Revised Second Edition

The Amazon Way

14 Leadership Principles Behind the World's Most Disruptive Company

John Rossman

Foreword by Terry Jones, Founder of Travelocity and Founding Chairman of Kayak.com

"In *The Amazon Way*, John Rossman brilliantly illuminates Amazon's secretive corporate culture, using a rare insider's perspective to show how Jeff Bezos has created an unique set of systems that facilitate good decision making at all levels of his company."

— Brad Stone, author, "The Everything Store: Jeff Bezos and the Age of Amazon"

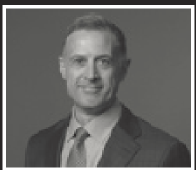
In the beginning, there was an online bookseller—and a visionary founder who dreamed of making it into so much more.

Now Amazon.com has conquered the world of online shopping, placing tens of millions of items at customers' fingertips, revolutionizing the personal reading device, and transforming one industry after another.

The company's secret? A customer-centric management style—along with fourteen leadership principles that represent the heart and soul of its business practices.

Having helped lead the iconic Internet retailer during its formative years, management consultant John Rossman now reveals the principles that drive Amazon's innovative culture, showing how the same principles can help any business seize the competitive advantage.

Along the way, you'll experience an authentic, often humorous, first-hand look at the inner workings of one of the world's most successful companies as it grew from simple bookseller to the game-changer it is today.



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1. Obsess Over the Customer

Leaders at Amazon start with the customer and work backwards, seeking continually to earn and keep the customer's trust. Although leaders pay attention to their competitors, they obsess over their customers.

Jeff Bezos's customer obsession is really something beyond a mere obsession—it's a psychosis that has generated many of his most vitriolic tirades or, more often, sarcastic comments directed at Amazon associates who have fallen short of his own standard for customer service. It stems from Jeff's unique ability to put himself in the customer's position, deduce his or her unspoken needs and wants, and then develop a system that will meet those needs and wants better than anyone else has ever done.

This approach to business is at the core of Jeff's genius. Long before social media revolutionized the retail world with its vast, transparent networks linking companies, customers, prospects, and detractors; long before companies like Zappos.com made customer service the foundation of their business model; and even long before Jeff had fully realized his own vision for Amazon.com, he had profoundly internalized two truths about customer service:

- When a company makes a customer unhappy, that customer won't tell a friend or two or three… he or she will tell many, many more; and
- The best customer service is *no* customer service—because the best experience happens when the customer never has to ask for help at all.

Of course, an actual business model that doesn't require *any* customer service is about as realistic as a perpetual-motion machine. But very early in the Internet revolution, Jeff saw that the online-retail model raised the bar of what was possible. He long recognized that the biggest threat to the customer experience was human beings getting involved and mucking things up. The logical corollary was that the key to creating the most pleasant, frictionless customer experience possible was minimizing human involvement through process innovation and technology.

(Of course, Amazon still needs human beings. Throughout this book, I will discuss the techniques Jeff developed to help him hire, evaluate, and retain the very best talent in the world. But Amazon's goal has always been to minimize the time and energy its talented people must spend on routine service interactions, freeing them to innovate new ways to delight the customer.)

Jeff's insight led to some counterintuitive tactics. Back in the late 1990s, Amazon.com made it intentionally difficult for customers to find the customer service number, which confused some observers who thought this reflected an attitude of disdain for customers. But those customers quickly realized that Jeff's engineers had created a robust technology that enabled them to deal with their service requests almost instantaneously with no human intervention. This wasn't as difficult as it might sound. After all, 98 percent of all

customer questions at a retailer like Amazon boils down to, "Where is my stuff?" An online tracking tool that lets the customer follow a shipment from the warehouse to his or her front door eliminates the need for a large, costly call center and the vast amounts of organizational friction it generates.

