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Selling Books Online in Mid-1998

Certainly Bertelsmann is better prepared to be out there than anyone else. Bertelsmann is going to commit all the resources it takes. It's going to cost money to build a global Internet, but Bertelsmann is debt free.

—Markus Wilhelm, CEO, Doubleday Direct[1]

I'm paranoid about Barnes & Noble's purchasing power, and I'm paranoid of Bertelsmann's marketing skills, extensive customer base and their publishing background. Our advantage is that we know more about e-commerce than anybody else. We've been doing it longer, and we've already leveled the playing field.

—Jeff Bezos, Founder/CEO, Amazon.com[2]

I think what we're seeing is the realization that the Internet is a viable channel, and Borders and Barnes & Noble realize that this is a viable channel, the demographics are tremendous, and the demographics are favorable. It's time to build a brand online.

—Roy Satterthwaite, Electronic Analyst,
Gartner Group[3]

A $290 million a year industry in 1997, Internet sales of new and used books was projected by analysts to total $500 million in 1998 and $1.3 billion by 2002.[4] The book publishing industry had 1996 sales of $26 billion in the United States and $82 billion worldwide. Goldman Sachs' 1997 Internet retailing report ranked books third (after computer hardware and software) out of 21 products with respect to the potential for online sales success. A 1997 AT&T Solutions/Mercer

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[1] Doreen Carvajal, "Making every book available—virtually," *News & Observer* (March 14, 1998).

[2] Ibid.

[3] Bob Woods, "Barnes & Noble rehabs web site," *Newsbytes News Network* (May 27, 1998).

[4] "1998 eCommerce report indicates . . .," *Business Wire* (May 19, 1998).

Research Associate Cate Reavis prepared this note under the supervision of Carin-Isabel Knoop, Director, Research and Development, Executive Education and Professor Jeffrey R. Rayport as the basis for class discussion. This note provides an overview of the trends and predictions for the online book retail industry as of August 1998, as well as, the current state of the online ventures of Amazon.com, barnesandnoble.com and other main players. It can be used to update "Amazon.com (A)," HBS No. 897-128 and "Amazon.com (B)," HBS No. 898-084 and "BarnesandNoble.com (A)," HBS No. 898-082.

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Management Consulting survey of 300 U.S. households found that 71% of respondents who purchased books online were satisfied with their purchases compared to 59% of those who purchased other goods.[5] (**Exhibit 1** presents an online shopper profile.)

Back list titles, less well known authors, and small presses were also benefiting from online services. In November 1997, Amazon.com customers purchased at least one copy of 84% of the books on publisher Simon & Schuster's 10,000 book backlist. Penguin Group sold one copy of 90% of the books on its 15,000 book backlist and 15% of sales for the Foundation Press, a leading educational publisher specializing in law and law related books, were through online bookstores.[6]

Established Players

Amazon.com Termed the "Earth's Biggest Bookstore," Amazon.com began operating strictly as on online book retailer in July 1995. Except for a small number of best-selling items it kept on hand, Amazon ordered most of its books from book distributors or publishing houses as customers placed orders at its Web site. By mid-1998, with more than 3 million customers in 160 countries and a library of 2.5 million books and 100,000 CD titles, the company was looking to broaden its customer base and retail offerings.

In April 1998, Amazon purchased three Internet companies for a total of $55 million: Bookpages Ltd., one of the Britain's largest book retailers with 1.2 million titles; Telebook Inc., a Germany-based online book store with a catalog of 400,000 German-language books; and U.K.-based Internet Movie Database. Amazon planned to exploit its April acquisition of Bookpages Ltd. and launch its U.K.-online book retailer, Amazon.co.uk, by fall 1998.[7] In August 1998, Amazon acquired, for $180 million in Amazon stock, Junglee Corp., a search engine that provided online comparison shopping for products ranging from computer modems to music and clothing; and, for $90 million in Amazon stock, PlanetAll, a 1.5 million-member Internet address and schedule service that stored members names, addresses, birthdays and other data. [8]

