Barnesandnoble.com (C)

The Internet is more than anything else, the biggest, the best, and most cost-efficient broadcast channel in the history of retail. It is specific to our demographics; it gets our customers full attention; and it will create more store traffic.[1]

— Steve Riggio, Vice Chairman and acting CEO, Barnesandnoble.com

During 1999, unlike Amazon.com, barnesandnoble.com's key competitor in the selling of books online, barnesandnoble.com had limited its expansion to the selling of books and other media-related products (see **Exhibit 1**). Whereas Amazon.com had quickly moved into other retail categories such as auction items, electronics, home improvement goods, and toys by the end of 1999, barnesandnoble.com stuck to its vertical niche strategy of only selling media-related products by limiting its increased consumer offerings to music, prints, posters, and e-cards. In addition, barnesandnoble.com continued to focus on the basic fundamentals of bookselling by carrying a larger number of new titles it had on-hand than Amazon.com and expanding the number of used books available for resale through its site.

As a result of barnesandnoble.com's continued emphasis on bookselling and media-related goods, the company enjoyed strong growth in 1999. During 1999, the company recorded $202 million in net sales, tripling $61.8 million in net sales that barnesandnoble.com had earned in 1998 (see **Exhibit 2**). Reflecting the increased sales, the company's customer base increased almost three-fold from 1.3 million to 4.0 million and the number of affiliate sites increased nearly six-fold from 48,000 to 300,000 over the same time period. The percentage of repeat customers increased from 63% in the Third Quarter 1999 to 66% in the Fourth Quarter 1999.[2] By the end of 1999, barnesandnoble.com was the 24th most visited site on the Web - up from 29th place during the Third Quarter 1999 — and the fourth most visited retailer, — but the number one multi-channel retailer on the Web[3] — behind Amazon.com, E-Bay, and Bluemountainarts.com .[4]

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[1] Barnes & Noble booksellers 1999 annual report

[2] barnesandnoble.com, 1999 earnings release, February 8, 2000.

[3] Barnes & Noble booksellers 1999 annual report

[4] "Top 50 Web sites," *San Francisco Examiner*, March 7, 2000.

Dickson L. Louie prepared this case under the supervision of Jeffrey F. Rayport, CEO of Marketspace, a Monitor Group Company, written while he was Associate Professor at Harvard Business School. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

Despite the increased sales and number of customers, barnesandnoble.com had lagged behind Amazon.com in market share of book sales, by almost a three-to-one ratio. During the Fourth Quarter of 1999, when Amazon.com first began to break out its sales figures by category, Amazon.com had recorded $317 million in book sales whereas barnesandnoble.com had reported $82 million in sales for the same time period. In addition, Amazon.com now reported 16.9 million customers, an increase of 10.7 million customers from the 6.2 million at the end of 1998.

A year earlier barnesandnoble.com had less than ten percent of all online book sales. During 1999, the company had increased its market share of book sales to 25% and the sales of media-related products — including books, magazines and CDs — were expected to almost triple form $3.6 billion in 1999 to $12.4 billion in 2004. In addition, a May 1999 IPO — in which Barnes & Noble and Bertelsmann A.G. each retained a 40% stake in the company — raised $486 million for barnesandnoble.com, which left the company debt-free and with almost $450 million in cash on hand at the end of 1999. By comparison, Amazon.com carried approximately $2 billion in debt at year-end 1999, largely due to the building of several super warehouses nationwide during 1999 to handle its increased product offerings.

Some industry observers began to wonder whether Amazon.com's expansion into new retail categories would stretch its brand too far[5] and would give barnesandnoble.com an opportunity to be able to exploit Amazon.com's weakness by making barnesandnoble.com the premiere "brand" for online book selling which it had already achieved in the physical, retail world with its 500 locations nationwide.

