Amazon.com - A Comprehensive Case History

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CASE #1- AMAZON.COM- A BUSINESS HISTORY[1]
TO APPEAR IN-"E-COMMERCE MANAGEMENT: TEXT AND CASES" BY
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Introduction

In many ways, Amazon.com is perhaps the company that is most closely tied with the E-Commerce phenomenon. The Seattle, WA based company has grown from a book seller to a virtual Wal-Mart of the Web selling products as diverse as Music CDs, Cookware, Toys and Games and Tools and Hardware. The company has also grown at a tremendous rate with revenues rising from about $150 million in 1997 to $3.1 billion in 2001. However, the rise in revenue has led to a commensurate increase in operating losses leaving the company with a large deficit. The company did make its first quarterly profit of $5.8 million in the fourth quarter of 2001. But, this was dwarfed by large cumulative losses. Its share price, as shown in Figure 1, is perhaps the biggest symbol of the rise and fall of the dot-coms.

[Insert Figure 1 About Here.]

The purpose of this case is to present a balanced and up-to-date business history of the company.

Background

The story of the formation of Amazon.com is often repeated and is now an urban legend. The company was founded by Jeff Bezos, a computer science and electrical engineering graduate from Princeton University. Bezos had moved to Seattle after resigning as the senior vice-president at D.E.Shaw, a Wall Street investment bank. He did not know much about the Internet. But, he came across a statistic that the Internet was growing at 2300%, which convinced him that this was a large growth opportunity. Not knowing much more, he plunged into the world of E-Commerce with no prior retailing experience[2].

He chose to locate the company in Seattle because it had a large pool of technical talent and since it was close to one of the largest book wholesalers located in Roseburg, Oregon. Clearly, he was thinking of the company as a bookseller at the beginning. Moreover, the sales tax laws for online retailers state that one has to charge sales tax in the state in which one is incorporated. This means that for all transactions from that state the price would be increased by the sales tax rate leading to a competitive disadvantage. Therefore, it was logical to locate in a small state and be uncompetitive on a smaller number of transactions rather than in a big state such as California or New York.

The company went on-line in July 1995. The company went public in May 1997. As a symbol of the company's frugality, Jeff and the first team built desks out of doors and four-by-fours. The company was started in a garage. Ironically, initial business meetings were conducted at a local Barnes and Noble store.

Bezos' first choice for the company name was Cadabra. He quickly dropped this name when a lawyer he contacted mistook it for cadaver. He picked Amazon because it started with the letter A, signified something big and it was easy to spell.

For his contribution, Jeff Bezos was picked as the 1999 Time person of the year at the age of 35 making him the fourth-youngest person of the year. Describing why it choose Bezos, Time magazine said, "Bezos' vision of the online retailing universe was so complete, his Amazon.com site so elegant and appealing that it became from Day One the point of reference for anyone who had anything to sell online"[3].

Vision and Value

Jeff Bezos was one of the few people to understand the special nature of Internet Retailing and E-Commerce. This is how he compares E-Tailing to traditional retailing[4]-

> Look at e-retailing. The key trade that we make is that we trade real estate for technology. Real estate is the key cost of physical retailers. That's why there's the old saw: location, location, location. Real estate gets more expensive every year, and technology gets cheaper every year. And it gets cheaper fast.

There were really two elements to his vision-

1. He wanted to build the world's most customer-centric company
2. He wanted to establish a place where customers could buy anything.

This is how he characterizes his vision of customer-centrism-[5]

> Our goal is to be Earth's most customer-centric company. I will leave it to others to say if we've achieved that. But why? The answer is three things: The first is that customer-centric means figuring out what your customers want by asking them, then figuring out how to give it to them, and then giving it to them. That's the traditional meaning of customer-centric, and we're focused on it. The second is innovating on behalf of customers, figuring

> out what they don't know they want and giving it to them. The third meaning, unique to the Internet, is the idea of personalization: Redecorating the store for each and every individual customer. If we have 10.7 million customers, as we did at the end of the last quarter, then we should have 10.7 million stores.

Interestingly, Amazon.com recently launched a "Your Store" service, thus translating this vision into a reality.

He strived to understand what was unique about the Internet in developing a customer-centric company[6]-

> "In the online world, businesses have the opportunity to develop very deep relationships with customers, both through accepting preferences of customers and then observing their purchase behavior over time, so that you can get that individualized knowledge of the customer and use that individualized knowledge of the customer to accelerate their discovery process. If we can do that, then the customers are going to feel a deep loyalty to us, because we know them so well".

The value elements Amazon.com sought to deliver are illustrated in this Bezos quote[7]-

> "Bill Gates laid it out in a magazine interview. He said, "I buy all my books at Amazon.com because I'm busy and it's convenient. They have a big selection, and they've been reliable." Those are three of our four core value propositions: convenience, selection, service. The only one he left out is price: we are the broadest discounters in the world in any product category. But maybe price isn't so important to Bill Gates".

Some of Bezos' critics have said that the extent of customer-centricism of the company is about the same as any other company. In other words, Bezos has been seen as generating hype and nothing much.

Bezos' vision has been translated into a large customer base and loyalty rate. Amazon.com's customer base has grown rapidly over the past several years. Customer accounts grew from 1.5 million in December 1997 to 24.7 million in December 2001[8]. The percentage of repeat customers increased from 64% in 1998 to 78% in 2000. In the fourth quarter of 2001, Amazon spent $7 to acquire a new customer and the average customer spending was $123.

In addition to customer-centricism, Jeff Bezos wanted Amazon.com to be the place where you could buy anything and everything online. While the company started out as the world's biggest <u>bookstore</u>, it wanted to become the world's biggest <u>store</u> in the long run. The company has made some progress along these lines by expanding into new product categories such as cookware and tools and also providing new services such as Auctions. However, he has conceded that this is a "multi-decade proposition".

Financial Analysis of Amazon.com

The financial statements of Amazon are shown in Tables 1, 2,3 and 4. Table 1 presents the historical income statements of the company, Table 2 provides the historical balance sheets, and Table 3 provides the historical cash flow statements. Table 4 is the segment-level analysis.

[Insert Tables 1, 2, 3 and 4 About Here.]

Few highlights from the financial statements-

- Sales has grown from $147 million in 1997 to about $3.1 billion in 2001. Average growth rate during this period was 141%.
- Gross margin during this period has averaged 21.68%.
- Ratio of marketing expenses to sales revenue has decreased from 16.33% in 1997 to 4.43% in 2001.
- Interest expenses have risen from $326,000 in 1997 to $139 million in the year 2001.
- Loss from operations has increased from $32,595 in 1997 to $412,257 in the year 2001.
- Sales from book, music and video have leveled off. But, this is a very profitable segment. On the other hand, the electronics, tools and kitchen segment is growing rapidly- but it is not very profitable.

Given its diverse set of products and services, it is hard to identify appropriate competitors. BN.com is frequently thought of as a strong competitor in the books, music and video categories. Its operating statement for 1998, 1999 and 2000 are attached in Table 5. Note that the level of sales is much lower than Amazon. Moreover, it spent a much greater percent of its sales on marketing and fulfillment-nearly 42% in the year 2000.

[Insert Table 5 About Here.]

Amazon.com has also been praised for its innovative financing strategy using a convertible bond issue. Prof. Ufuk Ince from the University of Washington, Bothell provides a detailed explanation that is attached as Appendix at the end.

Books- The Entry Point

Amazon.com started out as an online bookseller. Indeed, to some, Amazon.com will always be a bookseller. Selling books on the Internet made sense at many levels.

To Jeff Bezos, the main advantage was selection[9]-

> "Books are incredibly unusual in one respect, and that is that there are more items in the book category than there are items in any other category by far. There are more than 3 million different titles available and active in print worldwide. When you have this huge number of titles, a couple of things start to happen.
>
> First of all, you can use computers to sort, search and organize. Second, you can create a super-valuable customer proposition that can only be done online, and that is selection. There are lots of categories where selection is proven to be important: books, in particular, with the book superstores, but also in home construction materials, with Home Depot, and toys with Toys 'R Us. Online, you can have this vast catalog of millions of titles, whereas in the physical world, the largest physical superstores are only about 175,000 titles, and there are only three that big".

In addition, as a product, books were-

- Easy to ship since they were not bulky.
- Low value item and hence, low risk.
- Informational products making them amenable to selling them via online storefronts using features such as-
  - Sample chapters
  - Table of contents
  - Editorial reviews
  - Customer reviews

Moreover, Amazon.com felt that it could add maximal value given the archaic and inefficient structure of the $23 billion American publishing industry. An overview of the structure of the industry is provided in Exhibit I and II.

[Insert Exhibit I and II About Here.]

