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How to profitably navigate Amazon in times of inflation and rising costs

A handbook for 1P Vendors

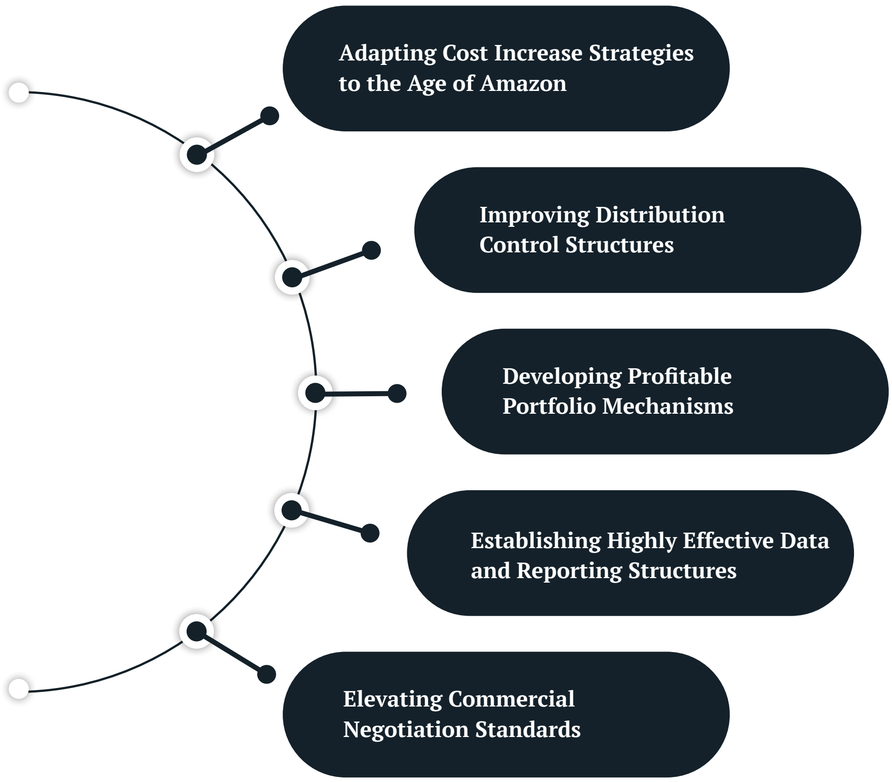
The current macroeconomic environment is putting pressure on the earnings situation and outlook of Amazon suppliers worldwide. Executives today must identify the mechanisms required to respond effectively and protect their profit margins.

The aftermath of the pandemic and the current war in Ukraine have led to widespread labour shortages, inflation, and a surge in logistics and commodity prices. Container freight rates still track 460% higher than two years ago, and leading commodity price indices have surged 164% above pre-pandemic levels. [1,2]

These additional costs first hit manufacturers before they are passed on to end customers through retailers. At least, that's the theory. But when it comes to selling to Amazon, many brands find themselves in a problematic situation: Amazon does not accept their cost increases and continues to price match the market.

So how can brands secure their profit margins?

The answer isn't to stop selling to Amazon. Nor is it to redirect investments to other sales channels. Instead, executives need to focus on five areas to build a resilient Amazon business that protects its bottom line in times of inflation and rising costs:



The following chapters are a playbook for business leaders who are ready to increase their margins, motivated to elevate their Amazon business, and incentivised to align their existing strategies with online marketplace requirements.

[1] Statista. Global container freight rate index from January 2019 to April 2022; https://www.statista.com/statistics/1250636/global-container-freight-index/

[2] IndexMundi, Commodity Price Index; https://www.indexmundi.com/commodities/?commodity=commodity-price-index

1. Adapting Cost Increase Strategies to the Age of Amazon

Unfortunately, the methods that most brands use to negotiate cost increases have not evolved in concert with the exponential growth of online marketplaces. Gone are the days when manufacturers could simply raise their costs, and retail prices would follow within weeks.

The price follower strategy and marketplace model do not allow Amazon to simply accept cost increases, as they cannot be passed on to the end customer in isolation. Consequently, brands must focus on increasing their account margins before making any changes to their account cost structures.

To illustrate this point, let's say that vendor A sells product X to Amazon for $10. Amazon sells the product at $15 by price matching other retailers. To improve profit margins, vendor A would like to increase the cost to $10.5. So, the team uploads a cost increase request in Vendor Central. But because the product price has not improved in the broader market segment in recent months, Amazon rejects the request immediately.

