forced the company into a sale because the radical reduction in margins scared investors who Quidsi needed to put more money in. Both Walmart and Amazon bid on the company, with Amazon eventually acquiring the company for \$545 million, and the founder departing to later found Jet.com, which subsequently got bought by Walmart.

After the ordeal was closed, Amazon once again made the industry sustainable and raised prices on diapers. Quidsi lines were eventually absorbed by Amazon, and then the company and its websites were shut down earlier this year.

This story is one anecdote, but it perfectly illustrates Amazon's ability to crush its competition. "Conform willingly, or we'll do it the hard way."

DATA

As outlined in several sections already, Amazon just knows more. It already has the customer relationships and has the budgets to acquire most anything not already in the company's possession. How they could potentially utilize that data is a fascinating rabbit hole that we at [adventur.es](#) explore frequently.

CONSUMER PSYCHOLOGY

Without going over all the benefits of Amazon Prime again and listing more statistics about their dominance, let's just say the relationship between Amazon and its millions of customers is far stronger than that of the average company-customer relationship.

As such, Amazon has helped to shape customer expectations. Consumers now expect free shipping, even though they know there is a cost to a box. Something not being delivered within 48 hours is hard to believe. Something being out of stock is a joke. If they don't like it for any reason, they expect to be able to return it. And they want to pay the absolute lowest possible price for it.

Such expectations are not easily achieved. On top of that, customers want to enjoy the shopping experience. This requires outrageously expensive infrastructure and is another moat for Amazon.

And even if a brand does match all the customer expectations, there's still an Amazon Prime membership, a commitment bias, to overcome. After all, if I'm paying \$99 per year, I should use it, right?

PAID EXPOSURE

Tens of millions of people visit Amazon.com each day. The company spends an estimated \$1 billion on media placement each year to promote the brand and its product selection. And then there's the actual shipping and delivery of over one million packages each day, prominently stamped with the friendly Amazon logo. Particularly with its dedicated Amazon Prime subscribers, there are lots of potential impressions at play. Most days I get home to an Amazon package, then later watch something on Amazon video.

At the organic level, Amazon only shows a bias towards what customers prefer. What this means is that even if you've spent millions of dollars establishing a brand through other channels, on Amazon if your product is in the same category as a startup's with no name recognition, you better guarantee more people buy your product and love it. Otherwise, be prepared to pay dearly, in profit and ad dollars, to compete for exposure.

Google's primary profit model is based off of its ad revenue from brands and websites that want to put themselves at the top of search results and in front of users on YouTube. By contrast, Amazon's core profit model is not based on advertising dollars, and yet it potentially has more advertising opportunities, both online and offline, than Google.

Amazon offers advertisers two primary advertising vehicles: Amazon Marketing Services (AMS) and Amazon Media Group (AMG). AMS is a self-service platform, similar to Google Ads, where advertisers can pay for impressions and clicks on their ads. AMG provides more opportunities for placement, including on Kindle devices and even on Amazon trucks, but is primarily used for brand-building impressions rather than click conversion.

Amazon clearly sees the value of their customers. They've established "Trusted Creative Partner" designations for marketing agencies, and are experimenting with all kinds of placement opportunities. In 2015, they let the release of Minions take over packaging. Lockscreens on Kindle and Fire tablets regularly feature ads. Amazon Lockers can now have giant ads across the front of them. Even the owned trucks and trailers are marketing content and brands around cities. More integrated opportunities like the recent Diageo-branded 20-minute "shoppable films" for Amazon Prime customers are likely in the future.

Amazon is notoriously secretive of customer data, and the platforms need further development before competing with Google or Facebook as far as buying and reporting sophistication. But we all know the data's value and Amazon is in a far better position to help us realize it. And the more the company owns, the more they control any individual brand's access to the customers.

As WPP's Sir Martin Sorrell put it: "The elephant in the room is really Amazon."

DEPENDENCY

The broadest threat for all businesses involved with Amazon is whether Amazon may change the rules at any given time, while the broadest threat for those working outside the Amazon ecosystem is customers' existing familiarity with the platform and its extensions.