The main features of this publishing industry were[10]-

- Concentration at all levels of the supply chain- publishers, printers, wholesalers. The top 10 publishers accounted for 20 percent of the new titles, the top 5 printers represent 40% of the market, the largest wholesaler accounts for 33% of all books shipped.
- No dominant player on the retail side- even No. 1 Barnes & Noble has only about 11% of the U.S. market.
- Publishers guarantee the sale of all books. Retailers could simply return a book if it did not sell in a pre-defined timeframe. As a result, in 1998 return rates of hardcover books were around 32% and those for soft-cover books were about 27%.

- It is a hit and miss business with major fluctuations in sales. Even though publishers incur the fixed costs of book production and editing for all books, only a few are very successful.
- Retailers bear the fixed costs of displaying the product in a brick and mortar location[11].

The traditional nature of the publishing industry is also illustrated in an amusing anecdote provided by Jeff Bezos-

> "The wholesalers had 10-book minimum orders. I tried to negotiate with them and said, "Let us just pay a small fee, and you waive the 10-book order," and so on. But they wouldn't go for it. So we figured out a loophole. It turned out that you just had to place an order for 10 books; you didn't actually have to get 10 books. We found an obscure book on lichens that none of our wholesalers actually carried.
>
> So whenever we wanted to order one book, we ordered the book we wanted, and then nine copies of this lichen book. They would deliver the one that we wanted, along with a very sincere apology about not having been able to fulfill the nine copies of the lichen book order. That worked very well for exercising our systems. I've since talked and joked at length with the people at these companies about this. They actually think it's very funny".

Amazon changed the traditional book publishing industry in the following ways-

- It reduced book return rates from about 30% to 3%. Industry experts estimate about $100 million being spent on returns. Moreover, "A truly efficient supply network, which processed only saleable books, could save over $2 billion - quite an opportunity given that industry profits from the one billion trade books total about $4 billion today"[12]. Reducing this by a factor of 10 can lead to an immensely profitable business.
- It relied on the existing distribution structure, building warehouses only for the top sellers and quick moving items. As a result, its inventory turnaround is much quicker than brick and mortar stores.
- "Physical bookstores must stock up to 160 days' worth of inventory to provide the kind of in-store selection people want. Yet they must pay distributors and publishers 45 to 90 days after they buy the books--so on average, they carry the costs of those books for up to four months. Amazon, by contrast, carries only 15 days' worth of inventory and is paid immediately by credit card. So it gets about a month's use of interest-free money[13]".
- Amazon.com passes on cost savings in the form of price reductions to consumers. Currently Amazon offers 30% of all New York Times bestsellers, for example.

- Amazon "has broken the principle of critical mass for the book market. For the first time, small and independent publishers as well as authors could place their products directly in a (on-line) store with global reach and without investments (except paying for transporting books to Amazon.com's distribution center)"[14].

The main competition to Amazon in this market was from bricks-and-clicks stores such as BN.com(and Barnes and Noble). BN.com, for instance, has noted the following sources of competitive advantage[15]-

- Superior brand recognition of the Barnes & Noble brand name and the security from knowing that this is associated with the 1000 retail bookstores nationwide.
- The use of Barnes & Noble's distribution center enables B&N.com to offer more than 880,000 in-stock book titles for fast delivery, representing the largest standing inventory of any online bookseller.
- The ability to conduct cross-marketing, co-promotion and customer acquisition programs with Bertelsmann's U.S. book clubs and Bertelsmann's Books Online in countries including the United Kingdom, Germany, France, the Netherlands, Italy, Spain, Norway, Sweden, Japan and China which provide B&N.com with: (i) access to millions of established book buyers; (ii) the opportunity to directly promote its online store to this large audience of proven buyers; and (iii) a potential new stream of customers that it will be able to acquire at a significantly lower acquisition cost as compared with customers acquired through other marketing channels.
- Participation in Barnes & Noble's membership loyalty program, Readers' Advantage, which offers discounts and other benefits to members. For a $25 annual membership fee, participating customers receive 10% additional discounts at Barnes & Noble stores and 5% additional discounts at B&N.com. Customer sign-up benefits include a one-year subscription to BOOK(R) magazine and a free canvas tote bag. The program benefits also include invitations to members-only events.

The company also continued the onslaught on independent booksellers. "Small independent bookstores have been pounded by two waves of change over the past decade, reducing their numbers from 6,500 in 1991 to 3,500 in 1998. First, the major chains introduced the category-killer superstores with up to 60,000 square feet of retail space and 175,000 titles in stock. With the addition of coffee shops, they changed book buying from a traditional retail activity to something akin to an intellectual social outing. In July 1995, Amazon.com launched the second wave by allowing consumers to browse 4.5 million titles from the comfort of their own computers[16]".

Independent booksellers responded in two ways[17]-

- In 1999, the American Booksellers Association announced BookSense.com, a Web site allowing customers to order books over the Internet with their local independent bookstore getting a commission on each sale.
- BookSite.com allows small brick-and-mortar bookstores to add an online storefront and with e-commerce tools and Internet ordering to supplement their inventory.

However, it is not clear if either approach has led to a credible threat to Amazon.

The dominance of Amazon in the book market was made abundantly clear by the capitulation of a major competitor, Borders. "In April 2001, Amazon made an astonishing alliance - with rival Borders. For years now the Borders Group has sought in vain to offer a Web site that would compete effectively with Amazon. Borders became a force in book retailing thanks to its superior computerized inventory management system dating back to the 1970s. It never figured out how to translate its computer expertise into an effective Web site. In April, Borders eliminated all staff positions in Borders.com, and announced that Amazon will front-end its online bookselling[18]".

Should Amazon.com have remained a bookstore?

Amazon.com rapidly expanded into a number of products. Here is a timeline for the first few product introductions[19]-

- June 1998: Music
- November 1998: DVD/Video
- July 1999: Toys and electronics
- November 1999: Home improvement, software and video games

Its foray into music was dramatic. "In Amazon's first full quarter selling music CDs, ending last September, it drew $14.4 million in sales, quickly edging out two-year-old cyber-leader CDnow Inc"[20]. However, it is not clear if it could translate such success into products as disparate as cookware and hardware.

The following arguments have been made in <u>favor</u> of rapid diversification-

<u>Cross selling</u>

Amazon wanted to get a greater share of each customer's overall shopping basket. They felt that they had already established a relationship with the customer with books. All that remained was to leverage this trust in persuading consumers to buy everything else from them.

Economies of Scale

From a technology standpoint, the company had already incurred the fixed costs of developing software for the online storefronts. Expanding into other product categories would allow the company to spread these fixed costs across a larger pool of transactions leading to greater profits. As Bezos put it[21]-

> On the Internet, companies are scale businesses, characterized by high fixed costs and relatively low variable costs. You can be two sizes: You can be big, or you can be small. It's very hard to be medium. A lot of medium-sized companies had the financing rug pulled out from under them before they could get big. …
>
> When we open a new category, it's basically the same software. We get to leverage the same customer base, our brand name, and the infrastructure. It's very low-cost for us to open a new category, whereas to have a pure-play single-line store is very expensive. They'll end up spending much more on technology and other fixed costs than we will just because our earlier stores are already covering those costs.

Forever Small

Selling books alone would not catapult Amazon as the leading E-Tailer and a cutting-edge firm. They would forever be constrained by the small market that they operated in. Moving into other product categories allowed them to be thought of as a dominant retailer as opposed to a ho-hum business. The operating statement of BN.com attached in Table 4 can be cited as evidence for this. BN.com chose to focus its energy on the book, music and video markets. As a result, its revenue is much smaller and it may never be as large as Amazon. The data from Table 6 is also consistent with this. We see that visitors to Amazon.com increased from 14 million in March 2000 to 18 million in March 2001. On the other hand, visitors to BN.com decreased from 5.4 million to 4.9 million!

[Insert Table 6 About Here.]

Blessing of Wall Street

Perhaps, the most important reason for Amazon to diversify was that at the time it was a darling of Wall Street. Skeptics were overruled by high-flying optimists who viewed Amazon as the symbol of the new economy and a new way of doing business. As a result, Amazon made the best use of the opportunity.

On the other hand, many arguments have been made against expanding into new product categories-

Brand

Amazon established a relationship with its first customers on the basis of being a bookseller. Redefining this relationship in terms of other product categories is a non-trivial task. A typical customer reaction can be stated as- "Many of us old customers have a hard time thinking of Amazon as a place to buy a set of Polk home theater speakers or a set of Calphalon cookware. For me, the Earth's Biggest Bookstore moniker has occupied a spot in my mind since it began appearing in those tiny bottom-of-page-one advertisements in the New York Times"[22].

New Products Lead To New Challenges

As mentioned earlier, books provided certain unique advantages to Amazon. Moving into new product areas provided new challenges-

- Bulky products- Consider cookware items such as pans, blenders and grills. These items are hard to stock, expensive to ship and return.