The above scenario demonstrates that price transparency in the online channel is the most critical factor when pursuing cost negotiations with Amazon. The marketplace retailer holds lower inventory levels than most other trading partners. It is, therefore, among the first affected by any cost changes. As a result, their buyers are largely concerned about decreasing their long-term margin structures by accepting higher costs that may arise from short-term trends and do not translate into the broader market segment.

Brands can address these concerns by ensuring that they de-risk the perceived margin impact for Amazon. This can be achieved by focusing on cost increases with known price leaders first and raising the recommended retail price in line with the cost increase second. Both actions ensure that the front margin on the brand's Amazon account improves, signalling a wider cost acceptance to their Vendor Managers.

This also shows why brands should not default to cost negotiations just because they are unhappy with their Amazon margins:

Vendor Managers will evaluate any cost increase solely based on the front margin performance of the affected portfolio. Consequently, a cost increase primarily serves as a mechanism to recover the front margin gains of Amazon after prices in the broader market segment have picked up. Because of Amazon's price matching strategy, it is not a tool to solve fundamental profitability concerns. These must be addressed separately through terms of negotiations with Amazon.

2. Improving Distribution Control

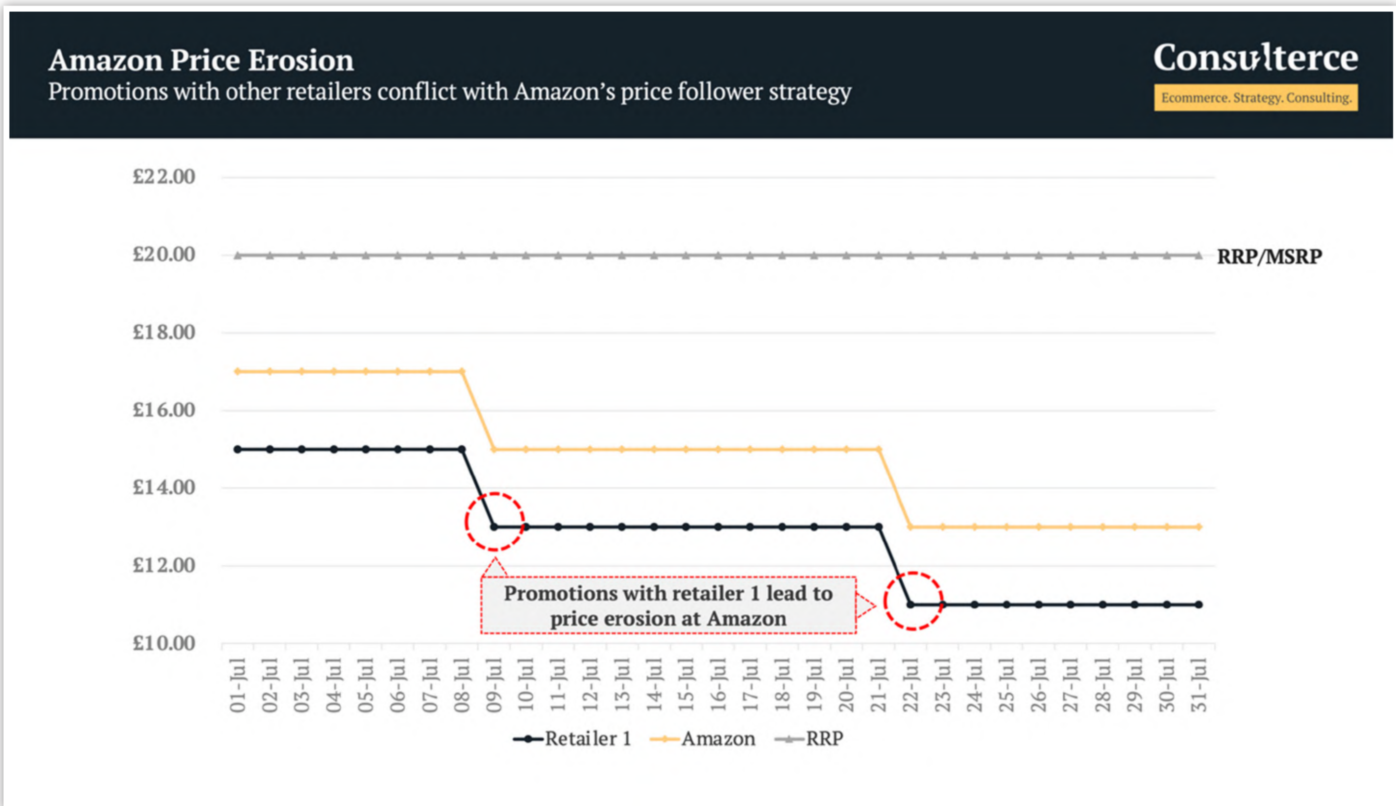
Controlling where and how brands sell their products is critical to managing margins in today's age of ecommerce, and Amazon is no exception. The online retailer is famous for its price follower strategy and prides itself on matching the lowest offer on and off its marketplace.

