Amazon's business strategies analysis--through financial statements and financial ratios analysis

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Abstract. Amazon is a multinational American technology corporation which focuses on e-commerce artificial intelligence etc, and has now gradually become the world's largest online marketplace for multiple product categories. Amazon has also expanded its business to other fields of science and technology and has developed a wide range of subsidiaries worldwide. This paper will discuss about how Amazon reaches such an unbelievable and rapid success and what strategies does Amazon use to achieve its goal. Qualitative and quantitative research methods have been used, through summarizing some previous related researches and analyzing Amazon's last three years' financial statements and ratios. As a result, Amazon will maintain its leadership position, and its customer-centric strategy, cost leadership strategy, differentiation strategy and so on will make a great contribution to its success. But under the effect of COVID-19, Amazon has to adapt some of its strategies to reduce the adverse effect of it. This report will focus on Amazon's current three years' annual report(from 2019 to 2021) and calculate three years' financial ratios and analyse its business strategies in various aspect.

Keywords: Amazon, business strategy, financial statement analysis, ratio analysis.

1. Introduction

1.1 Background

Amazon is the first large company to provides products and services through the Internet, founded by Jeff Bezos in 1994. Initially, Amazon is an online book store then it grows rapidly, selling new products, which are almost electronic products and enlarges its sales range that now it sells almost everything. Amazon try their best to get customer loyalty and trust. They also analyse customers' consumption behaviour to achieve customers' needs and wants. In addition, they have a lot of retailer stores, among different states and different countries and they develop convenient and on-time delivery system. Amazon has own over 40 subsidiaries which provide various services all over the world. Henceforward in this paper, Amazon's business strategies will be analyzed more deeply by analyzing Amazon's financial statement and ratio, which is very critical in determining company's profitability, liquidity and its competitors.

1.2 Related Research

Because of efficient operation of its business strategies, Amazon has been one of the top online retailers in the world. However, Amazon must notice that net income is not so much as expected and the growth rate of it is slow and the liability on the financial statement increase year by year. Bader argues that is because Amazon is committed to investing in long-term projects and acquiring big companies which would cause more expenses. But Amazon can curb the expected losses in the future [1]. By conducting Porter's Five Forces, Jiang found that Amazon's business strategies mainly include low average cost(cost leadership strategy), differentiation of productions and technology innovation. By establishing online stores, physical marginal cost can be decreased and then operating cost will be reduced. In addition, various categories of products are also related to the company's development. For example, by comparing homogenous products, consumers can easily decide which store's product they want to buy. Moreover, technology innovation is also important for Amazon, which is crucial to make both labour and capital work effectively [2]. Through Porter's Five Forces Analysis, financial statements analysis and ratio analysis, it is clear that through making vast investments, Amazon has become the world's top online retailer in e-commerce industry. In addition, Amazon is also a large investor compared to the FAANG stocks, which also increases the credibility of Amazon's investment opportunity, given FAANG group's valuation indicators of the [3]. Slobodan Aćimović et al. pointed out that Amazon keeps on improving its logistics performance. Amazon try their best to build a fast,reliable, and cost-saving delivery system with repeated transactions taking place among customers which are rising year by year [4].

Izogo and Ozo argue that although Amazon's revenue is increasing year by year, the proportion that finally translates to profit is infinitesimal due to its debt financing, serious competition situation, rising operational costs and expansion strategy. Amazon can reduce excessive debt financing within reasonable limits. Amazon can also leverage its good technologies to better analyse customers' behaviour. Amazon can also track profit returns of each customer, which will help Amazon update its customer base that could bring more orders and profits and reduce operational costs [5]. Hahn et al. stated that Amazon has been improving its own convenient and on-time distribution system, taking some measures to control inventory and transportation costs, which lead Amazon to build many different types of delivery facilities around the world. Amazon will keep on developing and implementing new and creative distribution strategies to distinguish itself from other retailers and e-commerce companies [6]. Nguyen Hoang Tien argued that Amazon has built its own brand. Online shopping is becoming more and more popular and widespread because during COVID-19, people gradually switch to online shopping. Recently, Amazon has many competitors, defeating them and improving Amazon's own brand will help it maintain customers' trust to a certain degree [7]. Baboolal-Frank pointed out that Amazon's customer-centric strategies have made it successful in the e-commerce industry, but all of Amazon's strategies still have to be improved in the future. Amazon should focus on share price, employees, inventory protection and security of customers' private information to get more investment and decrease operating costs and make customers more satisfied.[8]Amazon has been improving its convenient and on-time delivery system to controlling inventory and shipping costs, leading to Amazon building many different types of delivery facilities around the world.