Company revenues increased 300% during the second quarter of FY 1998 even as Amazon posted a loss of $21 million. Between June 8 and July 8, 1998, Amazon's stock price increased 165%, putting its market value $5.7 billion, almost the combined market value of Barnes & Noble ($2.95 billion) and Borders ($2.94 billion).[9] Amazon predicted 1998 sales of $300 to $400 million.[10] Prudential Securities estimated that Amazon would generate $633 million in revenue by 1999.[11]

Barnes & Noble Established in 1917, Barnes & Noble opened its landmark bookstore in New York in 1932. By mid-1998, the "World's Largest Bookstore" had 483 superstores in the United States and was opening new stores at a rate of 70 per year. It also owned, under the B. Dalton, Doubleday, and Scribner's names, 528 mall-based stores. Barnes & Noble entered the electronic book retail industry in March 1997 via a bookselling site on America On-Line and subsequently, through a May 1997 launch on the Web. By mid-1998, barnesandnoble.com had 500,000 customers in 158 countries, 650,000 book

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[5] "Internet survey indicates high potential brand-loyal market for premium level products," *M2 Presswire* (August 11. 1997).

[6] Carvajal.

[7] Alice Rawsthorn, "Online bookseller plans to launch U.K. retail site," *Financial Times* (July 1, 1998).

[8] Ibid.

[9] Leslie Scism and Rebecca Buckman, "Amazon.com price increase baffles analysts," *Asian Wall Street Journal* (July 9, 1998).

[10] "Amazon shadowing Barnes & Noble," *The Record* (May 5, 1998).

[11] Scism and Buckman.

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titles stocked in its distribution center, and access to more than 2 million books from more than 27,000 publishers.

Barnesandnoble.com reported first quarter sales ending May 2, 1998 of $9.4 million. Its operating loss of $13.6 million contrasts with an operating profit of $13.7 million posted by Barnes & Noble's retail business. Barnes & Noble expected barnesandnoble.com's Web sales to be $100 million for 1998[12] and analysts expected the site to break even in 2000.

E-Book War

Over the past year, Amazon.com and barnesandnoble.com had been engaged in an electronic bookselling war based on six service and marketing dimensions: pricing policies; branding alliances; associates and affiliates programs; personalization; customer service; and user navigation.[13]

Pricing policies In January 1997, barnesandnoble.com announced that it would sell hardcover titles at 10% to 20% off, and selected hardback titles at 30% off. The day before barnesandnobles.com's mid-March AOL launch, Amazon.com began offering selected hardcover titles at 40% off. In November, Barnes & Noble matched Amazon's discounts and offered 88% off bargain books. The following day, Amazon offered its bargain books at 89% off.[14]

Branding alliances Amazon had a number of strategic alliances with online partners, among them: AOL; Yahoo!; Excite; Netscape; and Geo Cities. AOL allocated Amazon.com a prominent icon near the top of its home page; the others displayed on their home pages a banner that enabled direct click-throughs to the Amazon.com home page.

Barnes & Noble had co-branding alliances with *The New York Times* Electronic Media Company's online book section; Lycos, the Web's third leading search engine; and Microsoft's MSNBC, Microsoft Investor, and The Microsoft Expedia sites. In December 1997, barnesandnoble.com signed a four-year, $40 million agreement with AOL to promote its online bookselling channels throughout AOL's commercial online service. The agreement was concluded in parallel with Amazon.com's three-year, mid-1997 agreement with AOL, which "made Amazon.com the exclusive bookseller on AOL.com and AOL's NetFind Search Engine."[15]

Associates/Affiliates Program Web sites, including personal home pages, could become associates or affiliates of either Barnes & Noble or Amazon by embedding a link to the online booksellers' Web page. If a link resulted in a sale for Amazon, the associate received a 15% (originally 7% through June 1997) commission. Links that produced sales for Barnes & Noble earned associates a 7% discount. In July 1998, barnesandnoble.com announced a program that would grant discounts of 5%--on top of the 20% to 40% online discounts offered--to *Fortune* 1000 corporate customers that installed links to the bookseller on their intranets. Corporate customers would be required to purchase $50,000 annually.[16]

Personalization Amazon and Barnes & Noble acquired and retained customers by developing one-to-one relationships. Amazon's "Eyes" and "Editors" services dispatched e-mail notifications of

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[12] "Amazon shadowing Barnes & Noble," *The Record* (May 5, 1998).

