



## Click to download

**Having taught the world how to shop online, Amazon.com now finds the world shopping elsewhere on the internet. It is time to become a pioneer again**

**I**N HIS most recent annual report, Jeff Bezos, the founder and chief executive of Amazon.com, reprints his letter to shareholders of 1997. "It's all about the long term," he wrote then. The point he is making today is that nothing has changed: the pioneer of online retailing is still having to place big bets on the future, cutting into profit margins and unnerving some investors. Having established the internet as somewhere to buy things, Amazon is again spending heavily on development in anticipation of consumers wanting to download music, video and books instead of having them delivered in the post.

Amazon is highly secretive about its plans, but the online industry expects it soon to launch a service for downloading films and television shows. Amazon's investment in new technology and services helped slash net profit by 58% to \$22m in its second quarter, compared with the same period a year earlier. This is despite a 22% increase in sales, which are expected to reach \$10.6 billion for 2006 as a whole.

Boosting sales has been costly for Amazon, which appeared on the internet in July 1995 selling books. It has pumped money into discounted shipping and

diversifying its merchandise away from books, to create what Mr Bezos likes to describe as "Earth's biggest selection". Not just music and video discs have been added, but also consumer electronics, jewellery, clothing and, most recently, groceries (largely non-perishable packs of items).

Amazon's product range is expanding in much the same way as online sales are. As people become more accustomed to shopping on the internet, they are ordering a greater variety of goods and services from a wider range of websites. In America online sales were up by 25% in 2005 over the previous year, reckons Forrester, a research company. Travel is now by far the biggest category, worth some \$63 billion last year, followed by computer equipment and software (\$14 billion), cars (\$13 billion), clothing (\$11 billion) and home furnishings (\$8 billion).

Amazon's challengers come from two directions. First, other online retailers are growing rapidly and appear in various forms. Many of the dotcoms are invading each others' turf. From auctioning people's old stuff, eBay now also hosts fixed-priced virtual shops offering new goods for sale. And Google is adding more shopping-type

services, such as Froogle, a shopping-comparison service, and more recently its new Checkout payments system, which rivals eBay's PayPal.

Second, traditional retailers are rapidly getting their online acts together. This pits Amazon against giant retailers with huge purchasing power, like America's Walmart and Britain's Tesco. These "multi-channel" retailers make a virtue of their ability to offer both "bricks and clicks". Many provide online customers with the option of picking up goods from the shop down the road. This is proving popular with web buyers who want things immediately or are keen to avoid shipping costs and staying in to accept a delivery. Circuit City, a big American electricals chain, expects in-store pick-ups to account for more than half its online sales this year.

Mr Bezos saw these threats coming and prepared for them. The internet provides consumers with near perfect product and price visibility. It does not take many clicks of a mouse to compare Amazon's prices. Mr Bezos decided there was no point trying to duck this and in 2000 invited other retailers to sell their goods on his website.

Many people, even some within the company, thought this would cannibalise Amazon's own sales. Yet as with many consumer innovations, Mr Bezos has said there was no way to know if the strategy would work other than to experiment.

It did help to lift overall sales. Amazon says sales of third-party items, from which it takes a commission, have increased from 6% of all items sold in 2000 to 28% in 2005. Over that time, the company says its own

retail revenues were up three-fold.

Amazon also runs the websites of other retailers, such as Target and Borders. Not all these arrangements are successful. Amazon used to have a joint webstore with Toys "R" Us, but earlier this year a court ruled that Toys "R" Us could end the deal because Amazon had breached an exclusivity agreement by allowing other merchants to sell their toys on the site.

Having other retailers competing with you so openly puts Amazon under pressure to make sure that it has the lowest prices. This can cut into margins, but the company hopes the payback will come from customers who want to buy something from a third party also acquiring goods that Amazon itself is selling.

To encourage this, Amazon provides the same checkout for both third-party sales and its own purchases. It also puts plenty of temptation in customers' way by recommending purchases. These are based on what other customers who have chosen the same product have bought and the buyer's own previous purchases. On August 10th Amazon expanded this with the launch of "Search Suggestions", in which customers, sellers, authors and other users can make recommendations that are linked to search keywords.

Getting things quickly and cheaply to customers can be expensive. Amazon often subsidises shipping costs through special deals. The main one is Amazon Prime. In return for a fee of \$79 a year, the company provides members of the programme with unlimited express shipping on most goods.

