

Amazon.com's Network Structure

Amazon.com (<http://www.amazon.com>) was launched in mid-1995 as the "Earth's Biggest Bookstore." It offered more than one million titles to online buyers, more than three times the number offered at traditional bookstores. Since then, it has evolved into a powerful network structure involving both other Internet retailers as well as more traditional retailers, including other bookstores. At the center of it all is Amazon's massive Web site, Amazon.com. By pairing Amazon's state-of-the-art technology, built-in traffic, and industry-leading fulfillment and customer service processes with its partners' products and their own strengths, a complex network of organizations is working together to make everyone more successful.

The company went public in the first quarter of 1997 riding the dot.com wave, and revenues have grown from \$147.8 million in 1997 to over \$3.93 billion in fiscal year 2002. Sales increased 26% over fiscal year 2001. Despite this impressive sales growth, there was increasing pressure to deliver profits, which occurred for the first time in fiscal year 2002. From at least one point of view, the development of Amazon's network structure is an important reason.

From the beginning, Amazon has operated as a virtual organization and leveraged the network structure. For example, it developed and operated its Amazon.com Web site to draw in customers and learn about creating an effective online customer experience. But the company owned little or no inventory, warehouses, distribution centers, or customer service operations. Early on, order fulfillment was left to Ingram Book Distributors, one of the largest book wholesalers, who also contracted out delivery to third-party vendors, such as UPS.

In June of 1998, Amazon began selling CDs, and added DVDs and videos in November 1998. It added electronic products, toys, software, and video games in 1999, and tools, health and beauty products, kitchen products, and photo services in 2000. It has also expanded internationally, opening up the UK and German markets in 1999 and in Japan and France in 2000. Amazon's first West Coast distribution center was built in 1996 and an East Coast distribution center was added in 1997. In 1999, in anticipation of the Christmas rush,

Amazon built five warehouse and distribution facilities and several customer service centers to improve its order fulfillment capabilities.

Amazon's initial forays into a broader network began in 1999 but were compartmentalized on the Web site. Non-Amazon products, such as used books or individuals auctioning off different products, were not allowed to infiltrate Amazon's millions of book, CD, and DVD pages. Third-party products were put under "tabs" that roughly described the kind of commerce to be conducted, such as the "auction" tab or the "zShops" tab, which contained a variety of vendor products. Thus, traditional Amazon products were separated from products offered by others. Continued profit pressure, however, forced the organization to look at relationships differently.

Jeff Bezos, company founder and CEO, stated as follows:

We realized that what was most important to the marketplace sellers was demand—access to prospective buyers. So, the idea of the "single store" was to give them a level of access equal to our own—listing their goods right alongside ours.

As a result, a Web page describing Amazon's product—say a DVD with the product's image and other information—was altered to contain product offerings and descriptions from other vendors, such as used DVDs, DVD players from Circuit City, and used soundtrack CDs from another partner.

With the "single store" strategy, Amazon.com transformed itself from an Internet retailer to a platform for commerce. Small businesses and individuals, which used to be in the Auctions or zShops section, were given the opportunity to place their products on Amazon's most visited sites. In exchange for this visibility, Amazon developed a contract that included a fee schedule and described the responsibilities and activities that each organization would perform.

Larger organizations had more options, including the Merchants@amazon.com arrangement, the merchants.com program, the syndicated stores program, as well as more traditional marketing relationships. The Merchants@amazon.com arrangement gave partner organizations, such as

Office Depot, Circuit City, Borders Books, and Toys “R” Us, access to Amazon’s customer base and Web site while retaining ownership of the inventory and the ability to set prices. Amazon got a service fee and commission on sales. For example, Amazon created a three-year partnership with Circuit City that allowed Amazon to generate revenue on people who performed product research online and then made purchases at the store. Amazon began by selling a limited assortment of Circuit City products for in-store pickup, and then expanded its selection of Circuit City products in 2002, including products that duplicated Amazon’s product mix.

The Toys “R” Us relationship is an excellent example of how networks operate to the advantage of both companies. Traditional retailers often get 60% of their annual sales in the final two months of the year; in Toys “R” Us’s case, it was more like 75%. In 1999, the Toys “R” Us Christmas season nearly ruined the company. As with many retailers, Toys “R” Us hoped to take advantage of the Internet shopping trend and opened *toysrus.com*. But their inability to fill customer orders produced such a large volume of customer complaints that the company was fined by the Federal Trade Commission for violating mail and telephone order rules. By partnering with Amazon, there was no need for Toys “R” Us to invest in an infrastructure that was going to be used only for eight weeks.

