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Evaluation of Online Retail Industry & Amazon Company

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Abstract- This paper led the researcher into believing that not only the Amazon or the online industry but any industry also faces the forces of bargaining power of customers and suppliers, the threat of new entrants, competitive rivalry within the industry and the threat of substitute products. This forces according to Michael Porter. In line with Amazon, the researcher learnt that indeed it is the largest company in the online industry that relies on the internet in selling its products and services. Moreover, the researcher learnt that in spite of the high growth of Amazon, the company is not able to sustain its net profits and is in a declining stage.

Introduction

The 21st century has been characterized by the substantive use of the internet in advertising and providing of products/ services. Consequently, this has boosted the business sector as retail sales are made online. As the modern generation switches to easy ways of communication, this has called for better ways to communicate with and reach this population. With the trend in the global number of Internet users increasing since 2005, capitalizing this trend and selling goods and services online using this internet could be essential in the business sector (Gen, 2015). This paper covers the topic online retail industry and uses Amazon.com as the case study. The paper seeks to find out the forces that affect the performance of an online industry. This paper is purposed to generating knowledge concerning the online retail industry, in particular, Amazon. Considering that there is an increase in the number of businesses that utilize the Internet in selling goods and services using the internet, this study was selected. The knowledge from this paper will provide a clear model for the online retail industry and forces that affect its performance.

The Online Retail Industry

The online industry is defined as a group of service organizations offering dial-up and broadband access to the database, entertainment, e-mails, climatic conditions, news, and shopping. It is the act of selling products and providing services by utilizing the internet. Over the years, the online industry has been growing steadily. In the United States, the sales made online in 2014 only contributed 8% of the total retail sales in comparison to 92% made by offline sales in the same year. 2015 indicated a slight improvement in online sales recording between 9 to 11%. According to the United States statistics, the online sales recorded $304.91 billion; the first time in its history it surpassed $300 billion mark. In 2015, this figure grew up by 10% recording $336.2 billion. This shows a growing e-commerce that would be anticipated to be higher in the future (Amazon.com LLC, 2015).

According to Porter, there are five forces that influence an industry. The forces include bargaining power of customers, the threat of new entrants, bargaining power of suppliers, competitive rivalry within the industry and the threat of substitute products. The online industry, just like any other industry is subjected to these forces that in one way or the other affect its performance.

The bargaining power of customers has an impact on the industry. When the bargaining power is high, the industry nearly becomes monopsony; the market characterized by several suppliers and few buyers. The trend in the global number of Internet users since 2005 had been increasing. The global number of Internet users was estimated to be 1000 million in 2005 and approximately 3000 million in 2015. This number is expected to grow in 2016 and 2017. The growth in the number of online customers suggests that a single buyer cannot have any particular influence on products or prices of products sold online (McCracken, 2015). With this growth in online customers, it may be dangerous on the type of products and services offered online as they can be substandard.

An online industry supplies products and services using the internet. This has led to the development of buyer-supplier relationships between the online industry and the customers who purchase the products. The low-medium relationship has been observed in the bargaining power of suppliers in the online industry. This bargaining power is based on the finished products, the type of products and the choice of the suppliers. The bargaining power of suppliers, if strong can exert an impact on the customers such as providing services/products at high costs as a

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strategy of capturing some of the online industry's profits. In case the suppliers become powerful, there would be credible forward integration threat by the suppliers, and this could drive the customers to be also powerful. The weak suppliers, on the other hand, could imply that there are several competitive suppliers and weak customers (Sidhu, 2015).

According to Porter, the substitute products are those products in different industries. In an online industry, the rivalry brought by the threat substitutes originates from those shopping ways that fall outside the online industry. The threat of substitutes is considered to exist in a scenario the demand for the products is impacted by changing the prices of the substitute products. The price elasticity of the product depends on the substitute product implying that when there are a bigger percentage of available products, the elasticity of the demand increases considering that the customers would have more alternatives. Close substitute products constrain the capability of businesses in the industry in raising prices. The newer shopping technologies, offline shopping and the revolutionizing structure of business are contributing to the rivalry among these substitute ways of connecting the customers to the products/services (Schiffrin, 2012).