The Online Bookselling Wars, 1999

While barnesandnoble.com increased the selection of titles which it had available on hand to almost 1 million — with the ultimate goal to stock every known book in print[6] — compared to Amazon.com's 300,000 titles, the online bookselling wars between Amazon.com and barnesandnoble.com was primarily fought in four areas during 1999: price, product offerings, patents, and marketing (see **Exhibit 3**).

Price With the pricing policies of both barnesandnoble.com and Amazon.com remaining largely unchanged—30% off of most hardbacks and 40% off of selected titles — during 1998, both companies increased the discount offered on *New York Times* bestsellers from 40% to 50% on May 17, 1999.

Product Offerings During 1999, barnesandnoble.com expanded into several media-related product categories. In July 1999, the company announced the launch of its music store, which offered CDs for sales. In October 1999, the company launched its prints, poster and e-card stores. And in December 1999, barnesandnoble.com announced that it had acquired a 40% stake in e-news, the leading seller of magazines online.

Patents In September 1999, Amazon.com received a patent for its one-click technology, which enabled consumers to order books and products from its site with a simple click of the mouse, saving consumers downloading time and the necessity of going through several pages to make an online order. Barnesandnoble.com had employed a similar technology with the introduction of its Express Lane Ordering in June 1998, after Amazon.com had introduced a similar feature on its Web site in December 1997. In December 1999, Amazon.com sought an injunction against barnesandnoble.com to prohibit them from using its Express Lane Ordering to protect its patent for one-click technology.

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5 Hof, Robert F., "Can Amazon Make It?" *Business Week*, July 10, 2000.

6 Barnes & Noble, 1999 Annual Report.

Marketing To solidify its position of becoming the dominant bookseller online and to simplify the ordering of books through its site, barnesandnoble.com added two URLs during 1999 that would also access the barnesandnoble.com site : www.bn.com and www.books.com. The first URL was added in April 1999 to make it easier for consumers to remember and access the site without keying in the full name. The second URL was purchased from Cedant Corporation in November 1999 to strengthen barnesandnoble.com's association with books. In addition, during 1999, barnesandnoble.com began to drive traffic to its site from its 500 physical stores, by offering store visitors coupons to makes purchases online. Approximately $6 million of barnesandnoble.com's marketing costs were related to these in-store coupons (see **Exhibit 4**).

Conclusion

While barnesandnoble.com had recorded an operating loss of $102 million in 1999, the company was beginning to scale up steadily and was expected to earn a profit in 2002.[7] Nevertheless, barnesandnoble.com's stock was trading at $14 per share, slightly below its IPO price of $18 per share. Should barnesandnoble.com stay on its steady course of constant growth or should it attempt to scale up quicker? Also, as Amazon.com continued to expand, what was the downside of not expanding faster? And how could barnesandnoble.com exploit the Amazon.com brand as it expanded beyond books?

[7] barnesandnoble.com, 1999 earnings release, February 8, 2000. Company CFO Marie Toulantis noted in the statement, “We see 2000 as a key inflection point, which sets the stage for significantly decreasing losses in 2001 and we anticipate a quick rise to profitability in 2002 as we benefit from leveraging our investments."

Exhibit 1 Barnesandnoble.com Home Page (July 2000)