At this point, major companies rarely try to partner with Amazon, instead choosing to partner with each other against the gorilla (i.e. Google and Walmart, grocers and Instacart). That wasn't always the case, and Toys 'R Us provides another cautionary case.

After the 1999 holiday season, in which Toys 'R Us had completely underestimated online order demand to the point that packages were delivered in January, the company was hit with a fine from the Federal Trade Commission. Shortly after, the company announced an investment from SoftBank and a 10-year partnership to sell toys and baby products through Amazon, leveraging their technology expertise and platform.

The terms of the deal looked like a long-term mutually beneficial partnership in 2000. Toysrus.com would redirect to Amazon.com. Toys 'R Us would be Amazon's exclusive seller of toys and baby products, and would stock the platform to meet demand. Toys 'R Us would pay Amazon \$50 million per year and a percentage of sales made through the site.

Within two years, demand was exceeding supply on Amazon. There were a series of lawsuits as Amazon sought to broaden its inventory and supply relationships. Toys 'R Us ultimately realized they needed online autonomy again. Toysrus.com was relaunched in 2006, but the company had lost six years of digital development opportunity.

Fast forward to today: Amazon grew its toy sales by 24 percent in 2016, while Toys 'R Us announced it would be filing bankruptcy in September 2017, right before another critically important holiday season. There are multiple causes of Toys 'R Us' recent troubles, but the Amazon agreement certainly didn't help.

There are likely many more tales in which Amazon used a strategic partnership as a stepping stone to gain footing in an industry. There are some we know (i.e. Borders). But many more are likely mid-sized private companies that won't make the front page of The Wall Street Journal or The New York Times.

TALENT

Most of what we've outlined so far has been in relation to competing in the marketplace. Looking through another lens, Amazon is also a recruitment and retention threat for many businesses.

The company recently announced that they are seeking to build a dual headquarters, keeping operations in Seattle while establishing another strong presence (to the tune of \$5 billion) in another city. Why do that? You've got more talent needs than talented people in a reasonable geographic radius.

The company's benefits packages are considered generous, and many employees receive restricted stock options, tying their wealth to the company's future performance. Bezos touts benefits that are not particularly sexy by Silicon Valley standards, such as 20 percent of employees walk to work, the vibrant food truck scene outside their headquarters, and the ability for employees to actually open their windows.

Amazon also needs lots of manual labor. By employing tens of thousands of people in its warehouses and distribution centers, the company is in a far superior bargaining position to set schedules and pay rates. But they also provide attractive benefits, job security and Amazon Career Choice programs in which the company prepays tuition on behalf of the employee and gives them space to train for a more skilled and in-demand career path.

For other employers, between dual headquarters, warehouses, distribution centers, Amazon Books stores, and more, Amazon needs a lot of people. And, so do you.



OUR AMAZON FILTER

We're optimists, but a healthy dose of skepticism pays the bills. The Amazon Filter has become a foundational piece of *adventur.es*' process.

Here are a series of questions we typically ask when evaluating an investment opportunity. Since we only look at North American-based businesses with three or more years of \$1 million to \$10 million in annual owner earnings, some of these questions aren't universally applicable.

- For any distribution or retail operation, is there a high-value service component? If so, how sticky is that component for their customers?
- How strong is the brand? Has the company's trajectory suffered as Amazon has risen to prominence?
- What, if anything, does Amazon currently control about the company's business model and/or profit margins?
- Is Amazon currently a friend or foe of the company's model? If currently considered independent (neither friend nor foe), why?
- If/When Amazon is a foe, what makes the company competitively viable? How could that change in the future? What investments will be required?
- If Amazon is currently a friend, under what circumstances would they be likely to become a foe?
- If the company is currently considered independent, under what circumstances would they be likely to become a foe?
- What, if any, intellectual property or regulations would make it difficult for Amazon to enter the company's market as a viable competitor? Is there an expiration date on any barriers?
- In what ways, if any, has the company made changes to their margins, operations and/or model in response to Amazon? What kind of pressure has Amazon applied through re-setting customer expectations?
- Review gross margins history. How have they changed over time? How does that compare to when there was noteworthy Amazon advancement within the company's industry?
- How has the company's income statement been altered by Amazon-oriented activity (i.e. free shipping, returns)?
- How has the company's balance sheet been altered by Amazon-oriented activity (i.e. having to hold more inventory)?
- Under what circumstances could Amazon serve as an enabler for the company?
- Under what circumstances could Amazon's scale of market and consumer intelligence threaten the company?
- How has the company responded to the rise of online reputation management? Does the company take online reviews/ratings seriously?
- What is the day-to-day leadership's view of Amazon? How proactive are they in consideration of future threats and opportunities?
- In what ways can the company "beat" Amazon within its niche?

