

Amazon Challenges Distribution Model With New Initiative

Have some sympathy for the OEM factory operators who build instruments and electronic products for Western brand owners and distributors. Theirs is a precarious existence. Customers continually pressure them for better pricing and terms, and it's not uncommon for them to lose half their business in a single stroke when they get outbid on a contract for as little as a dollar a unit. Is it any surprise then that they all covet the stability and extra margin points that come with owning a recognizable brand and having control over distribution? Few Chinese OEM factories actually have the ability to turn these aspirations into reality. Most lack the skill or resources to support a sustained brand building effort. Their narrow profit margins also preclude them from making the investments in inventory, people, and facilities required to build out a global distribution network. However, the pervasive Amazon is trying to help them overcome these hurdles with a new direct-to-consumer initiative.

Amazon scrapped efforts a year ago to develop a Chinese retail business after being boxed out of the market by Alibaba, China's dominant online player. Instead, it turned its attention to legions of Chinese manufacturers, offering them a platform for selling their wares in North America, Europe, and other developed markets. According to reporting in *The Wall Street Journal*, Amazon sales reps aggressively pitched manufacturers on the benefits of presenting their products on the Amazon website and using Amazon logistical prowess to get their goods into the hands of foreign customers, effectively cutting out the middleman.

No one knows exactly how successful this effort has been, given that Amazon is notoriously stingy in its financial reporting. However, if product listings are any guide, a number of Chinese music factories have apparently signed on. In addition to most familiar brand names, the Amazon site now lists hundreds of music products apparently available nowhere else: Donner, Bailando, and Grote guitars; Mahogany, EverJoy, and Hala ukes; Plixio and RockJam keyboards; Kliq tuners and accessories; and Cahaya gig bags are just a sampling. The volume of customer reviews—if they can be trusted as authentic—suggests a reasonable level of sell-through. A \$23 Kliq tuner received 3,354 customer reviews and earned 4.5 stars out of a possible five. A Donner power supply for effects pedals with a \$35 price tag secured 1,115 customer reviews and also had a 4.5-star rating. Other products didn't fare as well, like the Hamzer 61-note keyboard, retail price of \$67, that had only two customer reviews and a 2-star rating. However, most of these Amazon exclusives carry a 4.5-star rating.

Amazon's effort to serve as the de facto global distributor for

a legion of Chinese manufacturers in and out of the music industry hasn't been without problems. Selling foodstuffs, drugs, and cosmetics that don't meet safety standards has sparked the ire of U.S. and European regulatory agencies. A xylophone kit for preschoolers that had paint with excessive lead levels was flagged by the Consumer Protection Agency and even triggered a Congressional hearing. Nike went so far as stop selling on Amazon directly. The leading athletic wear manufacturer issued an anodyne official statement, citing the need to build out its own direct sales effort. However, former executives and online consultants say the decision was prompted by the presence of counterfeit Nike goods on the site and the clutter of off-brand products that created what one referred to as a "sub-optimal consumer experience."

The long-term success of Amazon's export initiative remains to be seen. We suspect that a large number of buyers will happily forgo no-name goods and pay the 10-15% premium to buy a product graced with a well-known brand name. When



confronted with Amazon's notoriously hardball tactics—premium pricing for positive search placements, penalties for late or incomplete shipments, and endless demands for better terms and pricing—some of these Chinese manufacturers could very well decide that life was easier with the middleman. As more than one observer has noted, "you can eliminate the distributor, but you can't eliminate the cost of distribution."

Mass merchants dabbling in music products are nothing new. Sears & Roebuck was at it over a century ago, and Walmart tried it with limited success a decade ago. However, anything Amazon does has a far-reaching impact: The company controls approximately 40% of all online retail sales. For m.i. retailers, it means additional competition at low-end price points, particularly during the fourth quarter. Amazon's seamless customer interface is a powerful draw for time-strapped parents. When industry suppliers do their annual competitive analysis, they'll no doubt have to include a few extra columns on their spreadsheets to account for these Amazon exclusives. Long term, though, Amazon will probably run into the same problems that hampered other mass merchants: namely the costs of slow-turning inventory, a high SKU count, warranty issues, and after-sale service. Whether they're borne by Amazon, or pushed back to the Chinese factories, they can't be avoided. Time will tell.

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