- Non-informational products- Books are informational products that lend themselves to features such as reviews and sample chapters. Except Music and Video, all other products Amazon sells are non-informational products that do not have these advantages. As a result, the advantage of selling them online may be limited.

In the consumer electronics business, for example, Amazon.com has not been able to buy directly from leading manufacturers such as Sony, Panasonic and Pioneer. As a result, Amazon is forced to buy products from distributors leaving it with a hefty competitive disadvantage that may be hard to overcome. In addition, selling at prices lower than what the manufacturer wanted strained relationships with such giants as JVC[23].

There are many reasons for this[24]. In the electronics business, manufacturers have a stringent set of requirements on how a retailer will display and sell their products. Only retailers who pass this are pronounced authorized dealers. Authorized dealers get lower prices, money for cooperative advertising and the right to sell warranties. Large manufacturers did not want to jeopardize existing relationships with retailers by selling through Amazon- whom they feared will sell at lower prices. At the same time, some manufacturers wanted to set up their own online stores. For example, Sony sells electronics through sonystyle.com and deals with the online counterparts of established players such as Best Buy and Circuit City.

Moreover, some manufacturers felt that Amazon did not have a long-enough history in the business and were turned off by its string of losses. Amazon may have appeared as too unconventional for them to feel comfortable- e.g. Amazon's reliance on e-mail as the primary customer service tool did not please some manufacturers.

The vital part of this is that electronics represent the fastest growing part of Amazon's business while the book, music and video portions have leveled off. As one analyst from Prudential put it- "It has been our contention that if the most profitable part of Amazon's business is not growing, and the most unprofitable part of its business is growing rapidly, the company will begin to experience economic deterioration".

In the final analysis, the company has showed an inability to grasp the intricacies of some of the businesses it entered into. Interestingly, BN.com did not diversify beyond books, music and videos.

<u>Competition</u>

Amazon.com was the *de facto* first-mover in the book market. But, this was not the case in most other product categories. For example, E-Tailers such as CDNow were already in place before Amazon.com appeared in the music category. As a result, Amazon exposed itself to new levels of competition creating new vulnerabilities. In many cases, established players in the brick and mortar space had also established a presence in the online arena. Moreover, as brick-and-mortar stores such as JC Penney and Circuit City expanded to the online arena, Amazon was faced with escalating levels of competition.

<u>Cost of Complexity</u>

Amazon.com's business is not driven by technology costs alone. Rather, its costs are significantly dependent on handling of physical goods and inventory. As the magnitude and variety of good increase, the cost of real estate, labor and inventory also increase[25]. This increased cost dragged the company down to some degree.

The Associates Program

Amazon pioneered the concept of the associates program- what is now also referred to as affiliate programs. The basic idea here was-

- Small sites would act as traffic generators for the company.
- These sites would post content on their site with a link to Amazon.

- Each site would receive a commission of 15% for any referred purchase and 5% for any other purchase made by that consumer.
- The company would benefit not only by traffic generation, but also by branding. Since the small sites would carry an Amazon logo, it would enhance the online presence of the company.
- The company paid for the customer traffic after the fact as opposed to traditional advertising where companies pay ahead of time without knowing the level of traffic that will take place.

The company also obtained a patent for its affiliate program[26], which was somewhat controversial. The program itself has been quite successful with the company reporting signing up at least 800,000 associates by September 2002. At this point, the vast majority of E-tailers have an associate program. But, once again since Amazon was the first to do this they were able to sign up a lot of small sites.

However, it has become challenging to run affiliate programs because of new software. When an individual visits software maker XYZ to download a program, the program marks the person's PC. After that point, if this individual goes to a affiliate ABC and visit's Amazon's site, the program will disguise this to make it look like Amazon actually got this business from XYZ's site. As a result, money that must rightfully go to ABC goes to XYZ[27].

Moving Beyond Retailing: Partnering, Auctions and the Zshops Initiative

Up to this point, Amazon.com mainly had a product focus- i.e., it was focused on selling products to others. However, the company realized that in order to grow further it had to move into services. This was the motivation behind entering auctions and launching the Zshops initiative. To allay the fears of the loyal fans of Amazon.com, Jeff Bezos explained this in this way-"It's not a shift in the model. It's something we had always thought about. For at least a year, we've been talking about ourselves as a "platform." It's a foundation or a workbench from which you can do a lot of things. In our case, it consists of customers, technology, e-commerce expertise, distribution centers, and brand"[28]. Amazon.com also entered into partnership agreements with other e-tailers.

With each of these initiatives, the company leveraged its reputation and minimized its risk, but is also relinquished control over the consumer experience. In addition, it created layers of complexity and cost due to issues of due diligence and monitoring partners and participants in Auctions and Zshops.

Partnerships

The basic idea with the partnering approach was to let another firm bear the risk of selling products that had unique problems and yet share in the potential upside from such a venture. Specifically, Amazon acquired ownership stakes in many companies including: Drugstore.com, HomeGrocer.com, Pets.com, Ashford.com, Gear.com, Audible.com, Greenlight.com, Living.com and Della.com. According to various estimates, Amazon spent at least $160 million in those investments[29]. In some cases, the investment was sizeable- Amazon owned a 46% stake in Drugstore.com and 50% in Pets.com[30].

Jeff Bezos' comments on the deal with Drugstore.com are particularly relevant[31]-

> "Take Drugstore.com as an example. That is a very complicated business, because you have to be regulated in all 50 states in a very careful way. You have two payers because you pay the $5 copay, and the insurance company takes care of the rest. That leads to a different set of technology systems to make that work. So, it becomes clear very quickly that because they're up and running and they have that customer experience nailed, it would be much better for our customers to offer them that experience than to put our energy and time into trying to replicate it".

However, these investments have proved to be disastrous. In most cases, the fees paid to Amazon by these partners were in their stock, which lost most of its value[32].

Zshops

Amazon.com got into the store hosting business with its Zshops initiative. This pitted it against portals such as Yahoo! and MSN.

The idea can be summarized as follows-

- Amazon.com provides a place for all kinds of small and medium-sized businesses to sell products.
- The company provides a guarantee that essentially insures the buyer in the event of non-delivery or the supply of a defective product.
- Sellers are provided a cheap way to sell their products to an already established customer base that trusts the company.
- Amazon gets a sales presence in products that it does not carry.

The company mainly makes money from sellers in Zshops in the following ways[33]-

- Listing Fees (Required)
  Every seller pays $39.99 per month to maintain as many as 40,000 items. If the number of listings exceeds 40,000 at any given time, sellers are charged a $0.10 listing fee for each additional individual listing.

- Merchandising Fees (Optional)

  Sellers can draw attention to their listings with Amazon.com merchandising features.

- zShops Closing Fees (Required): A closing fee is assessed when the item sells at the following rates-

  If the item sells for $0.01 - $25.00, Amazon collects a 5% closing fee.
  If the item sells for $25.01 - $1,000.00, Amazon collects $1.25 plus 2.5% of any amount greater than $25.
  If the item sells for $1,000.01 or more, Amazon collects $25.63 plus 1.25% of any amount greater than $1,000.

This initiative was seen as having the following advantages[34]-

1) It increases Amazon's inventory possibilities a thousand times over without adding inventory cost.

2) It creates new, eventually high-margin revenue streams in the form of a monthly fee paid to Amazon for listing items on its site, and in the form of a transaction fee paid to Amazon whenever a listed item is sold.

3) If successful, zShops could increase the number of customer visits on Amazon several fold.

4) zShops will provide another means for Amazon to cross-promote items over numerous product lines, creating tangential sales.

5) zShops should only strengthen the Amazon community because members are able to rate all outside sellers and their products.

zShops also presents new challenges to the company-

- If the company does not attract high-quality brands, the presence of these sellers can attenuate the strength of the brand and lead to brand confusion. It could further muddle the answer to the question- “What is Amazon and what does it stand for?”
- It takes it away from its core competence of retailing and presents it with new levels of cost and competition.
- The company takes on the risk of a fraudulent seller with this approach.

- In addition, this may create additional competition for the firm. In the words of Jeff Bezos-

  "The zShops compete against us. I am constantly finding toys on our site that a zShop is also selling, sometimes at a lower price. If you are used to having very strong control, that is a terrifying notion. But I really believe you can build a more robust company if you give up a bit of that control in this organic marketplace"[35].

Auctions

On March 30, 1999 Amazon.com announced that it was introducing Amazon.com Auctions[36]. This was a bold move on the part of Amazon to overthrow the large Internet auction house- eBay.

The rationale for Amazon's entry into auctions was-

- Cross-selling: Amazon wanted to leverage its large customer base and encourage them to become buyers or sellers on its auction service.
- EBay's focus was almost exclusively on small businesses (e.g. antique dealers) and collectors. The thinking at that time was that Amazon may introduce new kinds of buyers and sellers leading to a different market dynamic.
- Competition: At this point, variable price mechanisms such as auctions were being projected as the dominant form of E-Commerce in the future. As a result, a number of companies introduced auctions. Consider the moves made by Amazon's competitors in March 1999[37]-

  - PriceLine.com, the reverse auctioneer went public on March 30, rocketing 57 to close at 70.