The competitive rivalry within the industry is also another force that affects the industry. This rivalry is brought by new entrants in the industry. In standard practice, an enterprise should be capable of entering and exiting the market, and if this applies, then the profits should in all times be nominal. Unfortunately, the industries are characterized with protecting the high profits of enterprises in the industry and inhibiting new competitors from entering the industry by placing barriers to the entrants. The competition in the online industry is very intense and is comprised of more than abundant retailers who market and sell their products online. The abundant retailers increase the competition in the online industry to be intense since these high numbers of retailers compete for similar customers and resources. However, the offline players remain a big rival to the online players, something that results to lower retail sales in online in comparison to a high percentage of sales corresponding to the offline sales (Soyata, 2015).

The online sales have had a small part of the retail market in the U.S economy. However, with a growth of around 1-3% that was recorded between 2014 and 2015, the retail sales are forecasted to be higher in the future. The United States projects its retails online sales to fall at 2% and 3.3% in 2016 and 2017 respectively, which is higher than the 2014/2015 statistics (Safonov, 2016). The United States' higher risks are associated to originate from economic conditions. For instance, 2015 was characterized by shaky public finances, slower export growth with its households deleveraging. It, however, projects its real-GDP growth to dangle within 2-2.5% annually as from 2016. A high GDP in the future would help its economic state to be stable, and thus better prepared to deal its current economic risks (Gen, 2015).

The Amazon.com

The amazon.com was founded in 1994 by Jeff Bezos and headquartered at Washington D.C in the United States. Its key person is Jeff Bezos, who is its chairman, president, and CEO. It is the largest internet retailer in the online industry in the U.S. Its area of coverage is worldwide and provides online shopping and web distribution services. As per 2015 statistics, its number of employees were approximated to be 222,400. Its mission is being the earth's most customer-centric organization, the place where customers find and discover anything they may opt buying online. Its vision, on the other hand, is being the earth's most customer-centric company; building a place where people come to find and discover anything they may want buying online (Amazon.com LLC, 2015).

The strategy of amazon.com is based on building the loyalty of customers. Since it is the largest in the United States, Amazon aims to maintain and enhance its market dominance. Its strategy advocates for giving its customers products and services of high quality at affordable prices and extremely fast delivery. The company uses point and rewards cards as its loyalty programs of encouraging consumers to continue shopping at the company. The company sells its products not only in the United States but in worldwide. Such that it operates the worldwide marketplace, it has separate retail websites for the U.S, China, and various worldwide states. It's obsessed with its customers that why it ships its products to international customers who are miles away. Its products are of best prices in comparison to its offline competitors Walmart and Kmart that also take a large market share in the U.S. Moreover, Amazon provides luxurious categories of its products such as books, DVDs, Blue-rays and other forms of media (Amazon.com LLC, 2015).

Amazon's Swot

The following is the swot analysis of Amazon

Strengths

The company has a strong background, deep pockets, good cost leadership, and acquisitions. The company before dealt with books and grew to be very successful. Currently, it provides a wide variety of products including electronic products, toys, gaming products, home and entertainment, brown products and kitchen goods. This has made the organization to dominate globally as an E-commerce giant for the last twenty years. As a strategy of differentiating itself, Amazon developed a number of strategic alliances with various firms as a way of offering superior consumer services. An essential strategic tie-up are based on logistics providers who control costs. Owing that the company plays in a large economy of scale, the company has lowered its inventory replenishment time. Lastly, through acquisitions, Amazon has acquired Zappos.com, jungle.com, and even woot.com and this has made it be a giant revenue generator in the online industry (Weil, 2015).

Weaknesses

Some of its weaknesses are shrinking margins, tax avoidance issues and high debt. Because of price wars besides the delivery networks being costly, this has driven the margins of Amazon to shrink. Consequently, the company encounters losses because of the lower margin effect. For instance, the company made losses amounting to $359 in 2013-2014. The organization has also displayed a bad image by avoiding to pay tax in states such as the United States and the United Kingdom. A large percentage of its revenue comes from these well-established marketplaces. Moreover, in several developing countries, the company still struggles to make the business profitable, and this affects overly the profitability of the company pushing the company into high debt zone (Amazon.com LLC, 2015).

Opportunities

The Amazon's opportunities are based on background integration, global expansion, and opening physical stores in regions outside the United States. The Amazon company may establish in-house brands in various product groups. The company may additionally differentiate its offering. The step would make the company generate profits in highly competitive Electronic-commerce market. In line with the global expansion, expanding its market to Asia and in nations having developing economies would ensure that the organization dominate and make profits in such countries. This is from the fact that these markets have minimal competition in the Electronic-commerce sector apart from being not saturated like developed economies. Opening physical stores outside the United States would aid Amazon's consumers to interact with the brands. The move will lead to an increase in repeat purchases and improve its loyalty consumer base (Amazon.com LLC, 2015).

