

Amazon and mybabyallergy.com

E-commerce Decisions for a Start-Up

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César Pérez was going into the campus bar at quarter to four in the afternoon. It was a July day in 2018 and the thermometer was at 31 degrees. Despite the heat, Pérez was excited about meeting with a fellow graduate of the management program that had just finished and with their operations professor. Merely by going through the campus entrance, Pérez felt as if he was still doing the program. He seemed to relive those moments prior to the group discussions, as if it was a matter of preparing a case. On this occasion, he wanted the meeting to be useful for sharing experiences and listening to other perspectives so he could better face the challenges of his new start-up. Already at the bar and in a cool environment, Pérez was refreshing himself with an iced coffee, while his mind was going over the first six months of his business venture in online sales of special food products. Pérez could not help smiling happily when he remembered with a thrill the original reason why he founded the firm Mybabyallergy.com: to look after families with a food allergy problem. He was satisfied with how well accepted his product offering was in the market, as well as with the new relationships created with families in need of nutritional solutions. Pérez had chosen the e-commerce platform Magento,¹ which, after €6,000 in investment, provided him with great flexibility. To manage the operations, Pérez took advantage of the infrastructure of his business partner, who ran a pharmacy with a 300 m² warehouse and two workers. Up to then, Pérez was combining his managerial position in a pharmaceutical firm with his big dream: getting Mybabyallergy.com started and making it grow.

One of his recent experiments had been to offer his products on Amazon and now he was trying to compare its results with those of his own e-commerce model. Pérez thought that, through Amazon, he could aspire to something more. Paying €35 a month, he had activated a vendor account on Amazon and was pleasantly surprised by the increase in sales obtained from that channel. (See **Exhibit 2.**) Families that already bought through Amazon could also buy his products in the shopping cart now. Pérez received customer orders through Amazon but he was in charge of all

¹ Magento is a cloud-based e-commerce platform with an open-source ecosystem. It is very flexible for B2C and B2B, as well as hybrid solutions. Magento's scope goes beyond the shopping cart for every experience, including email, mobile, in-store, shipment and marketplace.

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the preparation and logistics until the final delivery. Pérez wanted to deliver the product in special packaging and be able to make the customer more aware of Mybabyallergy.com. Amazon, for its part, took charge of the online order platform, customer transactions and collecting payments.

These first dealings with Amazon had been very positive but Pérez harbored doubts about what his best strategy should be so he could continue growing sustainably in the coming years. He would have to decide soon whether he would make the online sales channel grow through Amazon or whether he wanted to make a firm commitment to his own e-commerce model. In the case of growing through the Amazon channel, Pérez would have to decide which relationship model it suited him to agree with Amazon. Specifically, Pérez would have to choose between three different models proposed by Amazon: FBA (Fulfillment by Amazon), FBM (Fulfillment by Merchant) or SFP (Seller-Fulfilled Prime). What would each of them involve and which one would be most suitable for his business circumstances?

Five minutes later, he saw Pablo Navarro enter. Navarro, an old fellow graduate, was the sales director of Treonis, a Spanish firm with more than 25 years of experience in the consumer electronics sector with several leading brands in the national market. The total turnover predicted for 2018 was a little over €140 million (see **Exhibit 1.**)

The Amazon Effect

Pablo Navarro:

Hello, César. Sorry I'm late, but listen to how things are: just now the Amazon account manager called me on my cell phone. You can't imagine the number of times he calls me on the phone and how exquisitely he manages my products. We've been working with them for only four years and my online sales have already grown so much that today they generate no more and no less than 10% of my turnover. I really can't complain. What's more, in the online world, I have to deal with far fewer competitors than in the traditional distribution channels.

Up to 2014, we had distributed only to wholesalers and retailers. At that time, at a trade fair for the sector, we met Amazon and unexpectedly it proposed that we be its supplier for the category of small household appliances. To be honest with you, at Treonis we accepted the proposal immediately because we thought it would be very difficult for us to develop the structures and infrastructure that we would need to enter the B2C world. We didn't know anything about direct online sales to the final consumer, whereas Amazon, after rapid penetration into Spain, offered us a very easy-to-manage model. They were going to take care of everything: processing customer orders and collecting the payments, managing the logistics, advertising, complaints and returned items.

In these past four years, Amazon has broken the market. It's what some people call the 'Amazon effect.' Many manufacturers and distributors, regardless of whether they compete directly with Amazon, are being affected because Amazon is changing consumers' expectations. Every day I see how neighborhood stores can't compete any more and are closing their shutters. The battle between the traditional channels and Amazon is merciless and, what's more, large retail is disoriented.

Pérez listened to him intently while gently stirring the ice in the cup of coffee. He was thinking about the implications but also about the opportunities of the Amazon effect for his own business.

There's a new consumer who is interested in basically two things to decide on a purchase: the customer reviews and the price.



The customer reviews (the product reviews by the Amazon customers themselves) and the ratings (the score awarded to the product through the allocation of stars) offer a new experience. Notice that the system of customer reviews is so important to Amazon that there is even a program called Vine in which the brands offer significant customers (generators of highly consulted reviews) products for free so that they continue generating useful assessments for other buyers.

The Amazon customer also looks for price and so Amazon is applying a daily comparison system ('daily matching') to set the price of our items and, whenever it can, to offer a price below that of its competitors, whether these are internal (sellers on Amazon Marketplace) or external (i.e., El Corte Inglés, Media Markt, etc.). This model erodes Amazon's margins but, as you can imagine, this is the reason why Amazon puts more pressure on me every day in the price negotiation and also tries to pass higher costs onto me for its management.

Management Costs With Amazon

If you work with Amazon, you have to get used to the 'additional charges' or 'discounts.' From the margin on sales, I have to subtract a series of atypical costs by virtue of the agreements that I have reached with Amazon. In total, they end up being in the order of 15%² on sales." (See **Exhibit 1**).

While listening to his friend, Pérez thought about the alert he had received in June from Amazon. They told him tersely that certain bad service indicators could put the account at risk. Amazon controlled everything: the customer replies, the average shipping time from the receipt of orders, etc.

Amazon had asked him to conduct a miniaudit as they thought that 2.82% of defective orders far exceeded the threshold of 1% that was considered as the acceptable maximum.

Pérez went back to concentrating on what his friend was telling him.

Let me give you a few examples of the management costs I have with Amazon but not with my traditional retailers.

Maintenance of the Product Catalog

Generation and maintenance of a catalog of quality products, with technical characteristics, detailed information about each item, photos of all kinds, videos, and even technical comparisons with other products of the brand. The more complete the record, the more interest in the buyer it generates and the better the customer experience. That's why I have someone dedicated to this activity. The Amazon platform has become a product search engine that almost replaces Google. From this very month, all the brands of any category that Amazon buys have the option 'add video' to show our product in better detail. In this way,

² These additional charges or "discounts" of 15% were broken down into the following entries: 5% on a discount for annual purchase volume; 5% on a discount for marketing investments by Amazon (i.e., investments in advertising on Google Shopping with my brands); 2.5% for **Amazon Vendor Services (AVS)**, which, jointly with the brand, devises all the strategy, operations, promotions, catalog organization and tools (this service is offered only to strategic suppliers by category such as Treonis); 2.5% for the management of returned items ("damage allowance") so that Amazon does not send us back products returned by customers. Amazon resells those products later on as "renewed" products.