  - eBay forged a $75 million deal with America Online on March 25 to promote its eBay auctions on AOL.

  - Catalogue retailer Sharper Image began offering online auctions of new and excess merchandise on March 1.

  - Computer E-tailer Cyberian Outpost launched a site on March 16.

How did Amazon's approach differ from previous efforts?

- Amazon provided a money-back guarantee for purchases below $250[38]. Since seller-side fraud is a big issue with auctions, this was seen as a radical move.
- In addition, Amazon invited a group of merchants to set up shop on its auction site.

The fee structure on the auction side is very similar to the Zshops fee structure described previously.

The biggest challenge in this arena was to find a way to topple the giant, eBay. As shown in Table 7, it is safe to say that Amazon's auction venture was not very successful. EBay continues to dominate auctions.

[Insert Table 7 About Here.]

International Growth

Even without opening web sites and distribution centers abroad, Amazon.com had consistently served a global audience. In July 1995, the customers of the company came from 45 different countries[39]. Currently, the company sells to over 150 countries[40]. As shown in Table 3, in the year 2000, about 13.8% of all revenues came from the International market. The company realized that by more closely targeting some markets, revenue could be increased even more.

Jeff Bezos provided this interesting anecdote about being a global seller[41]-

> We got an order from somebody in Bulgaria, and this person sent us cash through the mail to pay for their order. And they sent us two crisp $100 bills. And they put these two $100 bills inside a floppy disk. And then they put a note on the cover of the floppy disk, and they mailed this whole thing to us. And the note on the cover of the floppy disk said, "The money is inside the floppy disk. The customs inspectors steal the money, but they don't read English." That shows you the effort to which people will go to be able to buy things.

As a result of global interest, in 1998, the company launched a site in Germany- Amazon.de and a site in the UK- Amazon.co.uk. In each market, the focus was upon books, music and videos. The company adopted an acquisition strategy to achieve this goal. It acquired two European e-commerce sites in early 1998 (Telebuch in Germany, and Bookpages in the United Kingdom) and then relaunched them as Amazon.com-branded sites. The sites had loyal followings, allowing the company to gain a customer base in these markets. To serve the markets, the company opened customer service centers in Slough, England, Resenburg, Germany and in The Hague. Multilingual service representatives were hired to serve customers effectively[42].

Later, the company expanded into France[43](April 2000) and Japan(November 2000). With the French, Japanese and German stores, the company was forced to deal with creating content in local languages. In addition, with international expansion the company had to become sensitive to local cultures.

Amazon.com Technology

In the ultimate analysis, the true core competence of Amazon may be its technology and its web site that manifests it.

First of all, Amazon took a fundamentally different approach to developing an online store. As described by Salon.com's Scott Rosenberg- "Five years ago, entrepreneurs thought the way to duplicate the retail experience online was to build virtual replicas of physical stores: The theory was that you had to orient users spatially; the Holy Grail was the 3-D walk-through. Amazon never went down that path. Its founder, Jeff Bezos, and his talented crew of site builders seemed to understand from Day 1 that information organized thoughtfully can create its own experience -- one entirely different from the familiar store geography of aisles and shelves. They started with a vast but bare database of books in print and kept adding new layers of valuable information to it"[44].

Second, Amazon was a pioneer in introducing new ways to enhance the shopping experience. Here is a partial list of their innovations-

- <u>One-click shopping</u>: Amazon.com recognized that one of the most important ways in which it could value was to reduce the transactional burden on customers. If the company could remember all relevant information about the customer, the individual could breeze through the ordering process. This also established switching costs making it a hassle to switch to other online stores that may or may not have any given customer's information. In a controversial move, the company also obtained a patent on its one-click shopping system and successfully stalled its usage by its rival- BarnesandNoble.com[45].

- <u>Product Review Information</u>: All products on Amazon can be reviewed. In the case of books, editorial reviews by leading magazines are provided by the company. For all products, customer reviews are available. Moreover, customers can rate each other's reviews. A rating figure is placed against each review so that customers can decide whether to read it or not based on that.

- <u>Purchase Circles</u>: Suppose you are interested in learning about the books being read by your rival firm or scientists at MIT, Amazon provides you to do this. In the company's words[46]- "We group the items we send to particular zip and postal codes, and the items ordered from each domain name. We then aggregate this anonymous data and apply an algorithm that constructs bestseller lists of items that are more popular with each specific group than with the general population. No personally identifiable information is used to create Purchase Circle lists. The regularity with which a Purchase Circle is updated depends on its size and activity of a Purchase Circle group. Large Purchase Circles are updated weekly; smaller ones are updated monthly".

- E-Mail Alerts: Amazon allows consumers to keep tabs on their favorite author or musician. Individuals can enter the name of their favorite author, for example, and when that person's next book comes along, Amazon e-mails the customer with an alert. In some cases, customers are alerted before the book is available to the public.

- Recommendations: The company uses collaborative filtering(see the chapter on personalization for details) and other personalization techniques to recommend books and music to users. The company remembers the name of each customer and the web site greets each individual as they log in. Then, when the user picks a book(say), the system recommends a few other books that may be of interest. Clearly, this encourages the users to browse and buy more than what they had originally intended.

- Wish List: Each individual can create a wish list of items that they would like to acquire. This list is open to the world and if a friend or acquaintance wants, he or she can make sure that the items you want are ordered and sent to you.

- The Page You Made: The web site creates a special page that consists of recently viewed portions of the site. Consumers who have forgotten something that they looked at a few minutes ago can conveniently go to this page and locate the item of interest.

The result of these innovations manifests itself in the leadership role of Amazon. As shown in Table 8, Amazon dominates others in multiple product categories based on how well it serves its customers.

[Insert Table 8 About Here.]

The company continues to add innovative features on its web site. It added the “millions of tabs” feature in September. Customers now have a tab that is their own and is completely customized to their needs.

Amazon.com as Technology Provider

Up to this point, we have seen two roles for Amazon.com- e-tailer and service provider. However, considering its strength in technology, Amazon.com has now also become a technology provider.

A key partnership was announced with Target on September, 2001. Target agreed to use Amazon.com technology for order fulfillment and customer care services on its Target.com, MarshallFields.com, Mervyns.com and GiftCatalog.com web sites[47]. A new site was launched in August 2002. Similarly, the company also announced a partnership with Circuit City on December 11, 2001[48]. Customers can now place an order for an electronics item at Amazon.com and pick it up at their local Circuit City. The company has announced similar deals with Office Depot and Virgin Airlines' Japan operation.

This could be a future strategic growth area for the company. In one sense, this increases the influence of the company in the e-tailing sector since it may be running a large number of e-tailer's sites. But, to some degree, the company is surrendering brand control to achieve this.

The 2001 Holiday Shopping Season and Amazon's First Profit

Amazon.com reasserted its dominance in the e-tailing sector in the 2001 holiday season. According to Nielsen's Net Ratings, it was the number one site in terms of total number of unique visitors in the month of November 2001 with about 31 million visitors. It was followed by Yahoo! Shopping with 27 million visitors and eBay with about 26 million visitors.

Moreover, as shown in Table 9, Amazon.com ranked among the top 10 fastest growing E-tailers. This was interesting because this list usually has e-tailers who do not make the top 10 list in terms of total traffic.

[Insert Table 9 About Here.]

Buoyed by this dominant performance, Amazon.com posted its first quarterly profit of $5.8 million in the fourth quarter of 2001. The company achieved this due to a variety of factors. According to Bezos, the most important one may have been the reduction in prices[49]-

> Without a question, it was the very significant reduction in prices that we put in place in the fourth quarter(that contributed most to profits). We had always had low prices, but in the fourth quarter we really lowered prices -- for example, 30% off on books over $20. That had a substantial effect on volume. You can't do that until you have the operating efficiency to afford to do it. We just saw it a little bit faster than we expected.

Other factors helped[50]- E.g. A favorable exchange rate with the Euro, lower fulfillment costs(down 17% from previous year), better inventory management. The company has made great improvements in operations and shipped 35% more items with the same number of employees. This feat was achieved by farming out the fulfillment operations of certain products.

Interestingly, the company quickly announced that it may not make quarterly profits for a while. Retailers pay out suppliers in the first quarter of the year and demand slackens making it tough to turn a profit in this quarter. Amazon also carries about $2.2 billion in long-term debt that is expected to place a heavy burden. The company may have overinvested in distribution and some experts note that only 40% of warehouse capacity is being utilized. Some have started to worry that the company has sacrificed too much growth in sales by starting to focus on profits. People in this corner have cited the reduced expenditure on marketing as evidence for this[51].