1.3 Objective

With over 20 years' development, Amazon has surprised everyone with its current situation, putting its competitors far behind in the market. The objective of this paper is to find out what business strategies Amazon.com use to reach such a huge success and its financial condition in the recent three years, under the effect of the COVID-19. And the paper will analyse from three aspects one by one. First is Amazon's financial statement analysis. Second is Amazon's ratio analysis. And last is competitors analysis. So that, the current situation of Amazon will clearly be shown and it's easier for people to better know about Amazon.

2. Financial analysis

To better analyse Amazon's performance, this study will focus on Amazon's financial statement analysis and ratio analysis, which can clearly show how well Amazon is implementing its strategies year by year.

2.1 Financial statement analysis

Table 1. Balance sheet of Amazon from 2019-2021[9]

(all in $'000)	2021		2020		2019	
	Amount	Percent	Amount	Percent	Amount	Percent
Assets						
Current assets	161,580	38.4%	132,733	41.3%	96,334	42.8%
Inventories	32,640	7.8%	23,795	7.4%	20,497	9.1%
Accounts receivable	32,891	7.8%	24,542	7.6%	20,816	9.2%
Total assets	420,549	100.0%	321,195	100.0%	225,248%	100.0%
Liabilities						
Current liabilities	142,266	33.8%	126,385	39.3%	87,812	39.0%
Long-term liabilities	67,651	16.1%	52,573	16.4%	39,791	17.7%
Total liabilities	282,304	67.1%	227,792	70.9%	163,188	72.4%
Shareholders' equity						
Retained earnings	85,915	20.4%	52,551	16.4%	31,220	13.9%
Total shareholders' equity	138,245	32.9%	93,404	29.1%	62,060	27.6%
Total liabilities and shareholders' equity	420,549	100.0%	321,195	100.0%	225,248	100.0%

As shown in Table 1, it is from Amazon's annual report between 2019 and 2021, on Amazon.com. And here is Amazon's common-size balance sheet. Common size analysis evaluates financial statements by expressing each line item as a percentage of the base amount for that period. Using the figure from 2021 Amazon annual report, it shows that the percentage of assets are funded by debt, which is 67%, and high liabilities would increase the financial risk in the company. And the percentage of inventories are much lower, which is 7.8%, so it means the inventory turnover ratio will be lower, and there will be more spaces to produce new products. Using the figure from 2019 to 2021, there is a slight decrease in inventories, and although liabilities have decreased from 72.4% to 67.1%, it still have high proportion of total assets. There is a dramatic increase in the retained earnings, from 13.9% to 20.4%, it shows Amazon has a higher portion on the usage of equity, such as improving the R&D, and invest more capital. However, Amazon has a lot of debt and liability collected and also spent a lot of their money on acquiring companies and manufacturing big productions.