The Toys “R” Us case is a 10-year agreement where Amazon houses toy inventory, ships toys to customers, processes payments, and performs post-sale customer service. Toys “R” Us retains responsibility for buying and pricing products. This relationship was based on an understanding of the strengths of Amazon and Toys “R” Us. Bezos noted that

There are things we’ll never be able to do that partners can do effortlessly. Likewise, we bring certain skills and a customer base to the table that would be very difficult for partners to acquire. The toys category is a good example.

Amazon was building key capabilities in personalizing the customer experience, making it possible to suggest additional purchases based on information provided by the buyer and previous purchases. For example, Amazon’s “customer filtering” software tracks a consumer’s purchases

and finds other consumers in the database who have made similar purchases. It then recommends additional products assuming that the online customer has similar tastes. Other technologies that Amazon can bring include payment systems and Web customer assistance technologies.

On the other hand, Toys “R” Us is an incredibly large buyer, and the Internet sales unit enjoys the same purchasing power as its parent. As Christmas approaches and particular toys or categories of toys attract attention, the larger buyers are more likely to get the last-minute shipments that come in from overseas manufacturers. The partnership works well for both.

In the Merchants.com program, Amazon operated third-party Web sites on behalf of the merchant. For example, Amazon offered its know-how to operate Target’s Web site (<http://www.target.com>), took inventory into its distribution centers, and completed most fulfillment functions. In exchange, Target paid Amazon a fixed fee and commissions on sales. The syndicated store option was similar to the Merchants.com program in that Amazon operated the Web site. The difference was that Amazon offered a completely outsourced solution, taking responsibility for Web site development, buying, stocking, pricing, shipping, and servicing the customer.

Finally, Amazon also engaged in more traditional marketing arrangements where the Amazon.com Web site served as a marketing vehicle for other companies. From the Amazon Web site, users were transferred over to the vendor’s Web site and Amazon received a fee based on the number of customers exposed to the vendor’s marketing message or on the number of customers referred. Amazon made its first set of partnerships with *Drugstore.com*, *Living.com*, and *Wine.com* among others. As Amazon affiliates, they paid Amazon placement and referral fees for advertising on the Amazon Web site. This was called the Amazon Commerce Network.

By excelling at particular aspects of retailing in the Internet environment, Amazon has been able to leverage those competencies into a powerful network of alliances and partnerships. The network structure is one important reason Amazon is one of the few Internet startups to actually post a profit.



third of the 720 firms in the sample had rehired recently terminated employees as independent contractors or consultants because the downsizings had not been matched by an appropriate reduction in or redesign of the workload.²² Overall cost reduction was achieved by replacing expensive permanent workers with a contingent workforce.

Over the past decade, most major U.S. corporations and government agencies have engaged in downsizing activities. For example, a 2004 study by Mercer Consulting found that 71% of their respondents had a reduction in force since January 2001 and another study found that 94% of companies surveyed in the U.S. and Europe downsized between 1993 and 1995.²³ Recent government statistics show that more than 124,000 people were laid off in July 2007, and more than 129,000 layoffs were claimed in June 2007.²⁴ Other organizations have downsized by redeploying workers from one function or job to another. For example, AT&T, IBM, Boeing, Sears, and Xerox cut nearly a quarter-million jobs in 1993 and hired more than 63,000 in 1996. In IBM's case, it laid off more than 69,000 people but increased its total workforce by 16,000 as demand was shifted from hardware to software and services.²⁵

Downsizing is generally a response to at least four major conditions. First, it is associated increasingly with mergers and acquisitions. One in nine job cuts during 1998 was the result of the integration of two organizations.²⁶ Second, it can result from organization decline caused by loss of revenues and market share and by technological and industrial change. As a result of fuel oil prices, terrorism, and other changes, the airline industry reduced its workforce by more than 10% between early 2002 and early 2003.²⁷ Third, downsizing can occur when organizations implement one of the new organizational structures described above. For example, creation of network-based structures often involves outsourcing work that is not essential to the organization's core competence. Fourth, downsizing can result from beliefs and social pressures that smaller is better.²⁸ In the United States, there is strong conviction that organizations should be leaner and more flexible. Hamel and Prahalad warned, however, that organizations must be careful that downsizing is not a symptom of "corporate anorexia."²⁹ Organizations may downsize for their own sake and not think about future growth. They may lose key employees who are necessary for future success, cutting into the organization's core competencies and leaving a legacy of mistrust among members. In such situations, it is questionable whether downsizing is developmental as defined in OD.