The company announced a free shipping deal in the same press announcement as its first quarterly profit. The company said that it would offer free shipping to any sale(on items other than toys, video games, baby products and third-party goods) worth less than $99. Bezos has argued that, based on what the company knows about price elasticity, this may a reasonable way to increase sales volume and the size of the order. However, critics were quick to point out the greater price pressure this would place on the company that had barely come out of the red. Bezos is confident that costs can be further cut leading to profits in the future- others are not as sure as he is. Experts have pointed out that due to fine-print restrictions, a small proportion of consumers may benefit from this offer. From a competitive standpoint, bn.com already had such an offer and Buy.com quickly followed with a similar deal. Therefore, it is not clear if Amazon will pick up market share from these retailers.

A Discussion of Amazon.com's Cumulative Losses

When the discussion has turned to Amazon's first quarterly profit, it is appropriate to revisit the reasons for the company's large cumulative losses- the shareholders have an accumulate deficit of over $1.4 billion dollars. Here are the main arguments for the poor cumulative performance of the company-

<u>The company overspent on marketing and advertising</u>.
The marketing expenses are provided in Table 1. Analysis shows that marketing expenses were as high as 16.33% of net sales in the year 1997 and had reduced to 10.72% in the year 1999. The company drastically reduced

marketing expenses to about 6.52% of net sales in the year 2000 and it will probably be a smaller percent of sales in the year 2001.

Some critics have argued that Amazon.com had built a strong brand early on. As a result, the incremental sales as a result of the holiday advertising campaign was small and the company would have been closer to profitability if it had reduced marketing expenses sooner.

Poor investments
As indicated earlier, Amazon.com invested in a number of online retailing companies such as Drugstore.com, HomeGrocer.com and Pets.com. Most of these investments did not pay off (Pets.com and Homegrocer.com/Webvan, for example, are out of business) and the company wrote off about $135 million in the year 2000 alone.

It grew too soon
As shown earlier, Amazon.com rapidly diversified into a number of product categories and added new services such as zShops and Auctions. The company may not have fully understood the impact on the cost structure as it added these products and services. Some observers have pointed out that with only the book, music and video segments being profitable, the company may be forced to re-evaluate other products.

Technology features vs. cost
As described in the technology section, Amazon.com has introducing an amazing array of technologies on its website. It has been an industry leader in this regard. However, while developing these technologies in-house gives the company total control it is an expensive proposition. Some observers have asked if Amazon would have been better off adding fewer features and controlling costs rather than the path it took.

Conclusion

Amazon.com is a leader. As shown in Table 7, in many different categories, it stands head and shoulders above its competition.

However, the company stands at a critical juncture today. Profits have proven to be elusive. For the longest time Jeff Bezos has argued that focusing on profits would mean giving up on growth opportunities and is not in the interest of the company. However, this has now changed with Bezos saying- “This is the right time to focus on the fundamental economics of our business, even if it means sacrificing growth”. He forecasted that the company will turn an operating profit in the fourth quarter of 2001 and delivered on that promise. After achieving this, he has promised to focus more on growth next year, which is likely to result in further losses[52].

The vast majority of investments in online firms have been written off. The company does not have adequate cash to operate for a long period of time. The company has accumulated a vast deficit. However, this has not stopped the company from making new acquisitions and forming new partnerships. It acquired the operations of the defunct Egghead.com on December 19, 2001. This provides Amazon.com another channel to reach customers[53].

In addition, Amazon has aggressively expanded into new product categories. A snapshot of Amazon's different products and services is shown in Figure 2. Many of the products and services shown here are being offered on a trial basis. Only time will tell if they are profitable.

[Insert Figure 2 About Here.]

One problem that analysts have identified is that the growth in the number of customers has slowed down. One analyst has been quoted as saying- "Everyone who wanted to buy a book online has already heard of Amazon"[54]. An expert within Amazon has come up with this solution- "Amazon should increase its holdings of best sellers and stop holding slow-selling titles"[55]. He sees this as the way to reduce costs and move towards profitability. However, this has not been a popular view within Amazon.

Perhaps, the most significant new development has been the entry of Amazon into web services on July 16, 2002. The company has now allows developers to incorporate content and features from Amazon's site into their own. For instance, with this new service, it will be possible to search Amazon's database from a third-party site. Jeff Bezos dubbed this a "welcome mat for developers" and developer groups greeted this positively.

The company has attracted a $100 million investment from America Online fueling speculation that this may be the first step towards a merger[56]. Moreover, there is some sentiment that the long-term future of the company may be as a technology provider. This is really based on the alliance with Toys R Us where Amazon runs the online storefront and Toys R Us controls inventory and logistics.

The future of the company is unwritten and will prove to be as interesting as its past.

Questions for Discussion

1. What is the lasting legacy of Amazon.com?
2. What did Amazon.com get right and what did it get wrong?
3. Should Amazon have remained an online bookstore? Critically evaluate the arguments for and against quick diversification.
4. Can Amazon.com successfully compete with bricks and clicks stores such as Barnes and Noble?
5. Note from the financial statements that services still represent a smaller portion of the company's revenues. What is the role for services in the long-term for the company?
6. You should be able to obtain the answer to these questions from the financial statement-
    a. Compute the ratio of operating income to sales and gross profit to sales. See how these ratios have changed over time. Compare with BN.com and eBay.com. What do you learn from this?

    b. Compute the current ratio (current assets/current liabilities) and the quick ratio (current assets). See how these ratios have changed over time. Compare with BN.com and eBay.com. What do you learn from this?

    c. Study the accumulated deficit and how it has changed over time. How did Amazon.com fall into this perilous position?

    d. Monitor interest payments over time. How have they changed and what do we learn from that?

7. Several arguments have been provided for the lack of profitability of Amazon.com. Using the financial statements, identify the ones that are most applicable.
8. Can small booksellers compete with a large site such as Amazon.com? What would you do if you were a small bookseller online?
9. Based on what we know, paint a picture for how Amazon.com will look like in 1 year and in 5 years.

APPENDIX

Prof. Ufuk Ince's Explanation of Amazon's Convertible Bond Issue.

The choice between equity and debt is a fundamental question in practical as well as theoretical finance. Even though we know a lot now, still we do not know everything about this subject and it still maintains its place as a major research area. Some of the things we know are as follows:

* Equity is in general more costly to issue for the company than debt.
* Debt is more risky to issue.

There are several additional characteristics of these two financing choices that make them attractive as well as unattractive compared to the other-

- Interest payments are tax-deductible for the corporation and dividend payments are not. This makes debt more attractive than equity. This is true even for a non-dividend paying company such as AMZN for reasons I skip here for brevity.

- There is some argument that is also empirically observed in favor of some debt: The managers seem to work harder and do not waste as much capital if they have a debt obligation that they have to meet at periodic intervals. It sort of disciplines them.

- Even though some debt is good, when it gets too much the risk of bankruptcy tends to overweigh the benefits of debt. This, even if the company never actually goes bankrupt. The customers do not like to deal with a company that may go bankrupt soon. Many employees do not like to work for one either. Many such indirect costs make a heavy debt load dangerous.

The empirical observation is that debt level is highly industry-specific. Heavy/manufacturing industries can usually live with much higher debt loads than service or high tech that tend to have more intangible assets.

To understand the choice of AMZN in January 1999, let us look at the $1.25 billion issue in detail: This was not really a straight (plain-vanilla) debt issue. It was a hybrid (between debt and equity) security issue that is known as Convertible Bond (CB). In fact, it is the largest CB issue ever in the history of finance. It was originally set to be a $500 million issue but was later bumped up to $1.25 billion due to intense investor interest.

A CB pays interest every six months just like a regular bond issue but it gives the option to the investor who purchases it to convert it into (certain number of) shares of stocks of the same company. That is, there is a chance that the bonds that require regular interest payments, to turn into AMZN shares at some point in the future, at the investors' choosing.

The CB of AMZN was issued when its stock was trading at about mid $120's. It is a 10-year bond, and is convertible to about 6 AMZN shares at any time from the date of issue until maturity. Of course, the investors will decide to convert only if the shares become more valuable than the bond itself. The stock price that makes the conversion profitable is $156/share. This was about a 25% premium to where the stock was trading at the time of the issue. That is, the stock had to appreciate to $156 or above, for the debt issue to become a stock issue. Another important feature of AMZN CB was the rate of interest- 4.75% annually.

Why would a company issue a CB, instead of straight debt or equity? To understand this one must realize that at the time of the issue no one knows how the future will take shape. The company does not know what will happen with the stock price. It hopes that it will go up. The investors do not know this either. The company may want to issue stock, but at the then current price of $120’s it may have felt that the stock was undervalued. That is, if it were to issue stock at that time it would have undersold the stake in the company hurting/diluting existing stockholders’ stake. By issuing CB that would become stock at $156 dollar level, in effect AMZN issues (pseudo) stock at the time it needs the cash (January 1999) and not at the low price of $120’s. When/if the market price appreciates in the future to and beyond $156 the bonds will turn into stock and the company will have issued stock at that higher price but got the cash much earlier when it needed to finance immense investment throughout 1999.

