

# Fighting over the Internet

The virtual battle between Amazon.com (USA) and Bol.de (Germany)

Businesses can do things on the Web that simply cannot be done any other way. We are changing the way people buy books and music ... Amazon.com provides a whole new level of convenience and customer service for book buyers. These are [virtual] stores that are open around the clock, even on Christmas Eve, where people can find the specific books, music CDs, videos, computer games, etc. they want and discover others they may also like to buy. It combines the power of the Internet with a very personalized experience.

Jeff Bezos, President and Chief Executive Officer, Amazon.com

On the afternoon of 29 April 1999, as Jeff Bezos was contemplating the new business strategy Amazon.com needed to fend off increasing competition in the Internet book sales in general and Germany's Bertelsmann Online (BOL) in particular, an urgent message from Wall Street blinked on his computer screen. It read: 'While Amazon.com, the most stellar of all electronic commerce stocks, started the week at \$210 per share, it went down by today's close to \$168.' This information made Jeff Bezos realize that his company's stock had not followed the positive trend of the technology companies in a month that was one of the best in the history of the US stock market. In light of the recent news, he began to ponder whether Amazon.com could continue to revolutionize retailing and to set a benchmark for electronic commerce while repeatedly incurring heavy losses. He was wondering whether, in spite of its disappointing financial results at home, the company should continue with its geographical expansion and the increase in product and service offerings.

## The book industry in Germany

### Industry overview

In 1998, the book industry in Germany had sales of DM11.2 billion.<sup>1</sup> Around 5500 book stores operate in the highly fragmented German market. The 80 largest book stores (as measured by sales) had only a 30% share of the whole market. Hugendubel leads this group, with sales of DM299 million, followed by Karstadt/Hertie (DM262 million) and Phönix/ Montanus (DM221 million).<sup>2</sup> Hugendubel operates 20 branches throughout Germany with a total selling surface of 24 000 square metres<sup>3</sup> and 740 employees (see Table 1). Industry-wide, annual sales per employee averaged DM288 500 and annual sales per square metre of selling surface were DM9120. In Germany, 3200 publishing houses published 78 000 new publications in 1997. One local bookstore serves about 17 000 customers and the average purchase is around DM27.<sup>4</sup>

### Price fixing in the German book industry

A unique feature of the German book-retailing industry is the way in which book prices are fixed, requiring book retailers to sell their books at pre-determined prices set by publishers. The book price

1 On 12 June 1999, the exchange rate between the Deutsch mark and the US dollar was: US\$1 = DM1.864.

2 Buchreport 15, 1999.

3 One square metre = 10.76 square feet.

4 In the USA 270 000 customers are served on average by one book store.

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**Table 1** The ten Largest physical bookstores in Germany

	Sales in 1998 (DM Million)	Number of outlets	Total selling surface (m <sup>2</sup> )	Number of employees
1 Hugendubel	299 DM	20	24 000	740
2 Karstadt/Hertie	262 DM	230	21 000	Not available
3 Phönix-Montanus	222 DM	54	23 450	685
4 Kaufhof/Horten	174 DM	122	22 000	Not available
5 Librodisk	169 DM	240	23 000	430
6 Weltbild plus	125 DM	118	18 900	410
7 Thalia	117 DM	17	14 300	350
8 Mayersche	115 DM	14	20 200	300
9 Bouvier	108 DM	9	7 966	290
10 Weiland	80 DM	15	9 270	286
71 Boulevard (Bertelsmann)	15 DM	14	5 535	Not available

Source: Buchreport 15, 1999

fixing is a voluntary agreement between all publishers, wholesalers and book retailers in Germany; it is meant to protect the German book-publishing industry and the small book stores. The supporters of the book price fixing argue that the fixing is necessary for a variety of reasons. First, it protects smaller book stores (of which there are many in Germany) that cannot generate the same economies of scale as the large book-store chains, such as Hugendubel or Phonix do. If the book price fixing were to be abandoned, they argue, it would be impossible for the small book stores to compete against the discounts of large chains, which would have a stronger bargaining position vis-à-vis wholesalers and publishers. Second, it allows publishers to cross-subsidize the publication of seldomly bought books with the large profit margins from best-sellers. The publishers argue that they would not be able to provide such a wide variety of different books if they could not cross-subsidize, which is possible only as a result of the high prices that they can charge for their best-selling books. In 1984, the German parliament decided to maintain the system of fixing book prices arguing that ‘without protection through fixing book prices, the German book publishing and retailing industry would not be able to fend off the multitude of dangers that threaten the “reading culture” in Germany.’ Currently, the economics in the book-retailing industry in Germany are as follows: if the consumer pays DM100 for a book at the retailer, then this retailer paid around DM60–75 to the wholesaler, who paid about DM50 to the publisher. Critics of the price fixing argue that the book