This strategy serves two main purposes: first, it builds customer trust. Amazon wants everyone to know that the best product price can be found on its marketplace. Second, it allows Amazon to offer millions of products without manually setting their prices.

And as with any other retailer, the price Amazon displays to end customers directly impacts the account margin of its vendors. Brands that do not align their business with this pricing model quickly fall into a downward spiral: promotions that are run at other retailers are matched by Amazon, resulting in rock-bottom prices, delistings, and margin compensation requests from its buyers.

The added complexity with Amazon is that it does not only source products directly from manufacturers. It also has active relationships with most distributors and wholesalers from whom it may source the same items at a lower price. This causes friction in the business relationship between Amazon and other brands, as the online retailer can access volume discounts from resellers that were not intended for the online channel.

That's why brands should use Minimum Advertised Pricing (MAP) policies to set the margin floor with Amazon and third-party sellers whenever possible. Registering with Amazon Brand Registry will also help reduce the sale of counterfeit products on the marketplace.

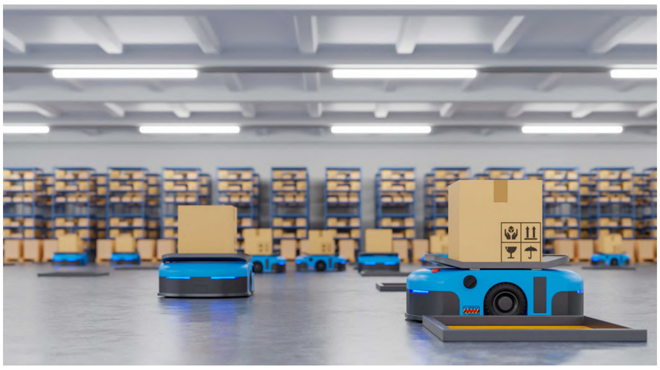


[3] Pricing at the sole discretion of the retailer

And although competition laws in most countries, including the European Union, restrict brands from imposing fixed or minimum selling prices, brands can regain control of where and how their products are being sold through a selective distribution strategy.

The legal requirements for the setup and enforcement can be complex and vary by region. But this should not prevent sales and marketing teams from reviewing their existing distribution. All it takes is a thorough understanding of where most profit margin headwinds originate.

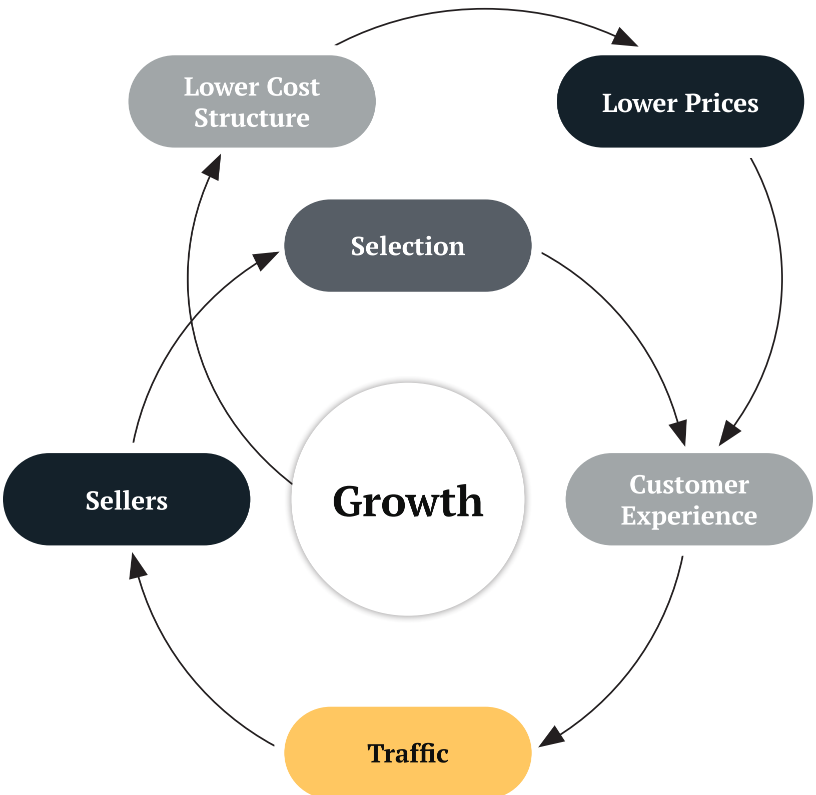
Tools like Profitero and Edge provide detailed insights into the Average Selling Price of products on the Amazon marketplace. They outline not only the selling price of Amazon but also its third-party sellers. Understanding these pricing structures allows brands to identify distributors who are violating MAP policies or selling products through unauthorised channels.



