What Happens Next – Sunday April 25, 2021
Reinventing Business, Liberty and Rights, Sex and Drugs in NYC, Xerox PARC and Bell Labs
Sunil Gupta QA

Larry Bernstein:
I want to start out with a competitor of Amazon and try to think about what they did right and what they did wrong. I think the precursor to Amazon was Sears, a broad-based retailer that was able to touch lots of customers. It innovated from a catalog to retail stores, and it started offering all sorts of interesting products. They offered the Discovery credit card. They created Allstate Insurance. They created an auto repair shop. They were revolutionary with Allstate for auto insurance, and they came up with the Sears credit card. Yet Sears is bust or close to bust. When you compare Amazon and Sears as they sort of develop products, why was Sears a failure, why is Amazon a relative success, and is it a matter of time before Amazon falls into the Sears death spiral?

Sunil Gupta:
So I think that's an excellent question, and I would say that Sears leveraged its existing customer base to offer new products. So once I have a large customer base, and by the way, Walmart is doing the same thing. "Once I have this large customer base, I can offer healthcare. I can offer banking. I can offer lots of other services." That's perfectly fine, but they're still using existing technology, existing capabilities to do that. All you're doing is leveraging the large customer base, and you're hoping that this becomes a one-stop shop for all the products that you're offering. What Amazon is also doing in addition to that is sort of understanding customers where the customers are moving.

So, for example, it's saying that, look, one of the biggest challenges for customers in the offline world is the pain that they face when they are standing in line to pay. That's why it leveraged its existing technology to develop completely new stores, the Go stores. So I think part of the difference is Amazon is not standing still, using the same model that has served it well in the last 25 years, which I believe Sears did the same thing, the same store, the same catalog, the same system, and it didn't change that in the 25 years. But having said that, I think that fear still exists for Amazon, but it becomes so big in the existing technology base that tomorrow a completely different world comes, and it might be very hard for Amazon to cope.

Larry Bernstein:
I like the metaphor of razor versus blades and how you applied it across the board. I remember that Warren Buffett used to say he only likes to buy businesses that have a moat, but yours is not moat-like at all. It's sort of like an interesting way, a way of not having to show a profit in one business to capture another. How do you can compare and contrast the razor and blade framework versus the moat model?

Sunil Gupta:
So I think the moat model is the traditional model of differentiation that you're so good at

something, either you have a cost advantage, the standard cost leadership, because I have economies of scale, and therefore my costs are so low that nobody else can compete and that's my moat or I have innovation R&D, so I will innovate at a faster speed or I have such fantastic technology or proprietary technology that nobody else can do it. That's fine and nice, and that's still important. A good product is still important. But the reality is that even if you're Apple and you have the best phone in the world, well, Samsung will catch up at some point in time. It becomes a competition of phone features. So Samsung will have three cameras, and the iPhone will to come up with three cameras. Samsung will put four cameras on the back, and iPhone will have to put four cameras in the back. That is sort of a strategy that doesn't go very far. So I think having good product differentiation is a necessity, but not sufficient condition to compete in this world.

Larry Bernstein:
We're going to be talking about Apple later in the show as it relates to Xerox PARC. But when you think about Apple's razor versus blades;I can see now that they're caught in an arms race, but how do they break through to crush music, phone or computer competitors? What was their product offering that made it more razor-like?

Sunil Gupta:
So for the longest time, Apple has been focused on devices, right? I mean, a majority of their revenue and profit has been coming from iPhone or MacBooks, et cetera. But now they realize that this has a limit. The number of iPhone shipments over time is not going to be the same that it was 10 years ago. So more recently, in the last five to seven years, they have gone heavily into services, so whether it's Apple Music or Apple TV or other things, it's almost like 20 - 25% of their revenue is now coming from services and that is likely to increase. Many of these services, they will offer at a much lower price, because that helps them lock in the customer on the devices as well. The beauty of the razor blade is that you can always change the way you make money. You can make the razor the blade or the blade the razor as the competition changes.

Larry Bernstein:
I want to ask a question about banking. The regulators have been very fearful of allowing industrial firms or call it non-bank regulated firms to engage in banking activity. They've banned Walmart from having its own bank, but you mentioned that Amazon is considering having a banking-like relationship. Can you expand on the threats from the regulatory state to permit Amazon to expand into that sector?