Broadly, the subject of Amazon serves as one vehicle to better understand how a company's leadership considers opportunities, obstacles and competition. How are they thinking about market forces? How quickly do competitive forces come up? What future growth sources are mentioned? Is the overall discussion optimistic or pessimistic? Is Amazon friend, foe, both, or unanalyzed?

What we are certain of is that Amazon should be a topic of discussion in every business. Independently, we've sought to understand the gorilla broadly so that our conversations with an investment prospect can focus on the nuances of Amazon in relation to their operations.

Amazon is one of many reasons why we only pursue businesses with a defined target and niche. At the scale of business size we consider for investment, it is extremely unlikely a business will out-compete Amazon on general business tactics that benefit from scale (i.e marketing spend, online checkout experience, inventory). So, the business needs to be better at something else.

A niche does not need to be defined by distribution strategy (or even related to it). We've considered businesses that sell through Amazon, including some that use Fulfillment by Amazon. If such distribution aids a company in meeting customers' needs, while remaining profitable, that's great. But, as long-term investors, we will also analyze why Amazon wouldn't go direct or change the market conditions to erode profitability.

Some niches are better protected than others. One of the reasons we seek out more blue collar, regional businesses is that their competitive moats seem more durable. Every time Google updates its search algorithm, for instance, it doesn't send their team into a frenzy. Rather, they know the people, they know the building codes, they know the processes, they know when and where to call B.S. They have reputations built through handshakes and multi-decade histories of successful outcomes; perhaps this has started to translate into "stars" and reviews online, or perhaps that's an opportunity for further reputation development.

Going beyond how we target and analyze individual opportunities to invest, Amazon is a company we respect and admire, and an entity with which we want to collaborate and compete against in our portfolio. For a variety of reasons, from antitrust regulation and consumer psychology, to supplier frustration and it's sheer size, we don't envision a future in which every purchase will be facilitated by Amazon. We don't envision they will enter every market. And we don't envision that they are capable of wiping out competition and profitability in every industry. However, we believe there are still a lot of tricks up Bezos' sleeve.

For now, we see two distinct groups emerging: those that will be (or already have been) swallowed by Amazon, and those that, due to niche, market barriers and many other factors, are able to maintain various levels of autonomy. In investing, we focus on the latter.

For any company, there is an ocean of opportunity to explore. Whether it's improving product information, sourcing customer data and feedback, utilizing Amazon distribution or warehousing services, or advertising on one of their platforms, there are lessons to be learned and capabilities to be leveraged from Amazon. It is possible for the marketplace's gorilla to be both friend and foe.

What we focus on is not how to beat Amazon by being like Amazon, but how to be the best with, without, or in spite of, Amazon in the marketplace. Bezos doesn't own the "Day One" mentality of continuous improvement, and "never resting on our laurels" can manifest in many ways.

For the business owners continuing to grind, maintaining autonomy while seeking to build and hold a competitive moat, you have a challenging, but not impossible road. But, that's always been true. Nothing worthwhile ever comes easily. If we thought the road impossible, we wouldn't invest.

We can offer you no quick fixes, nor a step-by-step resiliency guide, but we can offer you the core lessons we work to remember when evaluating investment opportunities and advising our portfolio leadership teams:

First and foremost, not thinking about Amazon is not an option. Doing so is akin to burying your head in the sand. The company exists and is a dominant force in the economy. Ignoring them just gives them more power to determine potential outcomes for you. Pay attention and put up a fight.

Conversely, obsessing over Amazon is not a leadership strategy. The company is a trendsetter and you should pay attention to how they operate, but it's also run by messy humans. They make mistakes. Don't try to be Amazon. Be you.

