Tech Exec Q&A
Amazon Secret Weapon Is Its Experimental Culture

By DOUG TSURUOKA, INVESTOR'S BUSINESS DAILY
Posted 06/25/2013 05:54 PM ET

Chris DeRose is co-author with Noel Tichy of “Judgment on the Front Line,” a new book about how smart companies win by trusting their frontline employees.

DeRose has been a consultant for more than 20 years to CEOs and other top execs of Fortune 500 companies such as Ford Motor (F) and Intel (INTC).

He’s also worked with executives at Amazon.com (AMZN) and says he knows why the No. 1 e-tailer succeeds: a customer-centric culture that lets all employees, from CEO Jeff Bezos on down, test new ideas that better meet customer needs.

DeRose says this was the genesis of Amazon's recent decision to expand its experimental online grocery business to Los Angeles and likely other cities. DeRose recently spoke with IBD about Amazon's experimental culture:

**IBD:** Why do you say that Amazon has a more experimental culture than other companies?

**DeRose:** I think Amazon has a point of view that’s deeply embedded in the company. It will win with the customer by doing a series of small bets that give it insight on how to build that long-term customer relationship. Bezos likes to say he never wants to reach a point where he has to make a “bet the company” situation as a result of failing to be innovative for too long.

Bezos encourages a 5- to 7-year vision. From the outset, he has encouraged employees to think long term, reportedly telling them to think about how they can impact the stock price in five years because nobody can meaningfully affect today's price.

It helps that Bezos owns roughly 19% of the company, so that enables him to resist pressure for short-term profitability. While there's always debate and consternation, investors seem to have accepted that Bezos tries to optimize for long-term growth over today's profitability. Whether they agree with that approach is a different matter.

**IBD:** What else is different about Amazon's innovative tack?

**DeRose:** As Amazon pursues growth through small experiments, they have tried to use data to trump intuition. The company culture embraces experimentation and Bezos recently said at a shareholder meeting that 99% of all innovations at Amazon are incremental. The company relies on “Testing in Production,” or TiP, methods such as A/B testing and ramped deployment. By showing user group “A” a different version of a Web page than group “B,” the company can measure how long they stay on the site, how much they spend, etc.
These are experiments everyone is encouraged to design. It's reportedly part of the employee review process to see what experiments were conducted and what was learned.

Chris DeRose

IBD: How does Amazon carry out such experiments?

DeRose: Before an experiment starts, there has to be a defined customer need that it's addressing and there has to be an ability to measure the change. This reportedly goes back to an epiphany Bezos had in the mid-'90s when he realized the Internet provided the ability to measure customer behavior like never before.

Like most companies, early executives at Amazon tended to argue about things like who should get prime real estate on the website or whether to use TV advertising. After the company committed to an experimental, data-based approach, they began testing these instead of debating them.

Amazon talks about how data trumps HiPPOs — the "Highest Paid Person's Opinion." Instead of letting whoever has the biggest salary or title make decisions, Amazon lets data do the talking so anyone — even the most junior person — can have an idea, measure it, and drive change.

That scalability gives Amazon an incredible advantage. Bezos says that if you double the number of experiments per year, a company can double its inventiveness.

IBD: How do you know about Amazon's experimental process?

DeRose: Primarily because Bezos talks about it publicly and frequently. You can go back to videos of him talking since the 1990s at conferences, to business school audiences, appearances on Charlie Rose — his point of view is clear, simple and consistent. But it's also been verified by many former insiders. For "Judgment on the Frontline," we interviewed Greg Linden. Linden joined Amazon in 1997 and shortly afterward devised an experiment to try the "shopping cart feature," which is now a staple of Amazon. It turned out a marketing vice president was dead-set against Linden's experiment, saying the shopping cart would be a distraction that would reduce sales, and actually forbade him from pursuing it. As Linden told us, it was hard to test ... (but) the results spoke for themselves, and led to such a big sales increase that Amazon rolled it out as quickly as possible.

There are a number of reported tests like this. One, focused on behavior-based search, was instituted by an intern and reportedly led to a 3% revenue increase.

IBD: What was the origin of Amazon's experimental culture?

DeRose: Experimentation is rooted in the customer-centric culture that Amazon has created. They work backward from the customer experience. Bezos has always been extremely sensitive to how everyone in the company impacts the customer experience. For example, early on he would go to the warehouses and talk to employees about how their work was one of the most tangible elements of the customer experience — do customers get the right product, on time. He symbolically leaves an open chair at some meetings to represent the "customer's voice."

The insight that Bezos had was that customer preference didn't need to be subject to opinion or subjective interpretations of focus groups. Experimentation is rooted in a fact-based approach to innovating around building long-term customer relationships.

Bezos talks about the need to be stubborn on vision and yet flexible about the details. According to him, you have to be stubborn enough that you don't give up on an experiment too soon. You also must be flexible enough that you don't keep trying the same thing.
This experimentation bias impacts how it thinks about new businesses. Instead of asking when or to what extent a new business will be (profitable), the senior team at Amazon reportedly first asks whether it will generate at least $10 million in revenue. If the answer is yes, then the idea gets farmed out to an internal team for further development and experimentation.

**IBD**: How does all of this relate to Amazon's rollout of AmazonFresh?

**DeRose**: AmazonFresh launched in Seattle (as a test) in 2007. Now, rather than try to go national based on its single market test, it is moving to one additional city (Los Angeles). My guess is that if Amazon gets confirming data about the impact on customer stickiness, cross-sales opportunities with non-grocery items, etc., it will start to move faster.

Many people see AmazonFresh as the key to same-day or next-day delivery across the board because the company can leverage its infrastructure. Yet in July 2012, the company's CFO said that they didn't see a way to do same-day delivery economically at scale. Whatever has changed internally is certainly the result of experimentation and learning that started in Seattle and will continue in LA.

**IBD**: How does Amazon know that its new Prime Fresh membership — $299 a year for Amazon Prime benefits plus free same-day or early-morning delivery of groceries, among other perks — will generate higher per customer profitability and "stickiness"?

**DeRose**: It's probably making an educated guess. From a capital markets perspective, Amazon isn't exactly a model of transparency, so we don't really know what they know. But we can count on Bezos to make a long-term bet. Something in their data set clearly told them that this was a driver for long-term customer satisfaction.

While Bezos said 99% of Amazon's innovation is incremental, the 1% represents big bets such as Kindle or the initial roll-out of Amazon Prime ($79 a year for free two-day delivery and more), which Bezos said was probably his biggest "gut decision."

**IBD**: Where have Amazon's experiments flopped?

**DeRose**: A9, Auctions, Endless, Amazon Wine Store. The first three were what Bezos calls "me too" ideas — A9 followed Google in search, Auctions followed eBay, and Endless was a shoe idea (that copied online shoe store Zappos, which Amazon later bought). What's interesting is that even in failure, these concepts help Amazon figure out how to improve its business. Auctions was a precursor for third-party sellers. Endless could be seen as a motivation to acquire Zappos.

Getting back to Bezos' point of view, none of these failures was "bet the company."

###