Sunil Gupta:
No, I wasn't suggesting that Amazon will go into banking. I'm saying that hypothetically, if Amazon were to go into banking, that's what they could do. If I were Amazon, I will never go into banking, because I will be more regulated. What I will do is I'll partner with an existing bank, but think about it. If I partner with an existing bank, who owns the customer relationship? It'll be Amazon. So the bank will become the backend. Therefore, the bank becomes a commodity. So the relationship that Amazon will build with its customers that they can provide

other services will make it difficult for the other players to compete in the marketplace, and that was the point. I don't think Amazon will ... or at least as far as I know has any reason to go into banking right now.

Larry Bernstein:
We had a panel on antitrust, and they focused on several of the names that you listed today, Amazon, Facebook, and Google. There's a fear of big tech. As big tech applies the razor and the blades and building and strengthening social networks, there behavior seems both to anger and frustrate the regulators. Is that just inherent in the business model, and is that going to be problematic for big tech if it accelerates?

Sunil Gupta:
No. I think that the challenge is if you look at the typical antitrust policies that have been designed for the last century, they're based on two fundamental principles. One is do the companies do harm to consumers if they become too dominant in terms of raising prices, for example, and the other is do they have a large share of a particular industry? A large share, maybe it could be 30% or 40%. So that's the definition of dominance in the industry, and that may be true, for example, for Google, because Google has a dominant share in the digital advertising business or Facebook in the social network.

But I think it becomes fuzzier in the case of a company like Amazon, because Amazon is in so many industries, it's very hard to define what business it is in and share of what industry are you talking about? Share of retailing? It has a very small percentage. Share of online retailing, yes, it has large share, but they can define, "We are in the retailing business," not just online retailing, because of the omni-channel story. Are they in advertising? Are they in movie production?

So I think the first question is the definition of the industry becomes fuzzy, and therefore the traditional antitrust regulators have trouble defining does Amazon have a dominant share in their industry? Because the definition of industry itself is different. The second basic dimension of antitrust is will it harm consumers? Most consumers love Amazon, because they can get anything they want conveniently, usually in a day or so, at a much lower price. So what's not to like? So I think it feels like Amazon is becoming dominant and it's actually hurting some businesses, but on the other hand, the traditional two dimensions that antitrust looks at, Amazon seems slipping through that criteria.

Larry Bernstein:
So you don't think that the regulators will simply change the rules of the antitrust by changing the You're right. They're not harming customers. They're making it better. Amazon’s retail market share is not that large, and Amazon’s growth is not fueled by acquisitions, but Amazon’s market power seems to anger and frustrate the progressive antitrust movement who want to go after Facebook, Google and Amazon.

Sunil Gupta:. I think Facebook and Google are in worse shape, because they have a dominant

share of their respective industry. Amazon, because the industry is less well-defined, it becomes a little bit more difficult for the regulators. Some of the small sellers are complaining about Amazon and fear future competition. That marketplace behavior might be considered anti-competitive, because it's basically hurting the small merchants. Amazon many times offers its own private label brands after doing market research to see which products will do well and then Amazon ends up selling its own product. Now, it might get into this trouble if it's using merchants' data to launch its own businesses and compete with them, and I think that has been in the discussion to some extent.

Larry Bernstein:
I want to ask about vertical versus horizontal integration. When I went to business school, we were told that the benefits from vertical integration are illusory that it sounds good on paper, but very rarely has the sort of benefits you predict. But horizontal integration is spectacular. It gets rid of a competitor. We're able to generate more market power, and that's where we run into friction with the anti-trust division. In the examples you were giving with Amazon, you were giving extremely broad examples of vertical integration. We weren't looking at movie theaters making movies. We are looking at a retail store making movies. Why do you think that the vertical integration in this bizarre fashion is actually a good idea relative to the historic vertical integrations attempted by others?

Sunil Gupta:
I think the traditional vertical integration is about control, control of the entire supply chain. So if I'm making computers, I start also vertically backward-integrating into making chips or forward-integrating into having stores, and that's for the traditional model. But that's still the same industry, and the hope was by having more control, I will actually have better economies of scale, better experience. To some extent, Apple is doing that, right? It's making his own chip. It has his own stores. It makes its own products, et cetera. But by and large, that gives you more control, but that means that if tomorrow the industry shifts and you are still caught in the same innovation, you will have difficulty moving along with the industry.

Amazon's vertical integration, is very different. It's not in the same industry. It's basically connecting dots across industries. But ultimately, if you ask me as to what are the key capabilities of Amazon that defines what business it will get into or not, I will say it has three core capabilities. One is logistics. It's very, very good at logistics, as good or better than Federal Express and UPS. It's very good in technology. Clearly, AWS is an example, but it knows lots of other components of the computer vision of AI or others. The third is it's very good and obsessed with customer focus, both in terms of culture as well as in terms of leveraging data to understand customer preferences. So anything that touches these three things, it will actually get into. Now, you call it vertical integration, but I don't see this the same way as we thought of vertical integration back in the eighties and nineties.