As you define what "being you" means with each market shift, you will come to a crossroads in which you must determine whether you are better off adapting to, accommodating, or resisting Amazon. This may mean selling through Amazon, depending on them for fulfillment, relying on their tech stack, or possibly even taking a loan from them to fuel increased working capital needs. Evaluating the cost/benefit analysis of autonomy at each crossroad is admittedly tricky. What you give up, you may not necessarily be able to get back. Conversely, stubbornly refusing resources may eventually leave you in the competitive dust.

Paying attention to Amazon may also yield unexpected prospects. Their scale and capabilities may be impressive, but they also create niche opportunities for others. Occasionally, you may find areas in which Amazon fails to meet customers' needs. Or you may find an industry in which they make conditions so hard for manufacturers that the segment willingly breaks ties and scales back. Or you may discover something smaller and not very scalable, but a potentially compelling differentiator for your brand. If you don't look, you won't find.

All of this analysis will mean nothing if you do nothing with it. Being relentless is critical. If you ever need inspiration on this point, just enter Relentless.com into your browser (spoiler: it redirects to Amazon). Amazon invests in R&D, and so should you. Amazon is constantly evaluating areas for improvement, and so should you. Amazon always considers it Day One, and so should you.

Above all, remember that quality matters. If something negative can be said about your offering, in the age of Amazon, it will be said. You won't be able to control every brand touchpoint. So work towards excellence at every step along the way, and know that it's a moving target.



APPENDIX

In Bezos' Own Words

As the company moves on so many initiatives simultaneously, it's hard not to pay attention to Amazon. As Bezos put it,

"If we can keep competitors focused on us while we stay focused on customers, we'll be alright."

So how does one compete successfully? Here's what Bezos has said through the years about that very topic:

KNOW YOUR MODEL AND COMMIT.

"There are two ways to build a successful company. One is to work very, very hard to convince customers to pay high margins. The other is to work very, very hard to be able to afford to offer customers low margins. They both work. We're firmly in the second camp. It's difficult—you have to eliminate defects and be very efficient. But it's also a point of view. We'd rather have a very large customer base and low margins than a smaller customer base and higher margins."

"A dreamy business offering has at least four characteristics. Customers love it, it can grow to very large size, it has strong returns on capital, and it's durable in time – with the potential to endure for decades. When you find one of these, don't just swipe right, get married."

"People will shop in different ways... There are department stores and chains and independent stores and big stores and small stores. All these companies can be successful."

"Customer obsession... competitor obsession... business model obsession... product obsession... technology obsession... There are many ways to center a business... Many of them can work. I know and have friends who lead very competitor-obsessed companies and those companies can be successful... I like customer obsession."

"Three big needle movers: selection, price, delivery/speed/convenience."

BE PROACTIVE.

"When we're at our best, we don't wait for external pressures. We are internally driven to improve our services, adding benefits and features, before we have to. We lower prices and increase value for customers before we have to. We invent before we have to. These investments are motivated by customer focus rather than by reaction to competition. We think this approach earns more trust with customers and drives rapid improvements in customer experience – importantly – even in those areas where we are already the leader."

"To me, trying to dole out improvements in a just-in-time fashion would be too clever by half. It would be risky in a world as fast-moving as the one we all live in. More fundamentally, I think long-term thinking squares the circle. Proactively delighting customers earns trust, which earns more business from those customers, even in new business arenas. Take a long-term view, and the interests of customers and shareholders align."

DEFINE WHAT IT MEANS TO BE CUSTOMER-CENTRIC IN YOUR MODEL.

"Our energy at Amazon comes from the desire to impress customers rather than the zeal to best competitors."

"Invention is not disruptive. Only customer adoption is disruptive."

"We don't seek to disrupt, we seek to delight. If you invent something completely new and radical and customers don't care about it, it's not disruptive. Radical invention is only disruptive if customers love it."

WHEN THEY ARE LIKELY TO PAY OFF, TAKE THE HARDER ROUTES.

"A brand for a company is like a reputation for a person. You earn reputation by trying to do hard things well."

UNSEXY THINGS ARE IMPORTANT.

