

Amazon Seeks More Control After Clicks Hit the Bricks: Gadfly

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By Shira Ovide

(Bloomberg) -- Amazon's biggest problem isn't Wal-Mart or any other retailer. It's a pedestrian one by the standards of technology moguls whose ambitions gravitate to colonizing Mars.

The trouble is, ordering a Christmas sweater online is pure bliss. Getting that sweater to a customer's door is war.

Look at the panicked faces of UPS drivers this time of year. They are practically running in and out of their package-clogged trucks to deliver a bounty of e-commerce orders.

Existing delivery networks are being overrun by the ambitions of Amazon CEO Jeff Bezos and by people's appetite to buy more and more goods without prying themselves off the couch.

Number of Amazon Warehouses

123

Amazon increasingly wants a direct hand in the path from one-click purchase to Main Street. There is the company's homegrown drone project, which for now is more marketing stunt than reality. Amazon hires its own employees or contractors for expedited deliveries to Prime members in select cities. Amazon has tested using its own delivery trucks in some places, either to drive among the company's warehouses or for the routes to shoppers' homes. The company has opened a couple dozen package sorting centers to organize deliveries and expanded by 13 percent this year the number of warehouses to get goods closer to population centers. The sorting centers let the company "control a lot more of our shipments for longer," Amazon's CFO has said.

Control of the delivery process is Amazon's obsession. Now the company is negotiating to lease 20 cargo jets, according to the Seattle Times, again with the ambition of having more autonomy over a part of the delivery path typically handled by shippers such as UPS and FedEx.

Even if Amazon's self-delivery initiatives never move beyond the experimental phase, they have the benefit of keeping the pressure on shipping companies not to drop the ball. Amazon can't afford a repeat of Christmas 2013, when UPS and FedEx were overwhelmed by holiday packages and made a portion of deliveries well after Christmas. Amazon had to offer gift cards to some of its customers to make amends. When Amazon executives are asked publicly about its partners in the package delivery business, they tend to say Amazon is happy with its existing relationships with shippers. Behind closed doors, it's a different story.

Even without mass purchases of jets, trucks and couriers, the package preparation and delivery process is growing more expensive for the company. Amazon's fulfillment costs -- the company's spending on packaging-and-distribution centers and related expenses -- were \$8.87 billion in the

nine months ended Sept. 30, or 12.4 percent of the company's net sales in the period. In 2012, they were 10.5 percent of net sales. Amazon's costs for shipping are also creeping up, from 8.4 percent of revenue in 2012 to 11.7 percent in the three months ended Sept.

30.

If Amazon needs to invest more in its own package delivery efforts, the company's meager profits will get even more Scrooge-like. Stock investors for the moment are happy for Amazon to sacrifice profits to pour money into expanding its business, but Wall Street's tolerance for such spending is fickle.

Amazon may not have a choice. In big potential growth markets outside the U.S., particularly in India and China, package delivery is even more challenging for Amazon and its local rivals including India's Flipkart. Beyond Amazon, physical infrastructure is a significant bottleneck for technology firms aiming for global domination. Less-than-zippy home Internet connections are a big problem for Netflix. Facebook and YouTube badly want to reach into every mobile phone in the world but run into problems with poor or expensive connections.

When Amazon started, its focus was on bits and bytes. Now the company's challenge is to bring together 21st-century computing networks and modern shopping habits with 20th-century physical infrastructure. It won't be easy or cheap to reconcile the two.

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