price fixing undermines competition, which ultimately hurts the customers, who pay more than necessary for their books. It is expected that price fixing will eventually be abandoned as the European Union (EU) continues to loosen up regulations within member states.

### Response of traditional book retailers to the Internet

Traditional book retailers have shown mixed reactions to the increasing importance of online book retailing. As of today, of the 5500 book retailers in Germany, 1200 are present on the Internet.<sup>5</sup> A variety of Internet-based book retailing exists in Germany. In addition to Amazon.de, Bertelsmann Online (Bol.de) and other virtual book stores that ship their books through the postal service, there are other online book stores that rely on traditional retail outlets for distribution. For instance, customers choose their books from a selection of 800 000 titles displayed on Buchhandel.de’s website and are then directed to a physical book store nearby, where they can pick up their purchase. Oliver Waffender, manager of electronic publishing at Buchhandel.de, comments: ‘We provide a high-performance Internet platform through which small and medium-sized book stores can connect.’

Other book stores are more sceptical about the possibilities of the Internet. Torsten Brunn, director

<sup>5</sup> Source: Gesellschaft für Konsum und Absatzforschung (GfK), a marketing research company.

of purchasing at Hugendubel (a company that does not yet have a website), comments:

We have been following the developments in the online business for a few years now. As long as the online book market still remains a market for insiders, it doesn't make much sense for a mass provider like Hugendubel to enter the online book market. Only very few customers ask for a Hugendubel homepage. As long as we cannot fulfil the [online] expectations that are placed on us as a market leader, we will not go online. This [the preparation for offering online services] will probably take us until the end of 1999.

At present, 42% of all German households own a PC; 22% of all German citizens who are above the age of 14 use the Internet, and in the second half of 1998 2.4 million Germans shopped through the Internet.<sup>6</sup> Approximately 400 000 German Internet users purchased books online in 1998. The average purchasing amount for Internet book buying is approximately DM60–70.<sup>7</sup>

### The media company Bertelsmann AG<sup>8</sup>

We have a broad range of media products in all fields. By the turn of the millennium, approximately half of our turnover will be in the print media industry, and the other half will be in the electronic media industry.<sup>9</sup>

Thomas Middelhoff, Chief Executive Officer Bertelsmann AG

### Company overview

Bertelsmann was set up a 163 years ago as a family-operated medium-sized publishing house. Today, Bertelsmann is a worldwide media group that operates in all areas of mass media. It is structured along five product lines, including book/magazine and newspaper publishing, as well as music, radio, television, movies and multimedia. Each business line is managed as a separate company, with its own board of directors. Bertelsmann's corporate headquarters, located in Gütersloh (a town of 50 000 inhabitants near Hannover), are responsible mainly for the company's financing and investment decisions as well as organizational development and group management. As a result of the decentralized organization, every company within the Bertelsmann group enjoys strong autonomy (in terms of its products and services, human resources, operating targets, etc.) and is responsible for its own business results. Mark Wössner, former chairperson and chief executive officer (CEO) of Bertelsmann AG, explains: 'We want the CEOs of the various Bertelsmann companies to feel and act like entrepre-

neurs. Our management structure is set up to put the "employee entrepreneur" in as analogous a situation to the "owner entrepreneur" as possible.'

Due to its decentralized organizational structure, one of Bertelsmann's challenges is to link effectively the different divisions of the company. Thomas Middelhoff points: that

If we don't work together, we can't achieve any synergies. If Whitney Houston [a pop singer who is under contract with BMG<sup>10</sup>] wants to write a book, it should be self-evident that this book will be published by Random House.<sup>11</sup> [Similarly] members of Bertelsmann book clubs pay a special rate when signing on to AOL.<sup>12</sup>

With more than 600 individual companies, the Bertelsmann group employed in 1998 a total of 57 807 people in 53 countries (including 23 817 in Germany). Thomas Middelhoff (who is 46 years old), replaced Mark Wössner in the autumn of 1998. Before that, he had been a member of Bertelsmann's executive board in charge of co-ordinating the group's multimedia activities since 1994.