Why do the investors buy into this scheme? Because they are betting that the stock will appreciate beyond $156 (maybe much beyond) which would entitle them to get a piece of the action at $156/share instead of whatever high market price everyone else might be paying. Of course, this is only one side of the coin. We all know NOW that AMZN stock has never seen the level of $156, and in fact plunged down to a level of $17 in 2 ½ years. That means the investors never got to convert their bonds into stock, and AMZN was not able to have stock issue at a higher price.

Does this mean AMZN and the investors made a huge mistake together? NO. And that’s the beauty of a CB issue that it is a contingent security. That is, since no one knows what will happen in the future, the contingent security takes care of possible future scenarios. What did the investors gain by buying CB instead of stock? They did not get the upside potential because of the stock price crash but they did not burn completely either. They still have in their hands a piece of paper that keeps paying them real cash every six months. If they had AMZN shares they would have 12 cents to the dollar of their original investment and no dividends whatsoever.

What did AMZN gain by issuing CB instead of straight bonds? The interest rate 4.75%. This is at least two percentage points lower than what a comparable 10 year T-note was paying at the time. Thus, a company as risky and speculative as AMZN was able borrow at 2 points cheaper than the safest borrower in the face of the world. AMZN got extremely cheap financing.

Table 1
Amazon.com's Historical Income Statements
(Source: http://www.iredge.com/IREdge/IREdge.asp?c=002239&f=2019,
Accessed September 26, 2002, all figures in thousands, 2002 YTD figures are for first 2 quarters)

	2002 YTD	2001	2000	1999	1998	1997
Net sales	$ 1,653,027	$ 3,122,433	$ 2,761,983	$ 1,639,839	$ 609,819	$ 147,787
Cost of sales	$ 1,211,735	2,323,875	2,106,206	1,349,194	476,155	118,969
Gross profit	$ 441,292	798,558	655,777	290,645	133,664	28,818
Gross margin	*26.70%*	*25.6%*	*23.7%*	*17.7%*	*21.9%*	*19.5%*
Operating expenses:						
Fulfillment	175,566	374,250	414,509	237,312	65,227	15,944
Marketing	61,076	138,283	179,980	175,838	67,427	24,133
Technology and content	113,662	241,165	269,326	159,722	46,424	13,384
General and administrative	40,336	89,862	108,962	70,144	15,618	6,741
Stock-based compensation	34,079	4,637	24,797	30,618	1,889	1,211
Amortization of goodwill and other intangibles	3,353	181,033	321,772	214,694	42,599	-
Restructuring-related and other	9,974	181,585	200,311	8,072	3,535	-
Total operating expenses	438,046	1,210,815	1,519,657	896,400	242,719	61,413
Pro forma income (loss) from operations (1)	**50,652**	**(45,002)**	**(317,000)**	**(352,371)**	**(61,032)**	**(31,384)**
As a % of Revenues	*3.06%*	*-1%*	*-11%*	*-21%*	*-10%*	*-21%*
Income (loss) from operations	3,246	(412,257)	(863,880)	(605,755)	(109,055)	(32,595)
Interest income	11,302	29,103	40,821	45,451	14,053	1,901
Interest expense	(70,895)	(139,232)	(130,921)	(84,566)	(26,639)	(326)
Other income (expense), net	(307)	(1,900)	(10,058)	1,671	-	-
Other gains (losses), net	(57,938)	(2,141)	(142,639)	-	-	-
Total non-operating expenses, net	(117,838)	(114,170)	(242,797)	(37,444)	(12,586)	1,575
Income (loss) before equity in losses of equity-method investees	(114,592)	(526,427)	(1,106,677)	(643,199)	(121,641)	(31,020)
Equity in losses of equity-method investees, net	(2,912)	(30,327)	(304,596)	(76,769)	(2,905)	-
	(149)					
Pro forma net income (loss) (2)	**(9,248)**	**(157,031)**	**(417,158)**	**(389,815)**	**(73,618)**	**(29,809)**
Cumulative effect of change in accounting principle	801	(10,523)	-	-	-	-
Net income (loss) - GAAP	$ (116,703)	$ (567,277)	$ (1,411,273)	$ (719,968)	$ (124,546)	$ (31,020)

Basic income (loss) per share - GAAP	$ (0.31)	$ (1.56)	$ (4.02)	$ (2.20)	$ (0.42)	$ (0.12)
Diluted income (loss) per share - GAAP	$ (0.31)	$ (1.56)	$ (4.02)	$ (2.20)	$ (0.42)	$ (0.12)
Basic income (loss) per share - Pro forma	$ (0.02)	$ (0.43)	$ (1.19)	$ (1.19)	$ (0.25)	$ (0.11)
Diluted income (loss) per share - Pro forma	$ (0.02)	$ (0.43)	$ (1.19)	$ (1.19)	$ (0.25)	$ (0.11)
Shares used in computation of basic income (loss) per share - GAAP and Pro forma	376,937	364,211	350,873	326,753	296,344	260,682
Shares used in computation of diluted income (loss) per share - GAAP and Pro forma	376,937	364,211	350,873	326,753	296,344	260,682

(1) Excludes the following operating items:

--Stock-based compensation

--Amortization of goodwill and other intangibles

--Restructuring-related and other

(2) Excludes all (1) items and the following:

--Other gains (losses), net.

--Equity in losses of equity-method investees, net

--Cumulative effect of change in accounting principle

Table 2, Amazon.com's Historical Balance Sheet Statements

(Source: http://www.iredge.com/IREdge/IREdge.asp?c=002239&f=2019, Accessed September 26, 2002, 2002 YTD figures are for first 2 quarters, all figures in thousands)

	2002YTD	2001	2000	1999	1998	1997
	30-Jun	31-Dec	31-Dec	31-Dec	31-Dec	31-Dec
ASSETS						
Current assets:						
Cash and cash equivalents	$270,438	$540,282	$822,435	$133,309	$71,583	$110,119
Marketable securities	553,141	456,303	278,087	572,879	301,862	15,256
Inventories	126,794	143,722	174,563	220,646	29,501	8,971
Prepaid expenses and other current assets	93,204	67,613	86,044	79,643	21,308	3,363
Total current assets	1,043,577	1,207,920	1,361,129	1,006,477	424,254	137,709
Fixed assets, net	249,452	271,751	366,416	317,613	29,791	9,726
Goodwill, net	70,811	45,367	158,990	534,699	174,052	-
Other intangibles, net	5,585	34,382	96,335	195,445	4,586	-
Investments in equity-method investees	3,188	10,387	52,073	226,727	7,740	-
Other equity investments	15,288	17,972	40,177	144,735	-	-
Other assets	47,146	49,768	60,049	40,154	8,037	2,409
Total assets	1,435,047	1,637,547	2,135,169	2,465,850	648,460	149,844
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)						
Current liabilities:						
Accounts payable	296,368	444,748	485,383	463,026	113,273	33,027
Accrued expenses and other current liabilities	236,234	305,064	272,683	176,208	47,484	8,871
Unearned revenue	69,128	87,978	131,117	54,790	-	816
Interest payable	44,396	68,632	69,196	24,888	10	177
Current portion of long-term debt and other	14,406	14,992	16,577	14,322	808	1,660
Total current liabilities	660,532	921,414	974,956	733,234	161,575	44,551
Long-term debt and other	2,218,426	2,156,133	2,127,464	1,466,338	348,140	76,702
Commitments and contingencies						
Stockholders' equity (deficit):						
Preferred stock, $0.01 par value:						

Authorized shares -- 500,000						
Issued and outstanding shares -- none	-	-	-	-	-	-
Common stock, $0.01 par value:						
Authorized shares -- 5,000,000						
Issued and outstanding shares	3,803	3,732	3,571	3,452	3,186	2,898
Additional paid-in capital	1,546,941	1,462,769	1,338,303	1,194,369	297,438	65,137
Deferred stock-based compensation	(9,778)	(9,853)	(13,448)	(47,806)	(1,625)	(1,930)
Accumulated other comprehensive income (loss)	(7,596)	(36,070)	(2,376)	(1,709)	1,806	-
Accumulated deficit	(2,977,281)	(2,860,578)	(2,293,301)	(882,028)	(162,060)	(37,514)
Total stockholders' equity (deficit)	(1,443,911)	(1,440,000)	(967,251)	266,278	138,745	28,591
Total liabilities and stockholders' equity (deficit)	1,435,047	1,637,547	2,135,169	2,465,850	648,460	149,844