Table 2. Income statement of Amazon from 2019-2021[9]

(all in $'000)	2019	2020	2021
Net product sales	160,408	215,915	241,787
Net service sales	120,114	170,149	228,035
Total net sales	280,522	386,064	469,822
Operating expense			
Cost of sales	165,536	233,307	272,344
fulfillment	40,232	58,517	75,111
Technology and content	35,931	42,740	56,052
Marketing	18,878	22,008	32,551
Administrative	5,203	6,668	8,823
Other operating expense(income), net	201	-75	62
Total operating expenses	265,981	363,165	444,943
Operating income	14,541	22,899	24,879
Net income	11,588	21,331	33,364

Table 2 is Amazon’s income statement from 2019 to 2021. It illustrates clearly that because of the COVID-19, many people choose to buy items through the Internet, Amazon’s revenue (net product sales and net service sales) increased 22% in 2021, compared to the prior year, which is because of the COVID-19, many people choose to buy items through the Internet. And there are also some other factors that would influence Amazon’s future revenue, which can be divided into external factors and internal factors. The external factors include the development of e-commercial industry, the effect of COVID-19, international situation and customers. The internal factors include technology and three segments. Because of increased sales, products and shipping costs are also increased, and then the cost of sales is increased compared to prior years. Besides, costs from expanding amazon’s fulfillment network, which is because of the increase of variable costs corresponding with the increase of the volume of product and service sales and inventory levels, as well as increased wage rates and incentives, etc are also some factors that add Amazon’s cost of sales.. Meanwhile, technology and content and marketing expenses also have an upward trend, which means that Amazon has invested more money on technology and marketing to improve their services and spread their brand. One of the reasons why Amazon is so competitive in the e-commerce industry is that Amazon has a firm customer loyalty, a huge customer base which would put them ahead of competition. Developing its own brand would improve both Amazon’s competitive advantage and industry strength. Amazon has already improved the delivery service with the help of scientific elements and technologies.

2.2 Ratio analysis

Table 3. Profitability ratios of Amazon

	2019	2020	2021
ROCE	0.12	0.13	0.1
Gross profit margin	41%	39.6%	42%
Net profit margin	4.1%	5.5%	7.1%

ROCE is generally considered to be the primary profitability ratio as it shows how well a business has generated profit from its long-term financing. From the table above, Amazon’s ROCE has a small margin up and then a small margin down. It is clear that Amazon’s ability to make profit through long-term liabilities and equity is generally good, but it has a small decrease which shows that its dependence on non current liabilities and equity reduces than before.

Gross profit ratio indicates the operational efficiency. It is the higher, the better. So it is clear that Amazon’s operating efficiency and business condition have improved in the last three years.

Net profit ratio also indicates the operational efficiency. It shows that Amazon’s net profit is not as much as people expect. It means that a large amount of its revenue doesn’t turn into profit, and its operating expense is very much.

Table 4. Liquidity ratios of Amazon

	2019	2020	2021
Current ratio	1.1	1.05	1.14
Quick assets ratio	0.86	0.86	0.91
Inventory holding period	45.2	37.23	43.75
Payable payment period	104.06	113.49	105.44

Current ratio is an important indicator to reflect the short-term solvency of an enterprise. Amazon's current ratio shows that it goes down first and then rise up. So perhaps Amazon has the improvement, which can reduce credit purchases, reduce bank loans, and increase liquid assets to increase the current ratio.

Quick ratio is a measure of the current assets in an enterprise that can be immediately realized, and the ability to repay the current liabilities. Amazon’s quick assets ratio shows an upward trend,but there is a certain gap with 1. An enterprise's quick assets ratio is 1 means that for every dollar of current liabilities, there is one dollar of easily liquidated current assets to offset, and it shows that the short-term solvency is strong. So that Amazon can reduce the inventory holdings to increase the quick assets ratio. Here are five tips for reducing inventory. First, use create removal order. Second, bundle or discount sales-list the products that have a high rating but weren't selling out.Those types of products can be promoted within the site.The similar products related to do bundle or discounts sales. Third, products are give as a present. Then, make a second price reduction-issue discount coupons. Last, use off-site promotion platforms-Find the popular people on the Internet platform such as ins,Facebook,YouTube or twitter. Using network benefits let these people do product promotion.