Compared with the previous year, the total sales in 1998 rose by 2.4% to DM23 billion, with Germany accounting for 30.5%, other European countries for 30.4%, and the USA for 30.5%. The remaining turnover was generated in other countries. After tax, income for the year increased by 9.8% to DM1.122 billion.

In order to achieve its business goals, Bertelsmann's guiding principles (as stated in company documents) are as follows:

#### 1. *Responsibility to society:*

- Our publishing work serves mankind's communication needs. It imparts knowledge and education and promotes the free development of opinions within society.
- We are a media enterprise with a pluralistic structure. The individual publishing houses and firms publish and circulate varied opinions and in each case develop their profiles. Freedom of publication and variety are ensured by decentralization and delegation of responsibility for programmes.

6 Buchreport 15, 1999

7 Die Zeit, 2 February 1999, p.

8 AG stands for 'Aktiengesellschaft', meaning corporation.

9 Excerpt from 'A media company's strategies for the next millennium', keynote speech given at the 7<sup>th</sup> German Multimedia Congress, Stuttgart, 26 April 1999.

10 Bertelsmann Music Group.

11 Random House is Bertelsmann's USA-based publishing house.

12 America Online.

- Given the international nature of our work, we intend to respect and promote national characteristics and cultural traditions.
- 2. *Entrepreneurial leadership and organization:*
  - Entrepreneurial initiative through business-related decentralization.
  - Consistent delegation of tasks, authority and responsibility in accordance with individual operational business units and central staff and services.
- 3. *Partnership in the company:*
  - Creation of areas of freedom for the individual so that they can fulfil the assigned task, and inclusion of the employees in the entrepreneurial decision-making process on a departmental and corporate level.
  - Implementation of a just compensation through wages appropriate to market conditions, compensation of executives in accordance with their success, and sharing by all employees in the profits and capital of the company.

These guidelines represent the framework within which each individual subsidiary creates its own identity.

The majority of the capital shares of Bertelsmann AG are held by the non-profit Bertelsmann Foundation. In September 1993, Reinhard Mohn, member of the founding family of Bertelsmann, transferred 68.8% of the capital shares of Bertelsmann AG to the Bertelsmann Foundation, the Mohn family kept 20.5% of the shares, and the ZEIT Foundation kept the remaining 10.7%. For Reinhard Mohn, the reason for the renunciation of a large part of the family's property was to secure the continuity of the media company irrespective of family interests.

### Bertelsmann's Buch AG

In the 1997–98 business year (ending 30 June 1998), Bertelsmann's book-publishing division (called Buch AG) had revenues of US\$7.3 billion (\$5.1 billion of which came from outside Germany), as compared with DM7.1 billion for the previous year. Sales revenues breakdown was 34% in German-speaking countries, 28% in the USA, and 36% in other European countries. During the same time period, the number of employees at Buch AG rose from 17 800 to 18 400.

Recent acquisitions by Buch AG include Random House (purchased at a price of \$1.4 billion), which is where all the USA-based book publishing activities are integrated. The newly formed Random House Inc.

group consists of autonomous publishing divisions of Bantam,<sup>13</sup> Doubleday, Dell, and Random House with its 27 publishing companies. Random House now operates publishing houses in the USA, Canada, the UK, Australia and South Africa. It currently offers some 25 000 titles in hardback and paperback editions. Best-selling authors such as John Grisham, Danielle Steel and Michael Crichton (who have each sold more than a million copies of their books) are published by Random House. The acquisition of Random House made Bertelsmann the largest consumer book publisher in the English-speaking countries.

The main revenue driver of Buch AG is the book-club business, which accounts for 60% of the company revenues. Other revenues are generated from publishing (23%), professional information (10%) and direct marketing (7%). These clubs operate in Germany, Austria, France, Italy, Portugal, Poland, Spain, the Netherlands and China,<sup>14</sup> with a total of 26 million members. Through its book clubs and magazines, as well as AOL and CompuServe,<sup>15</sup> Bertelsmann has direct contact with more than 44 million consumers.