Following this analysis, brands should review their existing incentive structures with key distribution partners. This audit often finds that a manufacturer's own sales teams offer deep discounts on product prices in exchange for bulk orders to meet their quarterly sales targets – a practice that not only impacts profit margins but also leads to these discounts being passed on to other third-party sellers or, worse, to Amazon itself.

3. Developing Profitable Portfolio Mechanisms

To understand the Amazon business model and how to reverse-engineer commercial decisions from it, let's take a closer look at how the online retailer operates its business and achieves growth:



First introduced by Jeff Bezos back in 2001, the Flywheel summarizes Amazon's business model, also known as the Virtuous Cycle. It states that growth results from available selection paired with a good customer experience. Both attract traffic, which leads to more sellers and vendors coming to its marketplace. The resulting growth leads to economies of scale that reduce cost structures for Amazon and its suppliers. The business model is a Virtuous Cycle because lower-cost structures allow Amazon to offer more products at lower prices. This, in turn, expands the available range and customer experience, fuelling the retailer's growth.

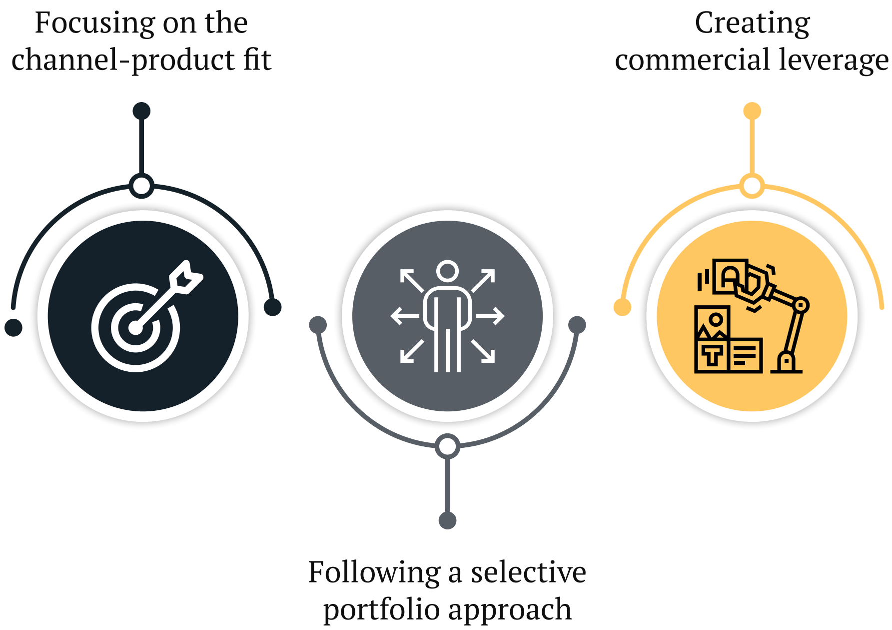
The Flywheel relies heavily on continuously listing new selections to ensure the marketplace stays relevant for its customers. With selection being guarded by manufacturers, listing new selection poses a powerful lever that brands can and should utilize for their commercial discussions with Amazon. Manufacturer brands that ignore this Flywheel concept are likely to blindly follow Amazon's narrative to list their entire catalogue on its online marketplace.