Inventory turnover ratio measures the time that inventory would be turned into cash in a relatively short period of time. The fewer days inventory was held, the lower cost it made. Amazon's inventory holding period is go down first and then rise up. So Amazon can use the above five inventory reduction tips to keep a lower inventory holding. This valuation needs to be combined with the information disclosed by Amazon. Any important change may affect the impairment of inventory. Because of the specific volume of Amazon, every 1% increase will result in a sales cost of 370 million dollars. Besides, it was also revealed in Amazon's annual report that Amazon has face significant inventory risks which are caused mainly by seasonality, changes in production cycles and customers desire that may adversely affect Amazon's operating results.

Amazon's payable payment period is rise up first then go down. Payable payment period is the longer the better. Enterprises should make good use of their own voice to reasonably arrange the payment cycle, so as to further improve their capital utilization efficiency. Therefore, under the premise of not violating the scope of the contract and not affecting the relationship with the supplier,the submission can be delayed.

3. Comparison

By using Porter's Five Forces analysis, Amazon continually addresses threat of substitutes, which threaten Amazon's performance. The low switching costs show that customers can easily choose other retailers such as Walmart stores or eBay, instead of choosing Amazon. In other words, the threat of substitutes is high and the switching cost is low, which would increase the influence of substitutes against the company. Thus, for long-term success in the online retail industry, Amazon will give priority threat of substitution.

However, as the disclosure in the annual report of 2021, Amazon was facing fierce competition as its business encompasses a variety of product types, service offerings and delivery channels. Amazon does not have the absolute price advantage over competitors such as Walmart and priceline.

Amazon does not have an absolute advantage compared to other competitors worldwide. For example, in east Asia, Alibaba and JD are generally the first choice of online shopping, and it is quite hard for Amazon to change the situation which makes the growth of Amazon in these areas are comparably slow. In the U.S., eBay is one of Amazon's strong competitors. Amazon is not only a bookstore, but also a top retailer. While, eBay has become an online market and entered the digital payment field through the acquisition of PayPal, further supporting the growth of e-commerce payment platforms. Through common-size analysis of Amazon and eBay, it is easy to find out that operating income increased for Amazon whereas it has decreased for eBay. Also through trend analysis researchers conclude that credit policy of eBay is more efficient than Amazon. Amazon is at a better position in context of long term solvency. Both the companies should try to reduce their dependency on outside liabilities to keep their debt to equity ratio ideal. eBay could still try to monitor the use of its current assets to utilize funds for other growth areas.Net receivables analysis and current ratio analysis show that eBay has lots of current asset which could be utilized in expansion of its business. Amazon can try to improve its efficiency of utilizing fixed assets. Amazon can try to enhance its inventory management by using principles of lean management. eBay could make decisions which enhance its return on equity.[10]

4. Conclusion

The paper has fully analyzed Amazon's last three years' financial statement and ratios, and make comparison with its competitors including Alibaba and JD in east Asia and eBay in the United States of America. To sum up, Amazon has its own customer loyalty, numerous products and service categories, database, technology and content,etc. Amazon, price is mostly lower than on another website or physical store, and the one-day delivery are huge assets that push customers to try Amazon, and eventually, become regular customers. Amazon's customer-centric strategy seems to have been the winning solution for the web merchant. To do this, Amazon continually tries to maintain good long-term relationships with its customers and suppliers. Finally, Amazon uses systems such as recommendations and e-mailing to get their customers back. Amazon is the leader of e-commerce in the modern society. It comprehensively analyzed current market situation and determined the needs and wants of its customers precisely by analyzing their desire. Besides, Amazon also pays attention to technology innovation. For example, Amazon has announced the launch of its first "fully automated mobile robot" in June 2022 to improve employees' efficiency. However, from the common-size analysis and ratio analysis, it shows that Amazon is dependent on long-term liabilities and Amazon has an increasing operating costs, which may threaten Amazon's future revenue, profit and cash flow.

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