Jeff believed that people don't actually like to talk to customer service representatives. He was right. All he had to do was provide the data and tools and retrain customers to answer their own questions. Now customers have come to expect and demand effortless self-service customer care technology, a concept explained by Bill Price and David Jaffe in their 2008 book, *The Best Service is No Service*: the more frictionless the experience, the more loyal the customer, and the lower the control costs. And this includes marketing and advertising costs. Price and Jaffe explain, "Amazon has enjoyed a 90 percent reduction in its CPO [contacts per order], meaning that it could keep customer care costs (head count and associated operational expenses) flat with a 9x increase in orders (revenues), a major contributor to the company's profitability beginning in 2002."[1]

The best customer service *just works*, without effort—producing incredible benefits both for customers and for the company that serves them. Take, for example, Amazon.com's revolutionary free shipping program, launched in November, 2000. It was originally called the "Free Super Saver Shipping Offer" and was good only for orders over one hundred dollars. Instead of paying for advertising, Amazon.com pumped its money into free shipping, which resulted in customer-driven word of mouth, the world's most effective (and cheapest) form of advertising. This created a virtuous cycle: by sacrificing short-term financials for customer benefit, the strategy drove long-term competitive and financial benefits. "In the old world, you devoted 30 percent of your time to building a great service and 70 percent of your time to shouting about it," Jeff explained. "In the new world, that inverts."[2]

At the time, free shipping seemed like a wildly radical and risky strategy. Now customers expect it. In fact, most people assume that companies will pay for return shipping as well—just one of the ways Amazon has raised the bar on customer service for countless businesses.

The Virtuous Cycle Goes Fractal: The Flywheel Effect

Allen Mandelbrot founded the field of fractal mathematics, which studies (among other phenomena) how patterns in nature have a tendency to repeat themselves at different scales—for example, the way spiral galaxies resemble whorling seashells, which in turn resemble tiny unfurling fern fronds. In a similar fractal fashion, the virtuous cycle is replicated throughout Amazon.com at macro and micro levels. It generates a set of self-reinforcing energies that continue to flow even when the energy source is discontinuous—much like a flywheel, which is the favorite metaphor for this phenomenon at Amazon.com.

Here's a macro example of how the flywheel effect works (see Figure 1.1). Jeff doesn't focus on margins. He's more focused on free cash flow—that is, the cash that a company is able to generate after laying out the money required to maintain or expand its asset base. Why? Because he believes the Internet's potential for growth is gargantuan and still fundamentally unexploited. To Jeff, the year is 1889, and the

Oklahoma Land Rush is on—or, as he likes to put it, it's still Day 1 of the Internet. So he's ready to slash prices and create programs like free shipping to cultivate customer loyalty and drive sales growth toward the unimaginable heights he foresees. Then he invests the revenue generated back into "the holy trinity": price, selection, and availability (more on this later).

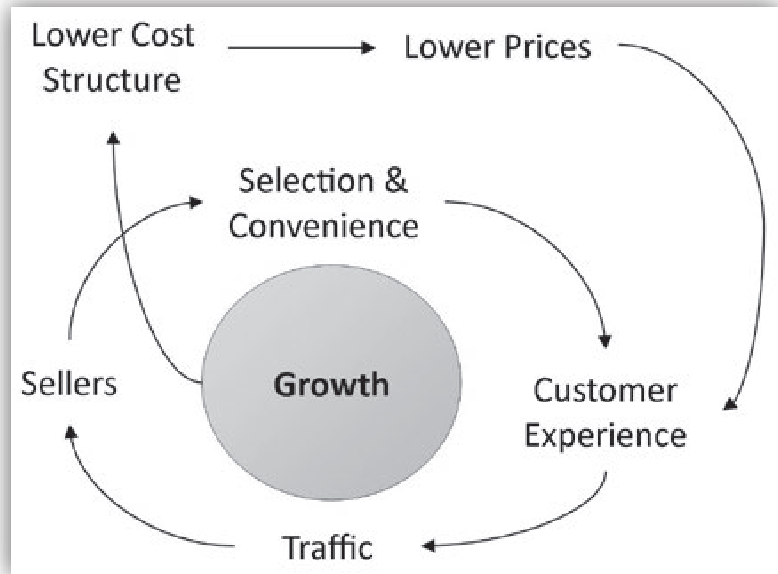

Figure 1.1. The flywheel effect. How an improved customer experience and customer growth feed each other in a virtuous cycle.