Larry Bernstein:
Then let's go back to the 1910s to 1920s, 1930s for Sears. So Sears goes from a catalog. It goes to a retail store, and not only the retail store. It says, "My God, they're getting here by car. We

should really create an auto center." Then when they had an auto center, they said, "Oh, we should probably create our own batteries, Diehard. We should probably offer our tool sets in Craftsman, and then they should sell their own dishwashers called Kenmore. Then they started offering auto insurance and were able to mass market auto insurance. Is that the sort of vertical integration that reminds you of Amazon and when Sears was being successful, and when Sears stopped doing that, it was a big problem?

Sunil Gupta:
I think your analogy of Sears is very apt. In some ways, you can say Amazon is the new Sears, in some ways. It may face the same fate as Sears did. But I think Sears could have been the new Amazon, because it had all the underpinnings of a great, successful business model for a very long time. But the Internet changed the fundamentals of the business for Sears, and it still remained a retail business. If it had changed the way Amazon changed, it could have been the Amazon. So, again, I mean, in all fairness, we are drawing an analogy from one data point in both the cases of Amazon as well as Sears. But I think what I'm trying to understand is are the principles Amazon applied beyond just Amazon?

So take the example of razor and blade. So I'm on the board of this company called US Food, which is a large food distributor, and we started thinking about, "How do we apply the razor blade analogy to a food distributor like US Foods?" This company distributes food to small, independent restaurants, like mom and pop restaurant owners. Traditionally, the way the company has been and still sells its product is I go to a restaurant and say, "My fish is better" or "My fish is cheaper." Make it better or cheaper, the traditional strategy and paradigm. Guess what the competition does? The competition does the same thing. They come and say, "Hey, my fish is better" or "My fish is cheaper." Very soon, the quality of fish is the same, and over time, it becomes a price competition and becomes a commodity. That happens to every industry.

So we started saying, "Hey, what might be the razor for our industry?" Now, it sounds strange. What do you mean, razor for a fish? But then the best way to think about this is put yourself in the shoes of a customer. Forget about your product for a while. So if you were to put yourself in the shoes of an independent restaurant owner and ask yourself, "What keeps this restaurant owner up at night?”70% of restaurants go out of business every year. This is pre-COVID, and that's because these restaurant owners, they love food, they love to cook, but they don't know how to run a business. They don't know how to manage their finances. They don't know how to manage labor. They don't know how to generate traffic. They don't know how to manage inventory, and that's the real problem, not the price of fish.

The moment we realized that, we started offering software services to these restaurants, many produced by the company and some others licensed from third-party. Third-party providers provided a subsidized discount. Now, that's the razor which US Food can offer these restaurants, solving a fundamental problem, and the moment I do that, the conversation shifts on the price of fish, because I'm solving a real problem. So that's a very different way of doing business. Again, I'm using the same analogy of Amazon, but in a very different context.

Larry Bernstein:
Another thing about Amazon which is really unbelievable to me is their willingness to cannibalize one of their own businesses. So, for example, the Amazon Marketplace offers the exact same products that they offer on Amazon, potentially at a cheaper price, by one of their competitors. We didn't see Kodak make the transition between analog and digital, and there was probably resistance internally to doing such. But Amazon seems to be willing to attack themselves in order to expand the pie. Somehow the entrenched bureaucracy that undermined Kodak or AT&T or whoever doesn't exist at Amazon. What makes them special, and why is there no inherency to the existing way of doing business?

Sunil Gupta:
I think it's Jeff Bezos's philosophy of customer first, and he somehow has been able to instill that in the company, even if it means it hurts their other business. So the Prime service is a great example, and there were internal debates when they offered the Prime service, which is two-day free shipping. There was a huge concern that this would eat hugely into the profit of the company. It was very likely that most people who will use the Prime service initially, these were the heavy buyers to begin with who would order tons of products at basically free shipping and would cost the company a ton. But they tested it, because they say, "Hey, this is actually worth testing, because it'll be good for the customers."

So they have done these things again and again which have cut into their business, and I think you have to truly believe that if you serve the customers well, in the long run, it'll pay off. In the short run, it might hurt. Now, I realize it's very hard to do, because in the short run, it will cannibalize your existing business, which is what happened to Kodak and many other places.