"When many of the dot-com companies went out of business when the internet bubble burst. One of the reasons is that they hadn't really put enough attention into their back end. They hadn't put enough attention into what some of the people consider the less glamorous part of the business."

PRODUCE SOMETHING WORTH BUYING.

"In the old world, you devoted 30% of your time to building a great service and 70% of your time to shouting about it. In the new world, that inverts."

"I strongly believe that missionaries make better products. They care more. For a missionary, it's not just about the business. There has to be a business, and the business has to make sense, but that's not why you do it. You do it because you have something meaningful that motivates you."

"If I were just setting out today to make that drive to the West Coast to start a new business, I would be looking at biotechnology and nanotechnology. I also think about data security... These are fundamental technologies, things that are going to change the world. But the truth is, I probably wouldn't do any of those things because I grew up programming computers. So maybe I'd think about data security, but I'm sure I'd do something with software and computer science and software engineering. Certainly, in the spring of 1994, the thing that motivated the formation of Amazon.com was noticing that Web usage was growing at 2,300% a year."

BE NIMBLE AND RESPONSIVE.

"Most decisions should probably be made with somewhere around 70% of the information you wish you had. If you wait for 90%, in most cases, you're probably being slow."

SEEK CUSTOMIZATION OPPORTUNITIES.

"In the online world, businesses have the opportunity to develop very deep relationships with customers, both through accepting preferences of customers and then observing their

purchase behavior over time, so that you can get that individualized knowledge of the customer and use that individualized knowledge of the customer to accelerate their discovery process.

If we can do that, then the customers are going to feel a deep loyalty to us, because we know them so well. And if they switch to a competitive website, as long as we never give them a reason to switch, as long as we're not trying to charge higher prices or providing lousy service, or don't have the selection that they require; as long as none of those things happen, they're going to stick with us because they are going to be able to get a personalized service, a customized website that takes into account the years of relationship we've built with them."

HAVE PATIENCE. LOTS AND LOTS OF PATIENCE.

"If everything you do needs to work on a three-year time horizon, then you're competing against a lot of people. But if you're willing to invest on a seven-year time horizon, you're now competing against a fraction of those people, because very few companies are willing to do that. Just by lengthening the time horizon, you can engage in endeavors that you could never otherwise pursue. At Amazon we like things to work in five to seven years. We're willing to plant seeds, let them grow -- and we're very stubborn. We saw we're stubborn on vision and flexible on details.

"In some cases, things are inevitable. The hard part is that you don't know how long it might take, but you know it will happen if you're patient enough."

"The common question that gets asked in business is, why? That's a good question, but an equally valid question is, why not? This is a good idea, we have a lot of skills and assets to do this well, we're already going to do it for ourselves—why not sell it, too?"

"By the way, it's not natural for humans... It's a discipline... Get rich slowly schemes are not big sellers on infomercials."

"Even once you have a strategy that makes sense and holds together from different angles, optimism is essential when trying to do anything difficult because difficult things often take a long time. That optimism can carry you through the various stages as the long term unfolds. And it's the long term that matters."

FOCUS.

"You need to identify your big ideas... and there should only be two or three of them... For Amazon, the three ideas are low prices, fast delivery, and vast selection... [These things] are stable in time... Customers are always going to like low prices."

"As a company, one of our greatest cultural strengths is accepting the fact that if you're going to invent, you're going to disrupt. A lot of entrenched interests are not going to like it. Some of them will be genuinely concerned about the new way, and some of them will have a vested self-interest in preserving the old way. But in both cases, they're going to create a lot of noise, and it's very easy for employees to be distracted by that. It could be criticism of something that we actually believe in. It could also be too much praise about something that we're not doing as well as the outside world says we're doing it. We're going to stay heads-down and work on the business."

"The thing I worry about the most is that we would lose our way... lose our obsessive focus on customers or would become somehow short term-oriented or.. become overly cautious, failure-averse."

IDENTIFY YOUR CIRCLE OF COMPETENCE.

"I went to Princeton to be where Einstein was. It is an extraordinary department. I learned a valuable lesson there: I learned that I am not smart enough to be a good physicist."

BE OBJECTIVE.

"The great thing about fact-based decisions is that they overrule the hierarchy."