### Movies to go

By building its brand and expanding its offerings, Amazon has done all the right things, says Safa Rashtchy, an analyst with Piper Jaffray, an investment bank. "Free shipping should not be taken lightly," he adds. "It is a major marketing tactic for them." But in the decade ahead, he wonders if Amazon will still be doing so well unless it can also offer delivery by download too. Mr Rashtchy thinks Amazon may have missed the boat with digital music, but could still have a chance to become a big online destination for digital video.

The battle for downloads is becoming more intense. The market for digital music is dominated by Apple's iTunes, which is also likely to expand into video. Microsoft is entering the music-download business with a digital player, called Zune. On August 8th Nokia bought an American digital-music distributor, Loudeye, to develop its own service for its music-enabled handsets. The Finnish telecoms-equipment company says these are now selling roughly twice as fast as Apple's iPods.

Video downloads are available online from some sites, such as Movielink.com, which is owned by five big film studios.

News Corp's websites, including MySpace.com, are planning to sell films and shows from the group's Fox network.

Amazon does provide some digital downloads of music and video, although it is mainly promotional material. At heart the company remains primarily a purveyor of old-world media: some two-thirds of its sales are from books, CDs and DVDs. Whatever share of media ends up being downloaded, Amazon will miss out unless it introduces its own service. The one it is said to have in the pipeline has evolved in the past year from offering mostly music to concentrating more on films and television shows, according to Advertising Age. The trade publication says this is because Amazon's executives felt Apple's grip on the music market would be too difficult to break.

A video service could resemble a downloadable version of Netflix, a Californian company that pioneered online video rentals. Netflix's customers compile online lists of videos they want to see and receive them in the post. When the DVDs are returned in their pre-paid envelopes, the next titles are sent. With no late fees, Netflix has pummelled Blockbuster's store-based video-rental model.

Netflix is also exploring how to deliver movies online. Amazon has already copied the Netflix postal model in Britain and Germany and it has dropped hints that it may launch a postal service in America: Mr Bezos told Wired magazine last year that Amazon was well placed to do so "...and we wouldn't have to pay heavy marketing fees." The same could be said about video downloads. Although Mr Bezos has discussed his strategy in the past with The Economist, the company did not respond to requests for an interview.

How much media will move to online delivery is the subject of huge debate. Plenty of music is already delivered this way. Yet for three-quarters of internet users, CDs remain the most popular format for music, according to a big survey of the British music market by Nielsen//NetRatings. Internet users are more likely to buy music online, on average spending £59

(\$10?) a year downloading it. But the study found they also spend another £99 on CDs.

"The need to own music in a physical form, whether it's to play in other music systems, to minimise the chances of losing it or just because they like to have a physical collection, remains very strong amongst internet users," says Alex Burmaster, the research company's European internet analyst. The same will be true for video, which in digital form is cumbersome and takes longer to download. Broadband-equipped televisions and personal video recorders will make the process easier. Reluctance to read books on digital devices could be even stronger.

### The great disintermediator

Yet digital downloads of all types of media will be demanded by some customers—perhaps too many to ignore. Amazon is already well placed to offer these, not least because of its high level of customer service. The company has been building up the capacity to store huge amounts of digital data: a subsidiary called Amazon 53 rents out temporary storage by the terabyte to other websites.

Some of this online equivalent to Amazon's physical warehouses is already being filled by digital copies of books. Another Amazon subsidiary, BookSurge, is busy courting publishers to have their works scanned into digital files. Modern printing techniques allow books to be printed relatively cheaply on demand, "whether it's one copy or one thousand", Greg Greeley, head of media products at Amazon, said when BookSurge was acquired last April.

On-demand printing is particularly suited to lower-volume books and those that would ordinarily be "out of print". Amazon already sells print-on-demand books, although that is "invisible" to consumers, Mr Bezos has said, because they look exactly like any other books.

Just as music and videos could be offered with the option of buying a downloadable version, so too could books. Many people are sceptical, yet devices for reading digital books and documents are rapidly improving. A new "e-reader" device from Sony has a special screen that mimics the way light falls on a printed page. The size of a paperback, it can store several hundred novels.

In a statement, Mr Bezos says he is "looking forward" to a slowdown in the company's rate of growth in technology spending later this year. That will cheer Amazon's patient investors. In the past year its share price has underperformed the NASDAQ. Unless the pioneer of online retailing can provide downloadable media it risks being "disintermediated"—rather as only a decade ago high-street bookshops, music and video stores were disintermediated by Amazon itself. •