[13] Much of the following material was taken from "Amazon.com (B)," HBS No. 898-084.

[14] "Amazon.com announces new deeper discounts," Amazon.com press release (November 21, 1997).

[15] "Amazon.com issues statement regarding Barnes & Noble/AOL commerce agreement," Amazon.com press release (December 18, 1997).

[16] John Evan Frook, "Barnes & Noble ups ante for Amazon, Borders," *TechWeb News* (July 16, 1998).

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book availability according to topic categories pre-selected by customers. Through its licensing agreement with Firefly Network, a software company that sold collaborative filtering technology, Barnes & Noble was able to generate recommendations for books and music via a database that carried a variety of selections but displayed similar preference profiles. In September 1997, Amazon introduced its "Recommendation Center," which included an "Instant Recommendation" feature that compiled automatically, based on customers' purchase histories, personalized lists of suggested titles. Another feature, "BookMatcher," made book recommendations based on profiles of individuals with similar preferences.

In July 1998, barnesandnoble.com launched its "Business Solutions" e-commerce program, which placed book titles and periodicals on a company's intranet in the manner of a "mini World Wide Web for a particular business." Lucent Technologies and Arthur Andersen were two of barnesandnoble.com's first clients.[17]

Customer service In the fall of 1997, Barnes & Noble finished construction of its 350,000 square foot New Jersey distribution center, which was to stock and enable next-day shipment of 90% of the books ordered through barnesandnoble.com. In November 1997, Amazon opened its 200,000 square-foot distribution center in New Castle, Delaware, which was to support same-day shipment of books to its east coast customers.

User navigation In September 1997, Amazon launched a new version of its home page that included a service that enabled returning customers to use one-click technology to order books online. In June 1997, Barnes & Noble launched an enhanced version of its Web site that included an Express Lane that supported single-click orders for books and other items from the Web site. The new site also introduced an online software superstore with more than 1,000 titles.[18]

Both Amazon.com and barnesandnoble.com were building their non-U.S. customer bases as well. In early 1998, both companies reported that 25% of their total annual sales came from abroad.[19]

New Entrants

By mid-1998, the industry was becoming more fragmented, with more than 500 online book retailers. Where once Amazon.com dominated the market, other superstores and publishing houses throughout the world were now competing for market share. Independent used and rare bookstores were also entering the market in droves. Meanwhile electronic book retailers were expected to enter the market by the fall.

Recent entrants included the following:

Bertelsmann In February 1998, German-based Bertelsmann announced its intention to enter the global online book retail business. The media and entertainment company would sell books in English, French, Spanish, German, and Dutch, from its publishing houses and those of other publishers, and ship them through its distribution networks in Europe and the United States.[20]

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[17] Bob Woods, "Barnes & Noble stumps for intranet e-commerce biz," *Newsbytes* (July 14, 1998).

[18] "Organic and barnesandnoble.com collaborate . . .," *PR Newswire* (May 27, 1998).

[19] Isabelle Sender, "On-line holiday shopping's happy new year . . .," *Chain Store Executive with Shopping Center Age* (February 1998).

[20] Carvajal.

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Chip Austin, the newly appointed president and CEO of the venture, was responsible for building Bertelsmann's global online book retailing business and further developing Bertelsmann's worldwide direct marketing consumer book clubs on the Internet. According to the press, Austin was exploring a number of options, including joint ventures or partnerships with existing Internet providers, existing retail services, and other potential entrants. Bertelsmann believed that within the next 10 years more than half of its business would be in electronic media and entertainment.[21]

Borders The world's second largest book retailer, with more than 200 superstores, 900 mall book stores (under the name Walden Books), and 24 U.K.-based Books Etc. stores, Borders launched its internet retail site, borders.com, in May 1998. The company expected to net $25 million in sales by the end of the year.[22] In June it announced an agreement with Muze, a leading provider of digital technology, to help borders.com create more customizable and searchable solutions for its customers. Between April 3 and June 1, 1998, six top executives (including the chairman and CEO) sold more than 1.1 million of their shares.