STRIVE FOR PERFECTION.

"We really obsess over small defects. That's what drives up costs. Because the most expensive thing you can do is make a mistake. We can afford to focus on smaller and smaller defects and eliminate them at their root. That reduces cost, because things just work."

"The companies that rely on brand loyalty are insane. Customers will be loyal to you because you don't take them up on it. It is one of those paradoxes. There is no resting on your laurels. If you assume anything, you are doing a disservice to your customers and they shouldn't be loyal to you. Our customers are loyal to us right up until the second that somebody else offers them better service. We live or die based on the customer experience."

"There's no chance that anything is perfected yet. I don't believe that."

INSTALL TRUSTED LAYERS OF LEADERSHIP

"Almost all the people I work with on a daily basis, are paid volunteers – at this point I've been working with them for more than a decade, and they can do whatever they want, they could be sipping margaritas on a beach, but they're here. Paid volunteers are the best people to work with as they're here for the right reasons. I have a team of people that I love. And we get to work in the future, and that's so fun, so I hope so."

"They are missionaries of what they do... You can't do that with people who are watching the clock all day... I like to use the phrase 'work/life harmony'... You can be out of work and still have terrible work/life balance... For most people it's about meaning. People want to know that they're doing something interesting and useful... We get to work in the future. And it's super fun to work in the future for the right type of people."

"Most of our compensation is done in terms of stock compensation. Part and parcel with ownership is long-term thinking... Owners think longer term than renters do."

RECRUIT TALENT THAT WANTS TO BE THERE.

"If you're ever talking to a college student... you should definitely advise them that the best way to pick your job is who has the best massages... [laughs]."

CONSIDER TECHNOLOGY AN ENABLER.

"All the effort we put into technology might not matter that much if we kept technology off to the side in some sort of R&D department, but we don't take that approach. Technology infuses all of our teams, all of our processes, our decision-making, and our approach to innovation in each of our businesses. It is deeply integrated into everything we do."

"We live in an era of extraordinary increases in available bandwidth, disk space, and processing power, all of which continue to get cheap fast."

IF RELEVANT TO YOUR MODEL, CREATE A DIFFERENTIATED PHYSICAL EXPERIENCE.

"One of the things we don't do very well at Amazon is a me-too product offering. So when I look at physical retail stores, it's very well served, the people who operate physical retail stores are very good at it...the question we would always have before we would embark on such a thing is: What's the idea? What would we do that would be different? How would it be better? We don't want to just do things because we can do them...we don't want to be redundant."

"It will force stores to get better. The ones that don't get better will go by the wayside. Stores will have to have better-trained people. They will have to be cleaner and better lit. They will have to provide something unique. The stores no one wants to go to will disappear. I don't say everything will change, though. People will still go out. They like to interact with other human beings. The Net is pretty cool, but the physical world is the best medium ever. There are many things you can do with physical stuff that you can't do with a computer. So the environments are going to coexist nicely. And it's all good news if you are the customer. More choices, more competition, better service."

BUILD A MOAT.

"Your job is to kill your own business... I want you to proceed as if your goal is to put everyone selling physical books out of a job."

"We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case."

OFFER THINGS AMAZON DOESN'T WANT TO SELL.

"Firearms. Living creatures. Body parts. [laughs] Actually Pets.com, which is not Amazon.com but is a company we work with, is going to start selling fish. Apparently they can be delivered safely and reliably. So there will in fact be living creatures. But still, no body parts."

"We won't get into things where the price of admission is so gigantic... as an example... oil exploration."

NEVER BE COMPLACENT.

"All businesses need to be young forever. If your customer base ages with you, you're Woolworth's."

[In conversation with Charlie Rose]

JB: *"Companies have short life spans Charlie. And Amazon will be disrupted one day."*

CR: *"And you worry about that?"*

JB: *"I don't worry about it 'cause I know it's inevitable. Companies come and go. And the companies that are, you know, the shiniest and most important of any era, you wait a few decades and they're gone."*

CR: *"And your job is to make sure that you delay that date?"*

JB: *"I would love for it to be after I'm dead."*

Jeff Bezos is 53 years old, and looks to be in excellent health. Confidential succession planning has been in place for years.



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