Table 3, Amazon.com's Historical Cash Flow Statements

(Source: http://www.iredge.com/IREdge/IREdge.asp?c=002239&f=2019, Accessed September 26, 2002, 2002 YTD figures are for first 2 quarters, all figures in thousands)

	Year Ended December 31,			
	2001	2000	1999	1998
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$ 822,435	$ 133,309	$ 71,583	$ 110,119
OPERATING ACITIVITIES:				
Net income (loss)	(567,277)	(1,411,273)	(719,968)	(124,546)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Depreciation of fixed assets and other amortization	84,709	84,460	36,806	9,421
Stock-based compensation	4,637	24,797	30,618	2,386
Equity in losses of equity method investees, net	30,327	304,596	76,769	2,905
Amortization of goodwill and other intangibles	181,033	321,772	214,694	42,599
Non-cash restructuring-related and other	73,293	200,311	8,072	1,561
Loss (gain) on sale of marketable securities, net	(1,335)	(280)	8,688	271
Other losses (gains), net	2,141	142,639	-	-
Non-cash interest expense and other	26,629	24,766	29,171	23,970
Cumulative effect of change in accounting principle	10,523	-	-	-
Changes in operating assets and liabilities				
Inventories	30,628	46,083	(172,069)	(20,513)
Prepaid expenses and other current assets	20,732	(8,585)	(54,927)	(16,758)
Accounts payable	(44,438)	22,357	330,166	78,674
Accrued expenses and other current liabilities	50,031	93,967	95,839	31,232
Unearned Revenue	114,738	97,818	6,225	-
Amortization of previously unearned revenue	(135,808)	(108,211)	(5,837)	-
Interest payable	(345)	34,341	24,878	(167)
	(119,782)	(130,442)	(90,875)	31,035
INVESTING ACTIVITIES:				
Sales and maturities of marketable securities	370,377	545,724	2,064,101	227,789
Purchases of marketable securities	(567,152)	(184,455)	(2,359,398)	(504,435)
Purchases of fixed assets, including internal-use software and web-site development	(50,321)	(134,758)	(287,055)	(28,333)

Investments in equity-method investees and other investments	(6,198)	(62,533)	(369,607)	(19,019)
	(253,294)	163,978	(951,959)	(323,998)
FINANCING ACTIVITIES:				
Proceeds from exercise of stock options	16,625	44,697	64,469	5,983
Proceeds from issuance of common stock, net of issuance costs	99,831	-	-	8,383
Proceeds from long-term debt and other	10,000	681,499	1,263,639	325,987
Repayment of long-term debt	-	-	(175,744)	(75,000)
Repayment of capital lease obligation and other	(19,575)	(16,927)	(13,142)	(3,108)
Financing costs	-	(16,122)	(35,151)	(7,783)
	106,881	693,147	1,104,071	254,462
Effect of exchange-rate on cash and cash equivalents	(15,958)	(37,557)	489	(35)
Net increase (decrease) in cash and cash equivalents	(282,153)	689,126	61,726	(38,536)
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 540,282	$ 822,435	$ 133,309	$ 71,583

SUPPLEMENTAL CASH FLOW INFORMATION:				
Fixed assets acquired under capital leases	$ 4,597	$ 4,459	$ 25,850	$ -
Fixed assets acquired under financing agreements	1,000	4,844	5,608	-
Equity securities received for commercial agreements	331	106,848	54,402	-
Stock issued in connection with business acquisitions	5,000	32,130	774,409	217,241
Cash paid for interest	112,184	67,252	30,526	26,629

Table 4
Segment-level Sales and Profitability Information

(Source: http://www.iredge.com/IREdge/IREdge.asp?c=002239&f=2019, Accessed September 26, 2002, all figures in thousands, 2002 YTD figures are for first 2 quarters)

		Year Ended December 31,		
	2002 YTD	**2001**	**2000**	**1999**
Net Sales				
North America				
Books, Music and DVD/Video	$ 854,765	$ 1,688,752	$ 1,698,266	$ 1,308,292
Electronics, Tools and Kitchen	254,634	547,190	484,151	150,654
N.A. Retail	1,109,399	2,235,942	2,182,417	1,458,946
International	443,977	661,374	381,075	167,743
Services	99,651	225,117	198,491	13,150
Net Sales	1,653,027	3,122,433	2,761,983	1,639,839
Gross Profit				
North American				
Books, Music and DVD/Video	246,808	453,129	417,452	262,871
Electronics, Tools and Kitchen	37,941	78,384	44,655	(20,086)
N.A. Retail	284,749	531,513	462,107	242,785
International	96,373	140,606	77,436	35,575
Services	60,170	126,439	116,234	12,285
	-			
Gross Profit	441,292	798,558	655,777	290,645
Pro forma income (loss) from operations				
North American				
Books, Music and DVD/Video	95,456	156,753	71,441	(31,000)
Electronics, Tools and Kitchen	(39,254)	(140,685)	(269,890)	(163,827)
N.A. Retail	56,202	16,068	(198,449)	(194,827)
International	(21,451)	(103,112)	(145,070)	(79,223)
Services	15,901	42,042	26,519	(78,321)
Pro forma income (loss) from operations	$ 50,652	$ (45,002)	$ (317,000)	$ (352,371)

Table 5
Consolidated Statement of Operations of BN.com
(Source: 10Q, November 2001, All figures in thousands unless otherwise stated, 2001 YTD figures are up to 30 September, BN.Com was a subsidiary of Barnes and Noble up to October 31, 1998)

	YTD 2001	YEAR ENDED 12/31/2000	YEAR ENDED 12/31/1999	YEAR ENDED 12/31/1998
Net sales	$289,562	320,115	193,730	61,834
Cost of sales	222,766	261,801	159,937	47,569
Gross profit	66,796	58,314	33,793	14,265
Operating expenses:				
Marketing, sales and fulfillment	31,820	132,483	101,077	70,423
Technology and web site development	47,560	40,391	21,006	8,532
General and administrative	34,859	31,293	18,842	12,026
Depreciation and amortization	23,626	36,088	15,510	7,140
Impairment and other special charges		75,051	--	--
Stock based compensation	--	11,740	--	--
Equity in net loss of equity investments including amortization of intangibles	20,593	30,728	--	--
Total operating expense	189,592	357,774	156,435	98,121
Operating loss	(122,796)	(299,460)	(122,642)	(83,856)
Interest income, net	6,265	23,737	20,238	708
Loss before minority interest	(116,531)	(275,723)	(102,404)	(83,148)
Minority interest	84,396	210,320	54,253	--
Net loss-historical	($32,135)	(65,403)	(48,151)	(83,148)
Basic net loss per common share(5)	($0.24)	($2.02)	($0.72)	($0.48)
Basic weighted average common shares outstanding(5)	43,787	32,386	28,778	28,797
Diluted net loss per share(5)	($0.24)	($2.02)	($0.72)	($0.48)

Table 6
Top Internet Retailing Sites in terms of Unique Visitors, March 2000 vs. March 2001
(Source: Media Metrix)

Rank	Mar 2000		Mar 2001	
1	Amazon.com	14,349,000	Amazon.com	18,229,000
2	BN.com	5,404,000	X10.com	8,406,000
3	CDNow	4,737,000	BN.com	4,877,000
4	Ticketmaster	3,617,000	CDNow	4,694,000
5	McAfee	3,549,000	Apple.com	4,029,000
6	Hp.com	3,441,000	Hp.com	4,018,000
7	Apple.com	3,185,000	Magazineoutlet.com	3,906,000
8	Enews.com	2,901,000	Sears.com	3,842,000
9	Iprint.com	2,871,000	Ticketmaster.com	3,813,000
10	Buy.com	2,624,000	Dell.com	3,800,000

Table 7
Top Auction Sites Ranked by Revenue Share, May 2001 (U.S.)

