THE AMAZON DISRUPTION

How to Survive in the World of E-Commerce

by **RONALD SOLOMON**, *president/CEO, MAPP Trap*

IMAGINE FOR A MOMENT THAT THE year is 1875. You make a comfortable living by running your own Western Union store. You send thousands of telegrams for people and businesses. Then along comes Alexander Graham Bell with a newfangled invention called the telephone. Just like the rest of the owners of Western Union, you pay it no mind. Flash forward to 1904: There are more than 3 million telephones in the U.S. and you are out of business because of what Western Union's president deemed "a toy."

This is an example of "disruptive technology." The term was first described by Clayten Christensen in his 1997 book, *The Innovator's Dilemma: When New Technologies Cause Great Firms to Fail.* Christensen defined a disruptive innovation as "an innovation that creates a new market and value network that will eventually disrupt an existing market and replace an existing product." For the purpose of this article, the value market is e-commerce. The existing market being replaced is brick-and-mortar retail, mail-order catalogs, and others.

As a prime example of the disruption caused by electronic commerce (aka e-commerce), Amazon has lowered the barriers and costs to entry for retailers. Before Amazon and eBay's third-party marketplaces came along, online sellers had to buy shopping cart systems, stock inventory, and fulfill orders. They even had to charge, collect, and report sales tax. But with Amazon, these functions can be outsourced. Many online merchants never even see or touch the products they sell.

It may seem like this disruption has only affected the brick-and-mortar retailers of the world. After all, with the lower cost models that online sellers enjoy, the physical stores live on the bottom edge of an unbalanced playing field. Their costs are comparatively much higher, thanks to retail rent, sales fixtures, inventory, insurance, POS systems, sales people, and more. Because online sellers enjoy lower costs of doing business, they can charge less money for the products they've purchased for the same wholesale price and still make similar profits.

Some manufacturers have looked at these market changes and declared themselves immune from any negative effects. They believe that as long as they still get the same wholesale price for their product, retailers (online or offline) can do what they please. Unfortunately for them, many of the brick-and-mortar retailers are fighting back. Like their customers, they look at the online prices of products. Clinging to what is perhaps an obsolete model called "key-stoning" (doubling a product's wholesale cost to determine its retail price), they demand a lower wholesale price. If extended to its logical end, this hints at a deflationary future.

Savvy manufacturers realize the disruption is not only affecting their brick-and-mortar customers. It has a direct impact on their businesses, too. Because of the unfettered and uncontrolled distribution of their products online, they no longer know who is selling them (there are more than 2 million third-party sellers on Amazon). They no longer have control of brand messaging, images, or product descriptions. Most importantly, because the only true distinguishing factor of a product online is its price, brands are suffering intense degradation to perceived value. This disrupted MSRP model causes brand erosion, decreased profits, and upside-down sales channels.

But brick-and-mortar specialty retailers are still alive. Last year, online sales only accounted for about 10 percent of all U.S. retail sales, though this percentage continues to grow.

Brick-and-mortar retailers are employing omnichannel practices that incorporate and enhance their physical locations with their e-commerce stores. They are learning how to use mobile technology to pull customers into their stores. They are learning that a hybrid model is the best and only chance they have to not only remain in business, but to thrive due to unparalleled access to millions of consumers.

Manufacturers are adopting new business practices as well. Companies that want to get a better handle on their distribution are bringing that aspect of their business in-house. To help them create a more level playing field and gain some control over counterfeiting, hyper-discounting, over-distribution, and an eroding brick-and-mortar population, they have created new kinds of policies. Other manufacturers are letting go of their distributors and selling directly to their retail customers. Some are creating authorized reseller agreements and strict buyback policies. Some have even gone as far as opening online stores themselves and are now in direct competition with their retail customers.

Those who are more concerned with the decline in their brand's perceived value due to hyper discounting are adopting and enforcing policies that include authorized use of intellectual property, such as copyrighted images and product descriptions. Others are employing a somewhat controversial strategy known as a Minimum Advertised Pricing Policy (MAPP), which imposes restrictions on the price at which a product or service may be advertised. It does not restrict the actual sale price.

Contrary to what some may believe, MAPP is not an illegal practice. In 2007, the U.S. Supreme Court addressed the issue of MAPP in Leegin Creative Leather Products Inc. v. PSKS Inc. (127 S. Ct. 2705 (2007)). In that case, the court overturned a century-old rule automatically prohibiting as unlawful all "vertical" price fixing arrangements in favor of a "Rule of Reason" test. MAPP is not a contract that must be signed, it is a company policy. With MAPP there is no negotiation whatsoever. They are unilateral statements that treat each retailer equally and set forth the rules under which a retailer may purchase their products.

No matter who you are, or what your business is, there will continue to be more market disruptions as time goes on. It's Darwinian. And, as the theory of evolution states, it's all about the survival of the fittest. In the case of the Amazon disruption, the fittest will be those businesses that take it seriously, study it, understand it, and then adopt whatever new business practices are necessary to stay alive. »

Ronald Solomon has created products and services including toys, games, and IT. He started The Creditors Network in 2006 to help vendors exchange credit information on their shared customers. In 2012, the company added MAPP Trap to its portfolio to help companies keep track of how their brands are represented by online merchants.