Application Stages

Successful downsizing interventions tend to proceed by the following steps:³⁰

1. **Clarify the Organization's Strategy.** As a first step, organization leaders specify corporate and business strategy and communicate clearly how downsizing relates to it. They seek to inform members that downsizing is not a goal in itself, but a restructuring process for achieving strategic objectives. Leaders need to provide visible and consistent support throughout the process. They can provide opportunities for members to voice their concerns, ask questions, and obtain counseling if necessary.
2. **Assess Downsizing Options and Make Relevant Choices.** Once the strategy is clear, the full range of downsizing options can be identified and assessed. Table 14.8 describes three primary downsizing methods: workforce reduction, organization redesign, and systemic change. A specific downsizing strategy may use elements of all three approaches. Workforce reduction is aimed at reducing the number of employees, usually in a relatively short timeframe. It can include attrition, retirement incentives, outplacement services, and layoffs. Organization redesign attempts to restructure the firm to prepare it for the next stage of growth. This



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is a medium-term approach that can be accomplished by merging organizational units, eliminating management layers, and redesigning tasks. Systemic change is a longer-term option aimed at changing the culture and strategic orientation of the organization. It can involve interventions that alter the responsibilities and work behaviors of everyone in the organization and that promote continual improvement as a way of life in the firm.

Case, a manufacturer of heavy construction equipment, used a variety of methods to downsize, including eliminating money-losing product lines; narrowing the breadth of remaining product lines; bringing customers to the company headquarters to get their opinions of new product design (which surprisingly resulted in maintaining, rather than changing, certain preferred features, thus holding down redesign costs); shifting production to outside vendors; restructuring debt; and spinning off most of its 250 stores. Eventually, these changes led to closing five plants and to payroll reductions of almost 35%.³¹ The number of jobs lost would have been much greater, however, if Case had not implemented a variety of downsizing methods.

Unfortunately, organizations often choose obvious solutions for downsizing, such as layoffs, because they can be implemented quickly. This action produces a climate of fear and defensiveness as members focus on identifying who will be separated from the organization. Examining a broad range of options and considering the entire organization rather than only certain areas can help allay fears that favoritism and politics are the bases for downsizing decisions. Moreover,



participation of organization members in such decisions can have positive benefits. It can create a sense of urgency for identifying and implementing options to downsizing other than layoffs. Participation can provide members with a clearer understanding of how downsizing will proceed and can increase the likelihood that whatever choices are made are perceived as reasonable and fair.

3. **Implement the Changes.** This stage involves implementing methods for reducing the size of the organization. Several practices characterize successful implementation. First, downsizing is best controlled from the top down. Many difficult decisions are required, and a broad perspective helps to overcome people's natural instincts to protect their enterprise or function. Second, specific areas of inefficiency and high cost need to be identified and targeted. The morale of the organization can be hurt if areas commonly known to be redundant are left untouched. Third, specific actions should be linked to the organization's strategy. Organization members need to be reminded consistently that restructuring activities are part of a plan to improve the organization's performance. Finally, communicate frequently using a variety of media. This keeps people informed, lowers their anxiety over the process, and makes it easier for them to focus on their work.
4. **Address the Needs of Survivors and Those Who Leave.** Most downsizing eventually involves reduction in the size of the workforce, and it is important to support not only employees who remain with the organization but also those who leave. When layoffs occur, employees are generally asked to take on additional responsibilities and to learn new jobs, often with little or no increase in compensation. This added workload can be stressful, and when combined with anxiety over past layoffs and possible future ones, it can lead to what researchers have labeled the "survivor syndrome."³² This syndrome involves a narrow set of self-absorbed and risk-averse behaviors that can threaten the organization's survival. Rather than working to ensure the organization's success, survivors often are preoccupied with whether additional layoffs will occur, with guilt over receiving pay and benefits while coworkers are struggling with termination, and with the uncertainty of career advancement.