	Auction Site*	Revenue***, $ million	Revenue Share	Satisfaction Rate	Conversion Rate
1.	eBay.com**	357.51	64.30%	8.42	22.50%
2.	uBid.com	81.73	14.70%	7.87	11.00%
3.	Egghead.com (Onsale.com)	22.24	4.00%	7.75	8.00%
4.	Yahoo! Auctions	13.34	2.40%	7.84	4.40%
5.	Amazon Auctions	11.12	2.00%	7.64	6.50%

Source: Nielsen//NetRatings & Harris Interactive eCommercePulse, May 2001
**Auction sites do not include travel related sites.*
***Figures for eBay.com do not include figures for Half.com.*
**** All revenue figures are for May 2001.*

Table 8
Amazon.com is the leader:
Top E-Tailers in Books, Toys, Videos and Music
(Source: Gomez.com, Accessed July 27th 2001, Max. score possible is 10)

	Books (Spring 2000)		Toys (Fall 2000)		Videos (Summer 2000)		Music (Summer 2000)	
1	Amazon.com	8.66	Amazon.com	8.02	Amazon.com	8.40	Amazon.com	8.16
2	barnesandnoble.com	7.63	SmarterKids.com	7.99	BUY.COM	8.25	CheckOut	7.67
3	BUY.COM	7.50	ZanyBrainy.com	7.33	CDNOW	7.73	BUY.COM	7.51
4	Borders.com	7.38	KBkids.com	7.06	Express.com	7.58	Barnes	7.47
5	Booksamillion	7.35	Wal-Mart	6.33	800.com	7.29	CDNOW	7.24
6	fatbrain.com	6.71	NuttyPutty.com	6.30	CheckOut Enter.	7.25	SamGoody	6.89
7	Wal-Mart	6.60	JC Penney	5.73	Blockbuster	7.03	Tower	6.86
8	gohastings.com	5.92	Target	5.61	Bigstar.com	6.90	Express.com	6.85
9	varsitybooks.com	5.83	FAO Schwartz	5.56	Borders.com	6.86	ARTISTdirect.com	6.45
10	BookBuyer Outlet	5.43			SamGoody.com	6.83	MuZic	6.31

Table 9
Top 10 Fastest Growing E-tailers in the 2001 holiday shopping season
(Source: Nielsen Net Ratings)

		Shopping Trips, Nov-Dec. 2000, in thousands	Shopping Trips, Nov-Dec. 2001, in thousands	% change
1	Columbia House	7,958	25,386	219.0
2	Fingerhut.com	3,300	8,051	144.0
3	Overstock.com	6,215	12,894	107.5
4	Officedepot.com	5,222	10,003	91.6
5	Apple.com	10,322	17,642	70.9
6	Bestbuy.com	13,735	22,389	63.0
7	HP.com	17,043	260,067	1425.9
8	Staples.com	5,609	8,509	51.7
9	Amazon.com	133,197	198,822	49.3
10	Circuitcity.com	6,346	8,950	41.0

Figure 1
Amazon.com's Stock Price Path
(Source: Quicken.com, S stands for stock split, Accessed on September 26, 2002)

Period : Sep-25-1997 - Sep-25-2002

Figure 2

Snapshot of Amazon's Products and Services

(Source: http://www.amazon.com/exec/obidos/subst/home/all-stores.html/ref%3Dtab_gw_storesdirectory/104-5060959-2105531, Accessed September 27, 2002)

Books, Music, DVD

- Books
- DVD
- Magazine Subscriptions
- Music
- Video

Electronics & Office

- Camera & Photo
- Cell Phones & Service
- Computers
- Computer & Video Games
- Electronics
- Office Products
- Software

Bargains

- Auctions
- Outlet
- zShops

Professional Supplies

- Industrial Supplies (Beta)
- Medical Supplies (Beta)
- Scientific Supplies (Beta)

Home & Garden

- Home & Garden
- Arts & Hobbies (Beta)
- Car Parts & Accessories (Beta)
- Health & Beauty
- Kitchen & Housewares
- Outdoor Living
- Pet Toys & Supplies (Beta)
- Tools & Hardware

Kids & Baby

- Baby
- Toys & Games

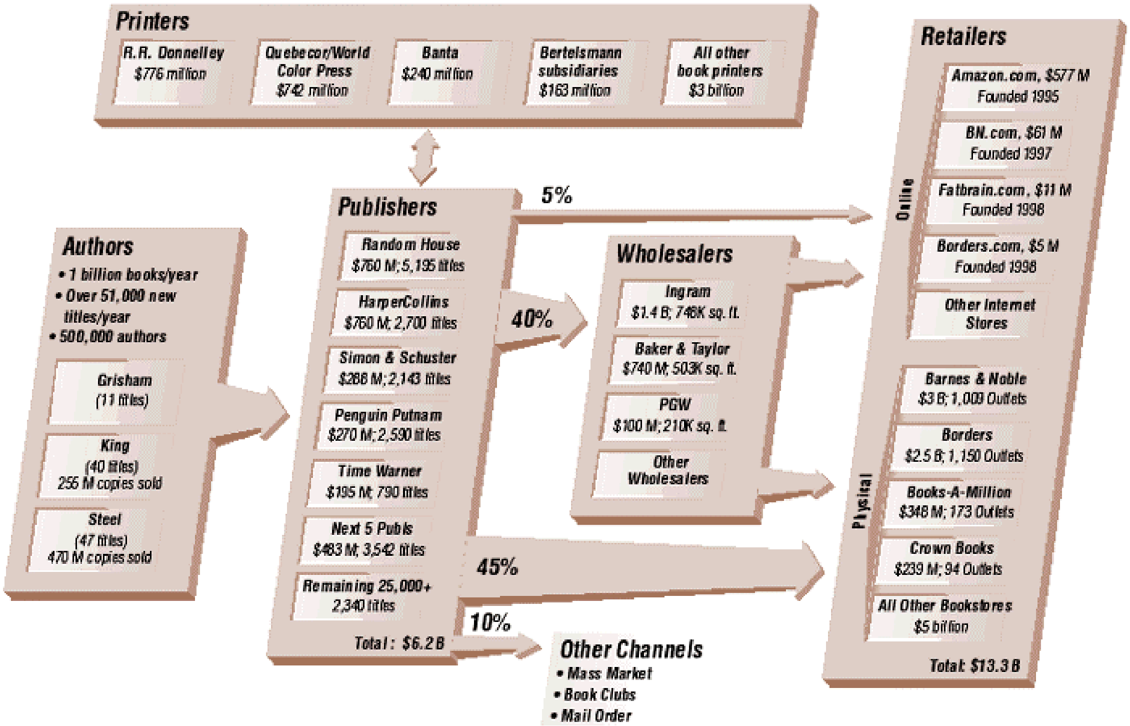
Gifts & Registries

- Baby Registry
- Free e-Cards
- Gift Certificates
- Gifts Store
- Wedding Registry
- Wish List
- Lifestyle & Gifts (Beta)

Services

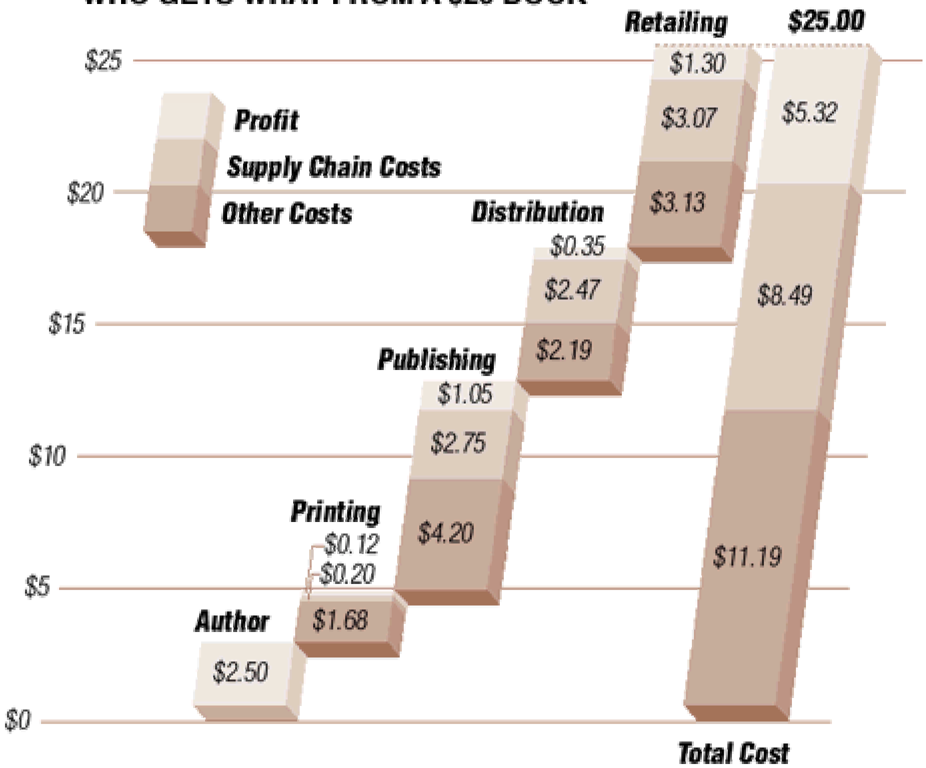
- Amazon.com Visa Card
- Associates Program
- Cars
- Chat
- Corporate Accounts
- Friends & Favorites
- Movie Showtimes
- Restaurants (Beta)
- Travel
- Web Services
- Your Recommendations
- Your Store

EXHIBIT I
A WHO'S WHO IN PUBLISHING'S SUPPLY CHAIN



Source: Simba Information Inc. Trade Book Publishing 1999.
Standard and Poor's Publishing Industry Surveys, company annual reports, and BAH analysis.

EXHIBIT II
WHO GETS WHAT FROM A $25 BOOK



Source: Simba Information Inc. Trade Book Publishing 1999.
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