### Bertelsmann's multimedia division

We have a core competence in the generation of media content, whether for books, magazines, newspapers, television, the radio or the Internet.

Thomas Middelhoff

The Bertelsmann multimedia division had consolidated sales of DM313 million in the 1997–98 business year and employed 930 people. The multimedia division is involved in the creation of content as well as services. It includes the subdivisions of new media media systems and electronic commerce.

### The new-media division

The new-media division currently includes the following multimedia offerings that target the end customer (i.e. the consumer):

- **AOL.** With 15 million subscribers around the globe, AOL is the world's largest Internet service. AOL Europe operates as a 50/50 joint venture between

<sup>13</sup> In 1997, Bantam Books had 32 best-sellers in the *New York Times's* books rating.

<sup>14</sup> The China Book Club, *Shanghai Culture Company*, has a membership of more than 600 000 subscribers.

<sup>15</sup> Bertelsmann owns a 50% stake in both AOL and CompuServe.

AOL Inc. and Bertelsmann. It has more than 2.5 million subscribers, including 800 000 members in Germany and 450 000 members in the UK.

- **CompuServe.** CompuServe Europe is a joint venture between Bertelsmann and AOL. It provides online users with PC-relevant offerings and business solutions. It has 850 000 subscribers in more than 30 countries, including the UK, Austria, Switzerland, Germany, France and the Netherlands.
- **Game Channel.** The Game Channel is an Internet channel that offers multi-layer games (i.e. games that are played with several hundred participants over the Internet). It also offers news, chats, and an 'e-shop' from which hardware and software can be ordered.
- **Lycos.** Lycos is an Internet-navigation system that is operated in Europe as a joint venture between Lycos, Inc., Bertelsmann AG and Christoph Mohn. In addition to advanced search operations, Lycos offers current information such as daily share prices, news, sports, weather services, personal Web guides and city information. Lycos is represented in the UK, Germany, France, Italy, the Netherlands and Sweden with services in their respective languages.
- **Sport 1.** Sport 1 is an Internet news channel that provides the latest sports information on soccer, Formula 1 motor racing and other sports. The offer includes videos with edited highlights of the latest Bundesliga events,<sup>16</sup> chat rooms, interactive games, and information from over 10 000 Bundesliga games.

Thomas Middelhoff states Bertelsmann's strategy for AOL, CompuServe and Lycos:

We will continue to develop AOL, CompuServe and Lycos as Internet portals.<sup>17</sup> The number of AOL members in Germany has doubled within one year, from 400 000 to 800 000. We are striving to double this number again in the coming year. Together with CompuServe, we have about one million members. Throughout Europe, 2.5 million customers are with AOL and CompuServe; we project this [number] will grow to ten million within the next three years.

### **Media systems division**

Bertelsmann's media systems division operates all computer centres and network infrastructures that operate within the Bertelsmann group and also offers

services to external customers. It is comprised of the following subdivisions:

- **mediaWays.** mediaWays operates one of the largest TCP/IP<sup>18</sup> networks in Europe and provides network solutions ranging from intranets to IT systems management. The company is a joint venture between Bertelsmann and Debis Systemhaus (an IT services subsidiary of the Daimler Chrysler corporation).
- **Pixelpark.** Pixelpark is a multimedia agency that offers digital services for corporate as well as brand communications in the fields of electronic commerce, electronic finance and electronic marketing.
- **Telemedia.** Telemedia designs and implements Internet and intranet solutions in Germany, including regional online services and turn-key solutions for electronic commerce.
- **C@llas.** C@llas offers telecommunication services that integrate the multimedia assets of the Internet. Private and business customers can use C@llas for their telephone, fax, answering machine and email services
- **NuvoMedia.** In June 1998, Bertelsmann made a significant investment in the California-based high-tech company NuvoMedia. The company core business focuses on the development and marketing of a portable 'electronic book' (called the Rocket Book), which allows users to load books from the World Wide Web via a network of online booksellers. The small appliance is the size of a pocket book, weighs about 600 g and can hold in its built-in memory at least 4000 pages of text (or the equivalent of ten novels). In Germany, the distribution of the electronic book, which will cost the customer around DM900 to purchase, will take place through the Bertelsmann Book Club. Its contents can be deleted at any time and replaced with new reading material. Henric Buettner, managing partner of Bertelsmann Ventures, explains:

This complementary book distribution channel offers great opportunities. For the user it means good value and simple access to all published products. For the publishers the Rocket Book represents the latest move

<sup>16</sup> The Bundesliga is the premier German soccer league.