This is problematic for three reasons:

First, it may lead vendors to list products never initially designed for the eCommerce channel. These items come in unoptimized packaging, which drives up costs and lowers profitability for both Amazon and its suppliers.

Second, the competitive environment on the Amazon marketplace gets ignored. Listing products subject to severe market segment dynamics can lead to further margin pressure that Amazon will likely request indirect compensation for, either through cost price discounts, an increase in base terms, or other funding support.

Third, listing new products transfers commercial leverage from vendors to Amazon. Without the listing, Amazon cannot sell the product. And even if the product is already available through other sellers, Amazon is likely interested in accessing commercial benefits such as lower cost structures when sourcing the product directly from the manufacturer, instead of intermediaries like wholesalers or distributors.



Focusing on the channel-product fit

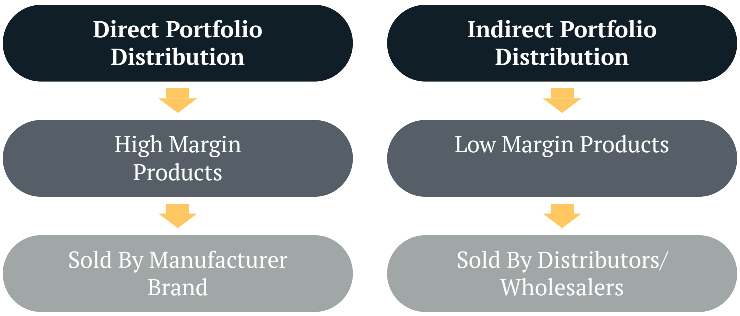
When deciding which products to list with Amazon, manufacturer brands should evaluate the ecommerce-friendliness of their portfolio. Items that can be shipped to end customers in standard parcel dimensions (⩽ 45 cm x 34 cm x 26 cm) and ⩽ 9 kg are so-called sortable products. Sortable products incur low variable handling and shipping costs for Amazon and are exempt from overweight and SIOC chargebacks. They are thus the ideal product type when selling in consumer goods categories.

But vendors should also review the expected Average Selling Price (ASP) band in which products are likely to perform once listed with Amazon. While prices are always at the retailer's discretion, Amazon is more likely to request additional volume and margin support for products with a Recommended Retail Price below €/$/£5.00. This is an important factor to consider as new product listings should support a vendor's margin position unless other strategic priorities take precedence.

Following a selective portfolio approach

Vendor Managers have a good track record of convincing vendors to list their entire product catalogue. But as we have seen earlier, that's not the best strategy for most brands.

To create a profitable portfolio strategy, vendors should assess their options to limit the available assortment through a direct distribution model.



Following a more selective portfolio approach allows brands to reduce their exposure to dilutive listings. At the same time, these low-margin products can be made available through an indirect portfolio distribution strategy, and the brand manufacturer supplies its less profitable range to distributors or wholesalers. They are then sold via Amazon and improve profitability through a volume-based approach.

Creating commercial leverage

As we have learned earlier, selection is the starting point of the Amazon business model. It is crucial that vendors become aware of the value they bring to the table when listing new products with the online retailer. Without this selection, Amazon cannot sell the product to end customers. This gives brands a handle on commercial negotiations with their Vendor Manager.

Consequently, vendor teams should always seek a conversation with their Vendor Manager to leverage the listing of new products and request commercial benefits from Amazon in exchange.

These can include but are not limited to:

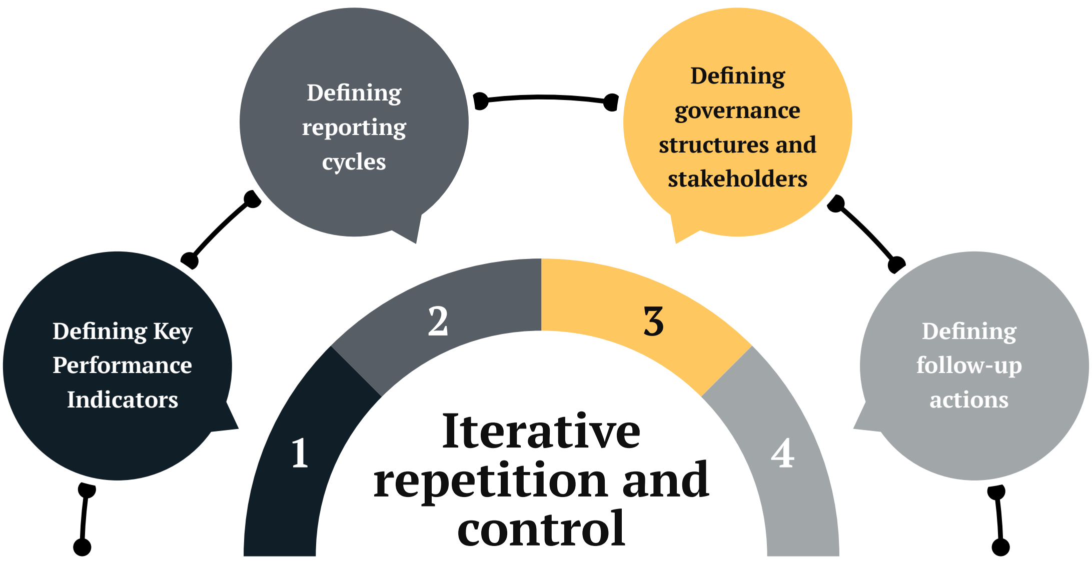
» Chargeback waivers,
» Free VINE credits,
» Access to enhanced category insights,
» Access to sales benchmark reports vs. category peers,
» Reduction in trade terms,
» Exclusion of products from trade terms,
» Access to senior Amazon leadership teams,
» Regular top-to-top meetings.

Vendor Managers are incentivized to onboard holdout selection from vendors and are likely to signal their support at the negotiation table.

4. Establishing Highly Effective Data and Reporting Structures

There is no shortage of available data points and KPIs to monitor the Amazon account. However, without clear systems in place to review the business performance, there is a risk that vendor margins could develop in the wrong direction over time. Executives can prevent this by setting up regular reporting workflows.

There are four aspects to consider when creating highly effective business reviews:



1. Defining Key Performance Indicators

No matter the goals of an organisation, it's crucial to define clear KPIs to ensure all teams are reviewing the right metrics on an ongoing basis.

Business leaders should recognise that not all metrics are equal. For example, sales and profit metrics will not tell the teams much about the direction that the business is headed in. Will sales go up or down next month? Will profit margins take a hit?

It's not feasible to answer these questions by looking at the past trajectory of those output metrics, as they reflect the result of a team's past actions. A better way to structure business reports is also to reflect input metrics that give an insight into how sales and margins are likely to perform in the foreseeable future.

If vendors focus on their business's input metrics, they'll be in a much better position to make solid predictions about the future health of the Amazon account. This approach is often the critical difference between companies that outperform the market and those that obsess over results that give them no direction for future decisions.

Take the following example:

Vendor A noticed a high unit count mismatch following multiple ASN errors with Amazon in June. They know this will lead to a high shortage rate, affecting their ability to receive on-time payments with Amazon. By focusing on the input metric (ASN errors) rather than the output metric (unpaid invoices), they can inform their leadership in time and prepare the negotiation with their Vendor Manager before Amazon notices the problem.

Other examples of input metrics include:

» Vendor lead times
» Out-of-stock rates
» Conversion rates
» Traffic performance
» PO rejection rates
» Availability rates
» Lost Buy Box rates
» Promotional market penetration
» etc.

2. Defining the proper reporting cycles

Most brands review their Amazon account once a month or every quarter. In a fast-paced world where consumer trends can arise and disappear within days, the frequency of reporting cycles needs to adjust as well. However, this doesn't mean that vendors must do a full account audit weekly. A two-paragraph comment on top- and bottom-line figures may be enough. A more extensive review should take place every month instead.

Bonus

Here's an example of a typical comment that summarises the current performance of a brand:

Brand's X sales revenue was at £0.7MM (-100bps MoM / +200bps YoY) in January. The MoM deceleration in growth was driven by 1) name driver 1 here; 2) name driver 2 here; and 3) name driver 3 here. To drive top-line performance and return to a positive MoM trend in February, we have started to 1) name action 1 here; 2) name action 2 here; and 3) name action 3 here. These measures will be fully implemented by CW05, and brand X's sales team will measure progress weekly from CW06 onwards to ensure a timely return to MoM sales growth.