Threats

Some of the threats of Amazon are low entry barriers of the online industry, the government rules, and local competition. The low entry hindrances impact the present player's venture owing that more and more companies enter the industry. The implication of this is intense competition, price wars, making the margins shrink and making losses to occur. This questions the sustainability of the players in the future. The government regulations, not only in the United States but several developing states are not clear on matters associated the FDI, especially in multi-brand retail. This has proven to be a hindrance in preventing the Electronic-commerce from being successful. Amazon faces local competition in some regions. For instance, in India, there are Snapdeal and Flipkart that are local players in the E-commerce retailers. These competitors seem to take away a big percentage of the market. Elsewhere, there are several local threats that play a role of biting from the market share and thus hardening gigantic E-commerce players such as Amazon from generating profits (Amazon.com LLC, 2015)

Quality of Earnings Analysis

In this part, I will discuss, revenue recognition accounting changes and estimates.

- Revenue Recognition

According to FASB (Financial Accounting Standards Board), the revenues may be recognized using persuasive evidence of the arrangement exists, delivery has occurred, or service has been rendered, selling price is fixed or determinable, and collectivity is reasonable assured methods. The company should use any of these methods depending on the technique it considers ideally fits it (United States. Department of Labor, 2011).

For the persuasive evidence of the arrangement exists, the existence of the agreements remains essential as they specify the nature and terms, that power ideal accounting treatment. For instance, if changes are made in terms that alter the return policy, there could be a significant effect on whether revenue should be recognized.

The delivery has occurred, or services have been rendered is another method of recognizing revenue. This technique stipulates that unless the delivery has been made or services have been rendered, sellers could not have completed their obligations. The delivery is considered to occur in case the consumers assume the risk and rewards of ownership. The revenue is only recognized once the obligations have been completed (Safonov, 2016).

In the seller's price is fixed and determinable, it is the agreements that specify the payment terms and factors it into determining in case the prices are fixed and determinable. In this criteria, the terms that permit for adjustment fall outside this technique. Therefore, companies using this method to recognize revenue need considering in case the revenue recognition is ideal until refund or adjustment periods ends.

Lastly, there is a technique of collectivity is reasonably assured. In this approach, the revenue is only realized in case the related assets can be converted to cash or claims to cash. In scenarios that collectivity fails to be assured, the company fails meeting such criteria and, therefore, the company would be incapable of recognizing the revenue (United States. Department of Labor, 2011).

- **Accounting Changes**

In line with methods of recognizing revenue, in May 2014, there was Accounting Standard Update (ASU), and this was done by FASB. The accounting standard update is effective for yearly reporting periods (and this includes the interim reporting period in that period) as from 15-Dec-2016. This only applies to the public companies. The FASB allows early adoption of the new revenue recognition standards for those companies that use the IFRSs.

According to the update, the new standard offers a single principles-based. The new standard is a five-step model that should be used to all contracts with customers. The following are the five steps under the new standard (Schiffrin, 2012);

- Contracts to be identified with the customers
- Identification of the performance obligations in the contracts
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contracts
- Recognition of the revenue in case the company meets the performance obligations

The May 2014 ASU continues to explain the new guidance in case the revenues need to be recognized at the point in time or over time. This is a new requirement that substitutes the previous distinction between products and services. In case there is revenue variability, the new standard stipulates that the revenue variable amounts can only be factored into the revenue when, and to the extent that, there are high chances that a considerate revenue reversal may not occur in the future because of re-estimation. On the other hand, for the sales- and usage-based royalties obtained from licenses of intellectual properties, for revenue ties, the recognition of revenue can only be achieved when the underlying sales or usage have taken place.

- **Estimates**

The term inventory is used to refer to a number of products and materials at hand. It is commonly referred to as stock. The inventory may be valued used FIFO (First-In, First-Out) technique. According to this method, at the terminus of the year, the inventory is required to comprise of goods/products that were most recently placed in the inventory. In situations that inflation occurred, the costs of products sold should be at the least achievable amount. This aids to maximize the net income within the inflationary environ. The associated downside of that impact would be shifting income taxes to their highest levels. In scenarios the inventory is valued at a lower cost or market value, this requires allowing for the deduction for the decrease in the inventory value before its realization by the sale of the inventory. Under such cases, the tax law allows the unrealized loss to be deducted (Sidhu, 2015).