Sometimes, the lever you need to pull in order to create the flywheel effect can be sticky and difficult to budge. The effort involved can be costly, even painful. Jeff and the company's stockholders had to be willing to sacrifice a lot at the very beginning, so long as the customer experience was the primary beneficiary. Not every CEO has the stomach this requires. But Jeff's readiness to pay the price has produced much of Amazon's success.

In July, 1999, Jeff decided to move Amazon into the electronics business. The company was making a lot of money on book sales, but he knew that the push into electronics would be the first big step into a limitless world of new markets. Critics doubted it would work. Many said that customers needed to physically see and touch the equipment in a showroom and learn how to operate it with help from trained professionals. These critics—including many at leading manufacturers like Sony, as well as analysts on Wall Street—needed to be convinced that Amazon.com was capable of selling electronics at a high volume and as an "Everyday Low Price" leader. Until they were won over, Amazon's electronics business would face tough sledding, including a cost structure much too high for the modest sales it would initially generate.

Many retailers aren't willing to operate in the red for a while. Jeff was. And although it was ugly for a number of quarters (seemingly validating the warnings of the doubters on Wall Street), by providing enough information and a frictionless return process, Amazon.com eventually built the type of volume that convinced the vendors and big-name manufacturers that people would buy complicated technology online. Jeff had wagered that his customers were intelligent enough to figure out electronics on their own—and he had won.

Once that flywheel was engaged, the energy generated was huge. Amazon.com's success in the electronics market kicked off a virtuous cycle of expanding e-commerce markets that continues to spin to this day.

The Holy Trinity

Amazon.com's strategy includes great pricing on virtually every product it sells. But the strategy is not just about price. A wide selection and fast, convenient availability with great delivery and service are equally critical elements of long-term customer needs. Price, selection, and availability…these are the three durable and universal customer desires that Amazon thinks of as its holy trinity.

Offer everything, get it cheaper, and make it more easily available. Fashions, tastes, product types, and form factors change, but the holy trinity won't. That's why Jeff Bezos embraced this strategy from the earliest days of Amazon. Here's an excerpt from his very first letter to Amazon's shareholders in 1997:

> From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to-search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click(SM) shopping, and vastly more reviews, content, browsing options, and

> recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and word of mouth have combined to make Amazon.com the market leader in online bookselling.[3]

Price, selection, and availability—all the elements of the holy trinity are there. Incidentally, Jeff has attached this original 1997 shareholder letter to the back of every shareholder letter he has written since. And he repeats the same mantra every chance he gets. In 2004, I accompanied Jeff when he gave a talk to the leadership team at Target, the large retailer. Jeff's message: he could never imagine a day when the customer would want higher prices, less selection, or a more complex and difficult transaction process. The holy trinity is eternal and must never be forgotten.

Let's take a closer look at the three elements of the holy trinity and consider how Amazon has built its business around each one.

Price. Amazon's low-price strategy is well documented. For nearly two decades, Jeff has proven that he is willing to make less on an item—or an entire line of products—in the short term to guarantee the long-term growth of the business. Yet Jeff's obsession with pricing knows no bounds. Here's an example:

During my years at Amazon, everyone understood that our goal was to be an Everyday Low Price leader. To do that, we had to make sure our prices matched those of our image competitors—Walmart, Best Buy, and Target. During one S-Team meeting, someone opined, "If the retailer with the lowest price doesn't have the item in stock, then we shouldn't match price. Why bleed the margin for no reason?"