Organizations can address these survivor concerns with communication processes that increase the amount and frequency of information provided. Communication should shift from explanations about who left or why to clarification of where the company is going, including its visions, strategies, and goals. The linkage between employees' performance and strategic success is emphasized so that remaining members feel they are valued. Organizations also can support survivors through training and development activities that prepare them for the new work they are being asked to perform. Senior management can promote greater involvement in decision making, thus reinforcing the message that people are important to the future success and growth of the organization.

Given the negative consequences typically associated with job loss, organizations have developed an array of methods to help employees who have been laid off. These include outplacement counseling, personal and family counseling, severance packages, office support for job searches, relocation services, and job retraining. Each service is intended to assist employees in their transition to another work situation.

5. **Follow Through with Growth Plans.** This final stage of downsizing involves implementing an organization renewal and growth process. Failure to move quickly to implement growth plans is a key determinant of ineffective downsizing.³³ For example, a study of 1,020 human resource directors reported that only 44% of the companies that had downsized in the previous five years shared details of their growth plans with employees; only 34% told employees how they would fit into the company's new strategy.³⁴ Organizations must ensure that employees



understand the renewal strategy and their new roles in it. Employees need credible expectations that, although the organization has been through a tough period, their renewed efforts can move it forward.

Application 14.3 describes the process of a strategically focused downsizing effort at Agilent Technologies.³⁵ It demonstrates how a senior leader built on the firm's strategy and culture, as well as important OD concepts, to manage a severe downturn in its business.

Results of Downsizing

The empirical research on downsizing is mostly negative.³⁶ A review conducted by the National Research Council concluded, "From the research produced thus far, downsizing as a strategy for improvement has proven to be, by and large, a failure." A number of studies have documented the negative productivity and employee consequences. One survey of 1,005 companies that used downsizing to reduce costs reported that fewer than half of the firms actually met cost targets. Moreover, only 22% of the companies achieved expected productivity gains, and consequently about 80% of the firms needed to rehire some of the same people that they had previously terminated. Fewer than 33% of the companies surveyed reported that profits increased as much as expected, and only 21% achieved satisfactory improvements in shareholder return on investment. Another survey of 1,142 downsized firms found that only about a third achieved productivity goals. In addition, the research points to a number of problems at the individual level, including increased stress and illness, loss of self-esteem, reduced trust and loyalty, and marriage and family disruptions.³⁷

Research on the effects of downsizing on financial performance also shows negative results.³⁸ One study examined an array of financial performance measures, such as return on sales, assets, and equity, in 210 companies that announced layoffs. It found that increases in financial performance in the first year following the layoff announcements were not followed by performance improvements in the next year. In no case did a firm's financial performance after a layoff announcement match its maximum levels of performance in the year before the announcement. These results suggest that layoffs may result in initial improvements in financial performance, but such gains are temporary and not sustained at even pre-layoff levels. In a similar study of 16 firms that wrote off more than 10% of their net worth in a five-year period, stock prices, which averaged 16% below the market average before the layoff announcements, increased on the day that the restructuring was announced but then began to steadily decline. Two years after the layoff announcements, 10 of the 16 stocks were trading below the market by 17–48%, and 12 of the 16 were below comparable firms in their industries by 5–45%.

These research findings paint a rather bleak picture of the success of downsizing. The results must be interpreted cautiously, however, for three reasons. First, many of the survey-oriented studies received responses from human resources specialists who might have been naturally inclined to view downsizing in a negative light. Second, the studies of financial performance may have included a biased sample of firms. If the companies selected for analysis had been poorly managed, then downsizing alone would have been unlikely to improve financial performance. There is some empirical support for this view because low-performing firms are more likely to engage in downsizing than are high-performing firms.³⁹

Third, disappointing results may be a function of the way downsizing was implemented. A number of organizations, such as Florida Power and Light, General Electric, Motorola, Texas Instruments, Boeing, DaimlerChrysler, and Hewlett-Packard, have posted solid financial returns following downsizing.⁴⁰ A study of 30 downsized firms in the automobile industry showed that those companies that implemented effectively the process described above scored significantly higher on several performance measures than did