- **Product Life Cycle**

It is worthwhile to note the current state of Amazon as one of the giants in the online industry. Moving back to approximately two decades ago when the company was launched, its reporting profits were higher than the figures the company has been posting in the last decade. In spite of posting the higher value of revenue as from 2010, this figures may not provide a person an ideal sense of what is going on in the company. They are illusions.

Amazon recorded a total revenue of $34204 million, $48077 million, $61,093 million, $74,452 and $88,988 in 2010, 2011, 2012, 2013 and 2014 years respectively. One key observation to make from these figures is that they have been increasing. Closely associated with these revenues are the cost incurred to obtain such revenues. They also indicate a growing trend as $26,561, $37,288, $45,971, $54,181 and $62,752 for 2010 up to 2014 respectively (Amazon.com LLC, 2015). However, one should note this is the net revenue, and an essential factor such as the net income has not come into play in this matter.

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If we now take a look at the *net income* of Amazon from 2010, it displays clearly the company is deteriorating. In 2010, the company posted a net income of $1,152 million. This figure declined to $631 million in 2011. This is almost a 45% decrease from the 2010 recording. In 2012, the company made a negative loss of $39 million. In 2013, Amazon had an only $274 million net income in spite of recording a $74,452 revenue. Ultimately, in 2014, the company again collected a negative income by making a loss of $241 million (Amazon.com LLC, 2015). The statistics are fascinating for a gigantic company like Amazon that has been dominating in the online industry.

In 2010, Amazon had a cash flow from operating of $3,495 million, and these figures have been increasing over the years. In 2011, 2012, 2013 and 2014, the cash flows from operating were $3,903 million, $4,180 million, $5,475 million and $6,842 respectively. The trend with respect to this parameter is increasing, and this is suggestive that the cash flow from operating is anticipated to be higher in the coming years (Weil, 2015).

The cash flow from investing is also another essential aspect as far as financial analysis of a company is concerned. In 2010, Amazon posted a negative $3,360 million cash flow from investing. However, in 2011, this value had a slight improvement of $1,430. Since then, the net cash used for investing activities has been increasing from -$3,595 million to -$4,276 million and ultimately to -$5065 million for 2012, 2013 and 2014 respectively (Amazon.com LLC, 2015).

Finally, let us review the figures of the cash flow from the financing of Amazon.com. This figures since 2010 have been dangling between positive and negative values. In 2010, this parameter was positive $181 million. However, it deteriorated to -$432 million in 2011. 2012 recorded $2,259 million and a negative cash flow from financing was also realized in 2013 (-$539 million). Lastly in 2014, Amazon had an improvement in terms of the cash flow from financing since it was $4,432 million (Amazon.com LLC, 2015).

Amazon's Risk and Growth

The Amazon company has a high growth although its risk is medium to low. Since 1997, the company has delivered a very high growth in terms of its revenue. This made investors optimistic concerning the future performance of the company. The high growth of the company has driven the investors into overlooking the organization's reluctance in generating maintained net profits. In case these bullish anticipations are not addressed to, the stock of the company may lose value owing that its high growth implies that its future performance would be strong in the market (Amazon.com LLC, 2015).

The company's risk is medium to low. Unlike its competitors such as Target, Walmart, and Costco, Amazon through differentiation does not face high risks as the ones faced by its competitors. The competition stands out to be the major salient operational risk that the company faces. Amazon, of all its major competitors, holds the largest share (23 percent) of the highly divided online retail market (Amazon.com LLC, 2015). This attracts several investors who may help the company in addressing its risks and uncertainties in case they emerge.

Conclusion

This paper covered that online retail industry. The content of this paper was centered around the act of selling goods and services online using the internet. The selected case study was Amazon.com; one of the gigantic key player in the online industry. The paper analyzed the performance of Amazon based on the SWOT analysis and later its financial performance. Through the analysis of financial figures of Amazon between 2010 and 2014, the researcher found out that the company is in the declining stage. Owing that the analysis of Amazon company was based in the limit 2010-2014, the researcher recommends future research especially in 2016 to provide up to date clear image of the company.

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