Jeff immediately objected, pointing out how this might backfire. If customers saw that our price was higher, they'd grudgingly buy an item unavailable elsewhere—but the transaction would leave a bitter taste in their mouth that they would associate with Amazon.com. Jeff rejected the idea of protecting our profit margin, emphasizing that what really mattered was what customers were thinking.

Of course, a low-margin pricing strategy is constantly under siege. Most recently, the pressure has been coming from some very unlikely competitors—brick-and-mortar retailers. An analyst for BB&T Capital Markets made waves in the media when he reported that the prices charged by retailer Bed Bath & Beyond on a representative "basket" of thirty items had fallen from 9 percent higher than those charged by Amazon (in early 2012) to 6.5 percent lower than Amazon's (as of August 2013).[4] Other traditional retailers, such as Best Buy, are offering guarantees to match Amazon's pricing. Thanks to factors such as falling real estate prices, the gradual leveling of the sales tax playing field between online and offline retailers, and the greater leeway to reduce prices among old-school merchants with healthy profit margins (like those currently enjoyed by Bed Bath & Beyond), Amazon's once-huge price advantage over brick-and-mortar retailers is fading. How Amazon will respond to this intensified competition is one of the big questions for the company's future.

Selection. From the beginning, Jeff Bezos's goal was to make Amazon a source for virtually anything a customer might want to buy, starting with an unmatched assortment of books and other media products and then expanded to include a practically unlimited array of goods.

Of course, trying to become "the everything store" (as described in the title of Brad Stone's excellent 2013 book about Amazon's history) is far from easy. When Jeff couldn't figure out how to organically scale Amazon.com to provide the vast assortment of products he envisioned, the idea of the third-party marketplace was formed. The world was full of people already selling everything under the sun. Jeff hired me to figure out a way to cohabitate with them under the umbrella of the Amazon.com brand (see chapter 7, "Think Big"). Long story short, we eventually figured out how to sell everything without carrying a huge load of inventory or the risk that goes with it.

Today, the scale at which Amazon.com operates is nearly infinite, providing a richness and variety of customer experience that would have seemed impossible a few years ago. What are you looking for? Uranium? Check. A fresh, whole rabbit? Sure. Bacon-shaped Band-Aids? Roger that. If you can imagine it, chances are it can be purchased on Amazon.com. And the more out-of-the-ordinary products customers discover when they browse Amazon's site, the more they make it their default location for any shopping they want to do, making the flywheel spin even faster.

Availability. Any time Amazon takes a customer's order, it offers a projected arrival time for the package using the Amazon-speak term, "the Promise." Why the heavy language? Because Jeff knows that in business, there are heavy consequences for those who don't have an item or can't get it to a customer quickly. Woe to those who fail to honor any element of the holy trinity—including convenient, timely availability.

One year, we ordered four thousand pink iPods from Apple for Christmas. In mid-November, an Apple rep contacted us to say, "Problem—we can't make Christmas delivery. They're transitioning from a disk drive to a hard-drive memory in the iPods, and they don't want to make any more using the old technology. Once we get the new ones made, we'll get you your four thousand. But it won't be in time for the holiday."

Other retailers would have simply apologized to their customers for the failure to deliver a product on time. That wasn't going to fly at Amazon.com. We were not the kind of company that ruined people's Christmases because of a lack of availability—not under any circumstances. So we went out and bought four thousand pink iPods *at retail* and had them all shipped to our Union Street office. Then we hand-sorted them, repacked them, and shipped them to the warehouse to be packaged and sent to our customers. It killed our margins on those iPods, but it enabled us to keep our promise to our customers.

During the next weekly business review, we had to explain to Jeff what we were doing and why. He just nodded approvingly and said, "I hope you'll get in touch with Apple and try to get our money back from the bastards." Ultimately, Apple did grudgingly split the cost difference with us. But even if they hadn't, it still would have been the right thing for Amazon to do.