WH Smith U.K.-based bookstore WH Smith took its first step towards the online retail market in June 1998 by acquiring Europe's largest Internet bookseller, bookshop.co.uk, for US$14.4 million. Bookshop.co.uk had 80,000 customers, 1.4 million titles, and 50,000 CDs, videos, and computer games. After realizing 25% increases in sales every three months, the company's orders for the first quarter of 1998 increased by more than 120% compared with the same period the year before.[23]

Chapters Inc. Canada's largest bookstore chain, with 338 bookstores under the names Chapters, Coles, SmithBooks, Classic, The Book Company, and the World's Biggest Bookstore, planned a fall entry into the online book industry. It anticipated offering 2 million titles through its chaptersglobe.com site.

NuvoMedia Palo Alto, California-based NuvoMedia planned to launch its E-book services by fall 1998. Electronic versions of books purchased from NuvoMedia would be downloaded instantaneously to a computer and stored until loaded into a paperback-sized Rocket Book (cost: less than $500). NuvoMedia did not intend to become a retailer, but rather an invisible distributor. Barnes & Noble had invested $2 million and Bertelsmann an undisclosed amount in the company.[24]

SoftBook Press A fall 1998 launch of its E-book business was also planned by Menlo Park, California-based SoftBook Press. Customers would be required to purchase a 2.9 lb. notebook-sized Softbook for $299 and agree to buy $10 to $20 worth of books per month for two years. To order, they would dial the store and touch the desired title and the content would be downloaded over a phone line. The company planned to cut the cover price of the books it sold by 20% to 25%.[25]

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[21] "In search of a modern structure . . .," *Financial Times* (June 27, 1997).

[22] Mark Veverka, "Top executives at Borders selling a hefty chunk of their stock," *The San Francisco Chronicle* (July 22, 1998).

[23] Louise Nevill, "WH Smith nets book firm for 8M pounds," *The Scotsman* (June 9, 1998).

[24] Carol Vinzant, "Electronic books are coming at last," *Fortune* (July 6, 1998).

[25] Ibid.

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Who Will Win?

As of mid-1998 it was not clear who was winning the online book retail race. Although the big retailers had the greatest Internet visibility,[26] they were accruing significant losses. Later entrants such as Chapters and Bertelsmann had the advantage of entering a more mature market. "By having waited as long as we did," explained Chapters CEO Larry Stevenson, "there are now more people comfortable with Internet buying and we are jumping into a bigger market."[27] Although market consolidation seemed imminent, it remained uncertain how the electronic book industry would affect hard-copy retailers, whether they would partner up or compete against one another.

Despite the uncertainties, one thing seemed clear to one industry observer: "Amazon may or may not make money on the Internet, but somebody will."[28]

Exhibit 1 Profile of the Online Shopper in 1997

Gender		**Income**	
Female	32%	<$30,000	7%
Male	68%	$30,000-$50,000	18%
Age		$50,000-$100,000	57%
Under 30	9%	$100,000+	18%
30-39	23%	**Geography**	
40-49	41%	Major metro	9%
50-64	23%	Suburb of major metro	43%
65+		Medium-sized city/town	29%
Education		Small town	19%
Some College	27%		
College	38%		
Post grad	26%		

Source: Ernst & Young's 1997 Internet Retail Shopping Survey.

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26 Amazon.com was linked to search engines Excite, Netscape, and Alta Vista; barnesandnoble.com to Lycos; and borders.com to Infoseek.

27 Judy Stoffman, "Chapter to launch Internet bookstore offerings . . .," *The Toronto Star* (March 27, 1998).

28 Clint Willis, "Does Amazon.com really matter?," *Forbes* (April 6, 1998).