3. Defining governance structures and stakeholders

Business reviews lose their purpose if they do not involve the actual decision-makers within an organisation. Identifying the correct stakeholders to discuss the results and align on the next steps is crucial to driving profitable business results.

Stakeholders outside the sales and marketing divisions, e.g., the finance and legal departments, should be consulted regularly and given up-to-date information on individual workstreams to ensure their function as support units can unfold effectively.

4. Defining expected follow-up actions

An average business report summarises the performance of a brand's actions to date to achieve a specified goal. But highly effective business reviews take it a step further as they also outline the actions required to improve any given input metric. To do that effectively, they need to be forward-looking, associated with an individual who drives the change, and specific enough to name an estimated completion time.

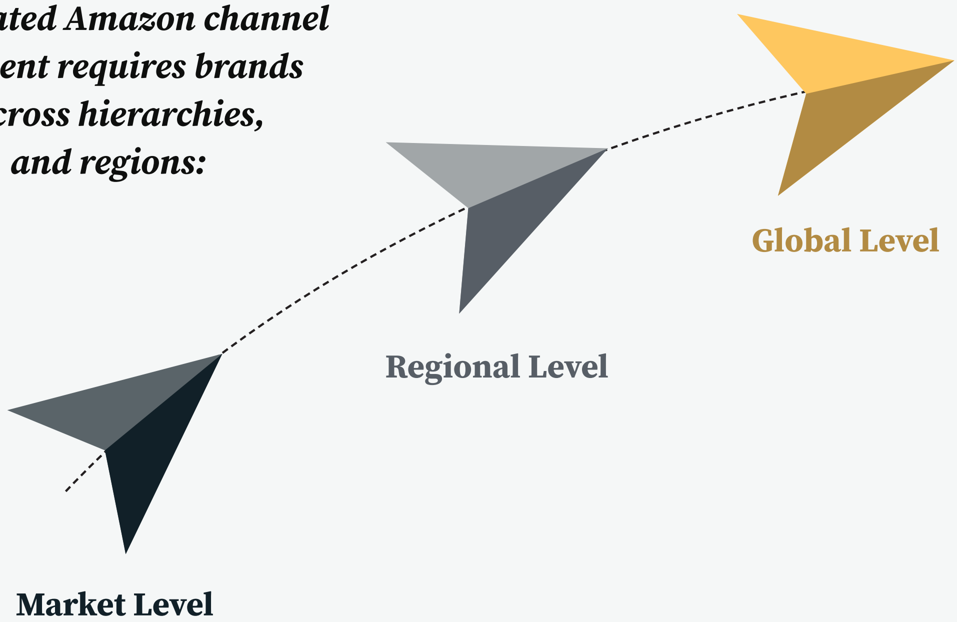
5. Elevating Commercial Negotiation Standards

The last few years have been marked by significant changes for Amazon vendors across product families: a major push towards lower-priced selection, the integration of the Pantry and Prime Now channels into Amazon Core, and the removal of minimum basket-building constraints for customers.

The pandemic has amplified the success of these long-planned growth initiatives, but it has also caused costs to explode for the online marketplace. This directs Amazon's attention to the commercial structures with its supplier base.

Seeking to bolster its bottom line, the online retailer has increased its focus on cross-border sourcing activities across North American and European regions. In other words, Amazon now sources products across markets for the lowest price. This has far-reaching consequences for suppliers' bottom line in an already difficult macroeconomic environment.

An integrated Amazon channel management requires brands to align across hierarchies, functions, and regions:



As ecommerce opens the doors to a borderless future, brands must focus on establishing cross-hierarchical and cross-functional knowledge hubs and consider the levels at which commercial decisions are being made. After all, if Amazon sources products at the lowest cost in one region, any local trade negotiations that are not aligned between markets can quickly turn the vendor business unprofitable.

Thankfully, most suppliers already have loose alignment structures across marketplace regions, but elevating these forums to a level where commercial decisions directly impact the often locally owned P&L can quickly raise concerns about the effects on other distribution channels across markets.

That's why vendors need to have a crystal-clear understanding of their current trading terms across regions: different customer, competitor, and pricing landscapes call for a framework that effectively guides the commercial decisions across marketplaces and considers how it affects local partnerships with other retailers.