Serving the Customer: The Andon Cord

The Andon Cord is not a unique Amazon concept; it is an idea borrowed from Japanese lean manufacturing. My Amazon colleague, Clifford Cancelosi, was in the room when the concept was originally adapted for use at Amazon. It's a lean manufacturing principle most famously used in car manufacturing. Say you're working in a busy Toyota assembly plant, and you notice that the widget you're installing doesn't fit or is broken. You immediately reach up and pull the Andon Cord, stopping the assembly line and forcing an inspection so that the defect can be ferreted out quickly. As consultant Todd Wangsgard explains, "The andon cord is literally a cord that workers can pull—a cord they should pull—any time something in the manufacturing process goes wrong that would compromise the quality of the product or safety of the people. The line stops immediately."[5]

The Amazon version of the Andon Cord started with a conversation about a customer care problem during a weekly business review. The issue centered on the way mistakes made by one set of employees—those working in the retail group—were creating headaches for a different set—those in the customer care department. "When the people in the retail group don't provide the right data for the customer, or enter a product description that's inaccurate," the head of customer care explained, "the customer is disappointed with the purchase. And that means they call customer care, which lands us with the hassle of refunding the product."

We discussed the problem and left the folks in the retail group with some action items intended to fix it. But a couple of weeks later, customers reported that nothing had improved.

Frustrated, the customer care group took matters into their own hands, creating their own version of the Andon Cord. When customers began complaining about a problem with a product, customer care simply took that product down

from the website and sent a message to the retail group that said, in effect, "Fix the defect, or you can't sell this product." Needless to say, in the world of retail, halting the sale of a product is a pretty disruptive step—the equivalent of shutting down an automotive assembly line. Yet Jeff was adamant about supporting the system. "If you retail guys can't get it right, you deserve to be punished," he declared.

The story of the Andon Cord underscores yet again the obsession with the customer that permeates Amazon. But it also illustrates the importance—and the challenge—of thinking about *internal* customers. When I was tasked with launching the third-party marketplace, I found it very difficult to get our internal people to think about the third-party sellers with the same amount of passion as shown for shoppers. But for my group, these third-party sellers were customers who deserved to be treated with the same reverence as our website shoppers. The Andon Cord is one way to force people to pay attention to the needs of their internal or external customers—by literally shutting down the business until those needs are met.

Amazon literally has a job titled "Senior Product Manager, Andon Cord"; the employee's role is to build cross-organizational process and systems that detect and "pull the Andon Cord" when defects occur. It's a form of real-time instrumentation to detect errors and force teams to fix them.[6]

The Voice of the Customer as a Driver of Innovation

In the early days of Amazon, Jeff Bezos would bring an empty chair into meetings as a constant reminder to his team that the customer, even though he or she might not be physically present in the room, still needed to be constantly acknowledged and heard. But Amazon also takes unusual steps to ensure that the literal voice of the customer is heard throughout the organization. The goal is to ensure that customer feedback is used to identify, examine, and fix root problems in Amazon's operations. Jeff requires all of his managers to attend two days of call-center training each year. In fact, if you dial in to the call center on just the right day, you may even get Jeff himself on the line. In theory, the resulting sense of understanding and empathy for the customer trickles up into the highest echelons of the organization.

Of course, in the age of blogs, tweets, and Facebook posts, a single customer complaint that goes viral can have a devastating impact. So Jeff has invested millions to construct systems that monitor the online feedback Amazon.com receives from its customers. For example, during my time heading up the third-party marketplace, we established an internal e-mail system that facilitates and monitors conversations with customers and retailers, uses metrics to track customer complaints about third-party retailers, and implements a fulfillment capability (Fulfillment by Amazon), which lets merchants easily leverage Amazon.com's distribution channels.