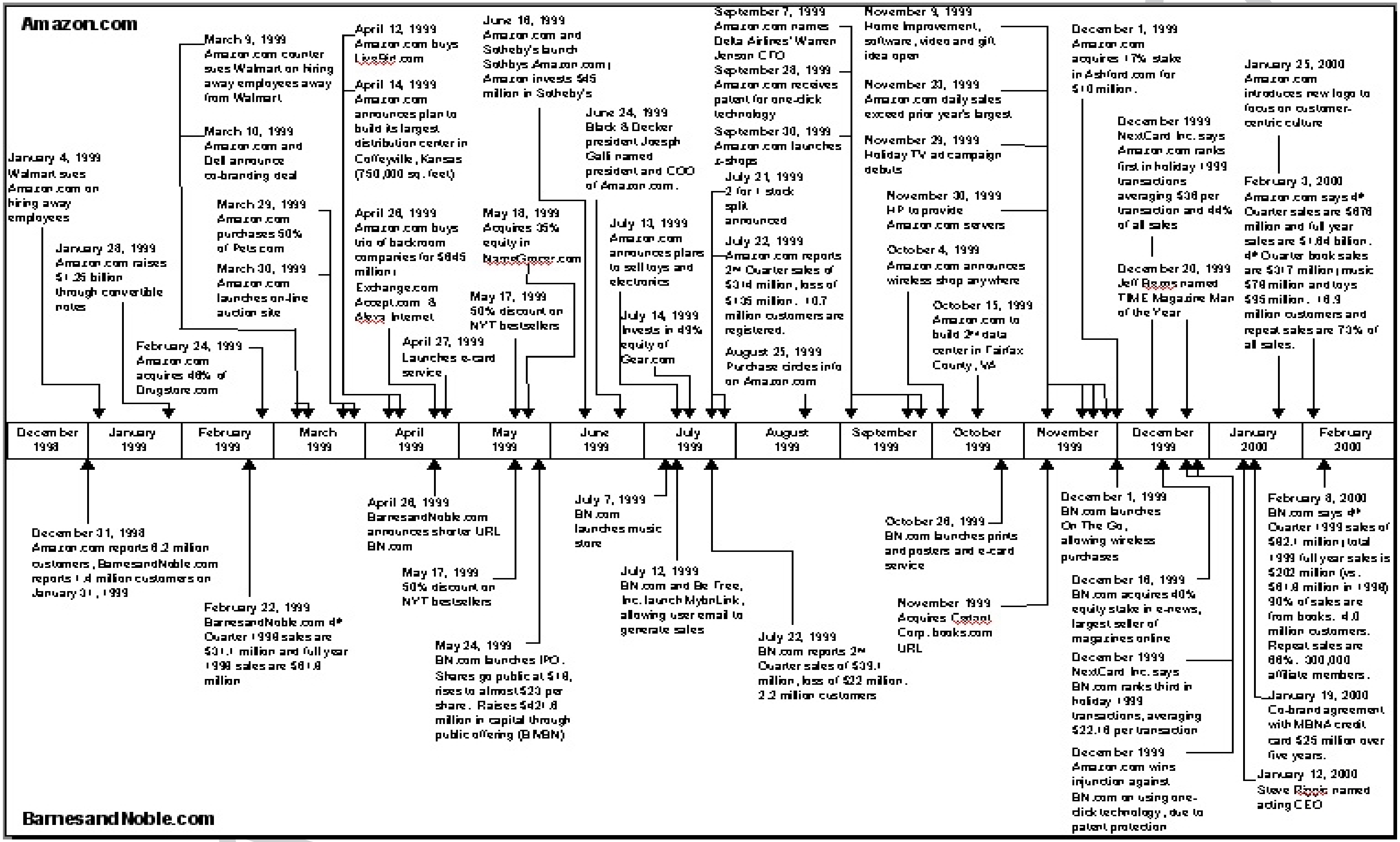
Source: barnesandnoble.com

Exhibit 2 Barnesandnoble.com Income Statement, 1998 and 1999 (in thousands)

	1999	1998
Net Sales	$202,567	$61,834
Cost of sales	159,937	47,569
Gross profit	42,630	14,265
Operating expenses		
Sales and marketing	111,553	70,423
Product development	21,006	8,532
General and administration	32,714	19,166
Total operating expenses	165,273	98,121
Operating loss	(122,643)	(83,856)
Interest income, net	20,238	708
Net loss	($102,405)	($83,148)

Source: barnesandnoble.com press release, February 8, 2000.

Exhibit 3 Online Book War Timeline, 1999



Source: Amazon.com and barnesandNoble.com press releases

Exhibit 4 In-Store barnesandnoble.com coupon

Source: barnesandnoble.com