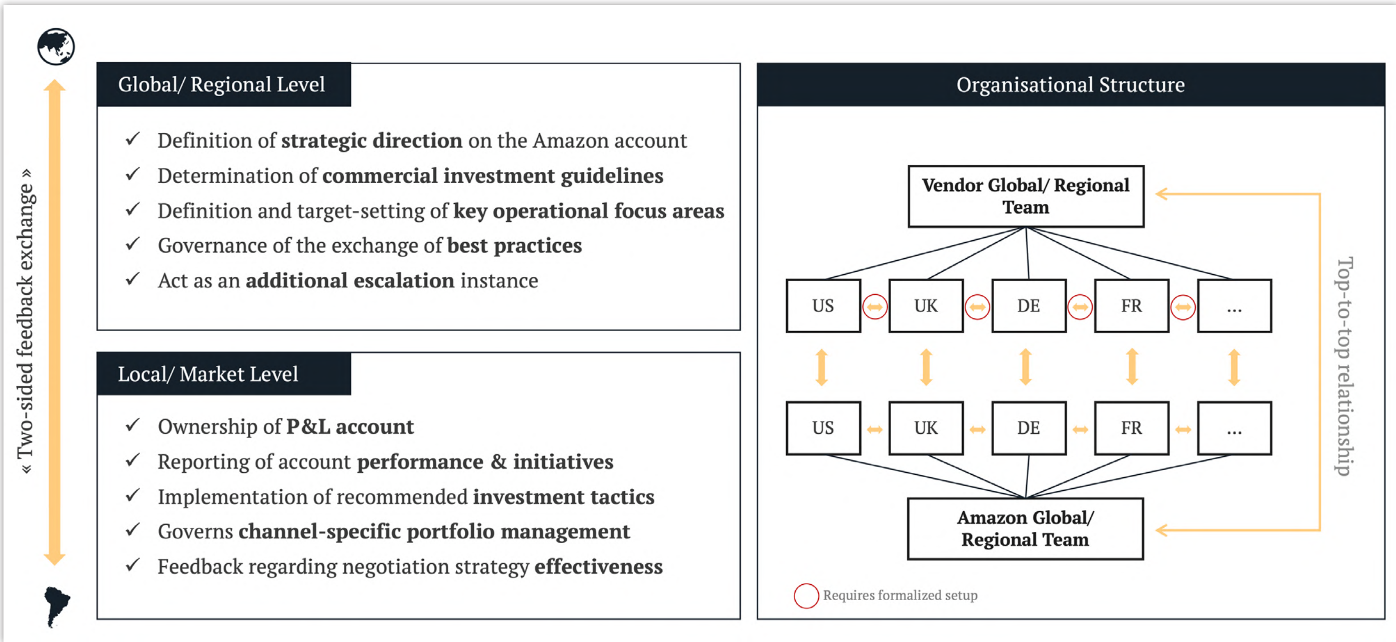
Brands can address these needs by creating different investment layers that standardise list prices and regional trade investments but still consider the competitive environment in each market through an additional investment layer.

This underlines why global and regional alignments come with various benefits for 1P vendors: they enable a better understanding of the bottom-line performance across regions and elevate a vendor's position in their trade negotiations with Amazon regarding the introduction of cost-saving initiatives.

For example: while local rate cards to launch supply chain programs come at hefty price tags, these start to decrease when discussing them at a regional level. This is because the underlying economies of scale become more attractive for Amazon when rolled out across multiple markets.

The conclusion for vendors who want to successfully improve their Amazon margins in future trade negotiations is simple but not easy to implement:

They must align their commercial ambitions at regional and often even global levels to ensure they can take advantage of these cost-saving opportunities with Amazon. This requires them to leave behind their single market negotiating standards and elevate them to at least the regional level.



Get in touch

Want clear advice on how to increase your vendor margins with Amazon? Then we should talk!

Consulterce offers industry-leading negotiation trainings and consultancy services that have helped thousands of decision-makers increase their vendor margins with Amazon.

About the author

Martin Heubel is a strategy consultant based in London, UK. As a former Senior Manager at Amazon, he has led several FMCG categories and helped companies like Nestlé, PepsiCo, and Mars to successfully sell online.

After five years at Amazon, Martin transitioned into his role as an independent consultant. His consultancy firm Consulterce works with 1P vendors across Europe & North America and provides tailored advice for brands seeking to elevate their Amazon margins to profitable levels.

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