Jeff's shareholder letter dated April, 2013, described another example of how the customer experience drives innovation at Amazon:

> We build automated systems that look for occasions when we've provided a customer experience that isn't up to our standards, and those systems then proactively refund customers. One industry observer recently received an automated email from us that said, "We noticed that you experienced poor video playback while watching the following rental on Amazon Video On Demand: Casablanca. We're sorry for the inconvenience and have issued you a refund for the following amount: $2.99. We hope to see you again soon." Surprised by the proactive refund, he ended up writing about the experience: "Amazon 'noticed that I experienced poor video playback…' And they decided to give me a refund because of that? Wow…Talk about putting customers first."[7]

The history of the company is studded with innovative triumphs driven by customer obsession. Pushing the publishing industry to make books available electronically provided readers with instant gratification at lower prices. Providing unlimited next-day delivery (the Amazon Prime loyalty program) for seventy-nine dollars (now ninety-nine) a year drove revenue by drastically reducing the friction involved in online shopping. And Amazon Web Services, the category leader and chief innovator in the field of cloud computing, was based on the idea of offering business customers the same sophisticated online infrastructure technology that Amazon has developed for itself.

Here is a closer look at some of Amazon's biggest customer-driven innovation hits:

Look Inside the Book.™ In 2001, Amazon.com launched this program based on a simple concept—the idea of emulating the bookstore experience by allowing Amazon.com surfers to look at pages inside the book before buying.

Of course, this required Amazon.com to house book content in online form on the site, which raised some questions about whether this would expose book content to piracy. Publishers were worried and skeptical. The program would also be very costly. Each book would have to be scanned digitally and indexed, a huge logistical challenge.

Jeff gave the go-ahead for a large-scale launch, recognizing that this was the only way to see whether it would go over with Amazon's forty-three million active customer accounts.[8] The feature debuted with an astonishing 120,000-plus books. The database took up twenty terabytes, which was about twenty times larger than the biggest database that existed anywhere when Amazon.com was founded.

David Risher was Amazon.com's first vice president of product and store development, responsible for growing the company's revenue from $16 million to over $4 billion. He described the strategy behind the launch of Look Inside the Book this way: "If we had tried it in a tentative way on a small number of books, say 1,000 or 2,000, it wouldn't have gotten the PR and the customers' perception. There's an X factor: What will it look like in scale? It's a big investment, and a big opportunity cost. There's a leap of faith. Jeff is willing to take those gambles."[9] Ultimately, the publishers embraced the Look Inside the Book program as an asset to sales.

Amazon Prime. Though many people think of Amazon Prime as a shipping program, it's really a very clever loyalty program. When we were coming up with this concept, Jeff referenced airline credit cards—how you never feel like

you're being rewarded when you're using one. He wanted to create a loyalty program that provided very tangible benefits. With Prime, the customer is very clear on how they're being rewarded for shopping with Amazon. The benefits started with free two-day shipping; now members also receive monthly e-book rentals on Kindle devices and can stream selected movies and television shows for no extra charge beyond Prime membership annual fees.

Since its inception in February 2005, Amazon Prime has become an increasingly important part of Amazon.com's broader strategy to retain customers and get them to spend more time and money on its services and products. Because they pay ninety-nine dollars per year to join, Amazon Prime members use the service more frequently. And Amazon Prime continues to up customer expectation: Prime Now offers 2 hour delivery in major urban areas.

In the end, Amazon.com's strategy for remaining the world's most customer-focused retail company in the years to come leans heavily on another leadership principle: a bias for action (see chapter 8). Rarely do you find Jeff Bezos reacting to a competitor's initiative. In his mind, it's preferable to launch a new innovation based on customer needs and experience and force your competitors to react—even if that innovation struggles or fails.

"If you're competitor-focused, you have to wait until there is a competitor doing something," Jeff explains. "Being customer-focused allows you to be more pioneering."[10]

Or, as he put it in a 2009 *Fast Company* interview: "There are two ways to extend a business. Take inventory of what you're good at and extend out from your skills. Or determine what your customers need and work backward, even if it requires learning new skills."[11]