AMAZON:
Retailer, or Parcel Provider?

■ *By Satish Jindel*

AMAZON.COM STARTED IN the 1990s as an online retailer catering to consumer needs for music CDs and books. In those days, sales of books and music CDs represented about 80 percent of total revenue for the company. Since then, Amazon has skillfully transformed its business model from a simple online retailer to a far more complex distributor for hundreds of online retailers.

Their status as a retailer, of course, is now unassailable. Amazon is at the absolute leading edge of the online sales revolution that is transforming the retail industry and the transport and logistics operations that serve the industry.

Forrester Research expects online sales to reach nearly $280 billion by 2015, a 68 percent increase over 2010. The comScore research group estimates online sales in November and December increased 15 percent year-over-year to $35.3 billion. For carriers, there is an added bonus: Online sales invariably trigger returns, and UPS said it expected to carry about 550,000 return shipments on the first business day of the new year.

Amazon holds a special place in this increasingly virtual retail universe. Although the company ranked only No. 19 on last year's list of top retailers compiled by the National Retail Federation's Stores magazine, the company that counted nearly $33 billion in global sales in 2010 also expanded its revenue that year by more than 46 percent while most retailers were treading water at best. Amazon's only rival in sales growth was Apple Stores and its iTunes business, which grew 32.3 percent.

While Apple is selling music downloads, however, Amazon is selling mostly in the world of physical goods, and this is where the company is having a dramatic impact on the distribution business.

Amazon has 34 distribution centers in the U.S., with each ranging in size from 600,000 square feet to 1.3 million square feet, and the company has another 24 facilities in other parts of the world. As for the most recent few months, we estimate Amazon is shipping more than 2 million packages per day — more than DHL was handling at the time of its exit from U.S. domestic shipping in 2008 — and that increases to more than 3 million per day in peak holiday season.

With such a high parcel volume, Amazon, if it was considered a light-asset parcel carrier, would rank as the fourth-largest after UPS, FedEx and the U.S. Postal Service (or third if the USPS is excluded), with annual revenue from parcel distribution services of more than $4 billion.

By comparison, in the early 1990s, when Roadway Package Service (now FedEx Ground) had nearly full coverage of the U.S., it was generating less than $1 billion in revenue with an operating margin of more than 15 percent.

With such daily parcel volume, Amazon would be many times larger than all the regional and niche parcel carriers combined. Amazon average daily volume is even many times larger than Puro-

lator in Canada, larger than Aramex in the Middle East and GeoPost in Europe. On a global basis, Amazon would rank as the fifth-largest private parcel delivery service behind UPS, FedEx, DHL and TNT.

Amazon is not a carrier, or a third-party logistics provider, of course. But its sheer scale as a distributor makes it a major force in shipping.

Amazon already has a network of fulfillment facilities and a linehaul network for inbound and outbound flow of products from its 34 distribution centers in the United States. Amazon can leverage the pickup capability of USPS and regional transportation companies (less-than-truckload and parcel) for pickup from small shippers just as it uses the Postal Service and other carriers for last-mile delivery, thereby providing a full door-to-door parcel service for hundreds and thousands of online retailers.

The rapid growth in online retailing is contributing to the double-digit growth of business-to-residence parcel volume at UPS and FedEx (via SmartPost, which grew 17 percent in the second quarter of fiscal year 2012). That means Amazon itself can become a greater force in the parcel industry simply with its weight providing parcel delivery service to other online retail shippers.

Because most postal services are suited to handle small parcels (both in size and weight, and most of the online retail shippers' parcels are small in size and lighter in weight), Amazon can penetrate a large amount of the online retail parcel market as a provider of third-party services. Even for the total parcel market, about 60 percent of the total volume weighs less than 10 pounds. So the limitations of postal services in the U.S. and around the globe will not be a significant constraint on growth of Amazon as a parcel delivery service provider.

Using the industry standard for parcel market including packages weighing less than 150 pounds, the U.S. domestic parcel market is about $60 billion; globally, the market is about $115 billion. However, with the shrinking of products (desktop computers into laptops and iPads, etc.), and faster growth of online retail sales, the parcel industry is primed for segmentation into a small parcel service that can be offered without requiring the capability to accept and delivery heavier parcels that weight more than 25 pounds.

Based on a database of more than a billion parcels processed by shippers using ShipMatrix business intelligence applications, small parcels weighing less than 25 pounds represent more than 80 percent of the total parcel market, which would amount to a total market size of $40 billion in the U.S. That is a market opportunity larger than the total LTL market of $31 billion, a market that supports nine carriers (such as Con-way, ODFL, FedEx Freight, UPS Freight), with each generating more than $1 billion in annual revenue.

The 34 distribution centers Amazon has in the U.S. give Amazon more capacity to process packages than FedEx Ground had in 2006, when that profitable and fast-growing division of FedEx had 24 hubs and a daily parcel volume of 2 million parcels. These centers are concentrated in 10 states, but these facilities are strategically located to provide one- to two-day delivery service to more than 90 percent of the U.S. population.

With capability for next-day or two-day delivery service using an outsourced ground network, Amazon has an opportunity to take over the shipping and distribution of online orders for large retailers such as Best Buy, Target and others.

The need is there in the market. In 2011 Cyber Friday sales, Best Buy was very successful in generating record online retail orders, but failed to process those orders and disappointed many customers who did not receive gifts for Christmas. Amazon will provide an even more compelling value proposition for companies such as Best Buy to consider letting Amazon handle its online orders.

And oddly enough, Amazon may have competition in this space.

Google, with its focus on sales linked to search engine results, may try to extend its reach into retail by offering same-day or next-day distribution services to online retailers to compete with Amazon. That means the competition for the hearts and minds of consumers and of online retailers will intensify. Although Google may have an advantage as a search engine, it will be challenged to match the distribution infrastructure and scale of Amazon, and it almost certainly would look to get into that business with partners.

Those who monitor developments in the parcel industry — shippers, competitors, suppliers and even investors and security analysts — should look toward Amazon for potential changes in the parcel industry. RPS was the last major attempt by a company to compete and succeed in gaining a strong foothold in the parcel industry, such that today, as FedEx Ground, it generates more than $8 billion in annual revenue.

Although there are a few regional parcel carriers (such as Eastern Connection in the Northeast and OnTrac on the West Coast) and niche carriers (such as Streamlite and Newgistics) that have tried to compete in the parcel industry, they have had minimal impact on the growth of two industry giants.

However, Amazon's entry into the parcel industry with full door-to-door service for the online retail segment could alter the fortunes of UPS and FedEx. They would not compete directly with asset-based pickup-and-delivery services, however, focusing instead on the inventory management and distribution. That could provide a boon to the USPS in its troubled times. JOC

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