<sup>17</sup> An Internet portal acts as a gateway to other sites. They vary from industry, product or consumer interest. They do not contain information at the site.

<sup>18</sup> Transfer Code Protocol/Internet Protocol.



in the rapidly growing online book business. It offers reliable and easy access to new readers who don't traditionally purchase in bookstores but are digitally open-minded.

## Bertelsmann online venture

Bertelsmann Online [BOL] will be the first truly international media retailing service, offering a comprehensive selection of titles in a variety of languages, supported by locally implemented customer marketing and fulfilment services.

Heinz Wermelinger, President and Chief Executive Officer,  
Bertelsmann Online

## Company history

On 25 February 1998, Bertelsmann announced that it had launched a project to develop an online bookstore in 1999. Klaus Eierhoff, member of the Board of Bertelsmann AG, explained: 'In just a few years time, the Internet will be a central distribution channel. Therefore, this is exactly the right time to launch BOL.'

By entering the online book market, Bertelsmann hopes to leverage the assets of its global network, including:

- a large database with more than 35 million active books and music club members in North America and Europe;
- access to a global inventory of available titles published in a wide range of languages;
- a well-established editorial and operational infrastructure in key countries around the world through the existing Bertelsmann direct marketing clubs;
- a close relationship with AOL through its equity stake in the parent company, which provides domestic Internet access service.

Markus Wilhelm, President and CEO of the US publishing house Doubleday Direct, further explains the rationale for launching BOL:

Digital retailing is both a natural progression for our ever-growing international database marketing operations, as well as a potential to be a very attractive business in its own right. With the surging popularity of the Internet and online book buying becoming more prevalent, our expertise in how to reach the general-interest as well as niche consumer book market segments makes Bertelsmann Online an appropriate and exciting fit with our long-term growth strategy and our assets.

BOL was launched on 4 February 1999, simultaneously in Germany (through [www.bol.de](http://www.bol.de)) and France (through [www.bol.fr](http://www.bol.fr)). Thomas Middelhoff elaborates on Bertelsmann's electronic commerce strategy:

Now BOL is also operating in England and the Netherlands, with considerable startup success there as well. This year, Spain and Switzerland will follow. It is our goal to become the number one in Europe. In the medium-term we are planning the start of BOL in Italy and in Asia. We know today that books make up a quarter of all goods and services purchased on the Internet – and we recognize the tremendous potential that exists here.

BOL has entered new markets mainly through joint ventures such as the one it has with Havas in France, with Planeta in Spain and with Mondadori in Italy. Furthermore, it is currently looking for partners in Japan and Asia.

## The IT system of BOL

Bertelsmann formed a partnership with Oracle, the database provider, to develop and implement the technology platform needed for the online bookstore. The platform was built in just nine months, a record time to market in the industry. Its open and modular features offer the scalability and flexibility needed not only to integrate software components from other providers but also to expand over time. All BOL stores use the same technology platform; the latter can be adapted easily to new market needs, new products, new currencies and new languages. Heinz Wermelinger explains: 'Our e-commerce platform is international. The individual stores, however, are adapted to the needs of the specific countries in which we operate.' The high quality of this technology platform enables BOL to set up a new store within six to eight weeks.

## The BOL.de website

In Germany, BOL currently offers through its virtual store a selection of 500 000 book titles. Its website (BOL.de) provides customers with information about best-selling books as well as abstracts, contents, reviews and editorial recommendations about all listed books (see Exhibit 1). Customers are thus better informed before making their purchasing decision. Christoph Pech, a young manager at a large consumer goods company in Cologne, elaborates:

It is fairly easy to find a specific book through the BOL website. The [site's dialogue] menu has a clear struc-

### Exhibit 1 B0L.de website



ture, and the organization of the home page is very customer-oriented. With the links to the international activities of BOL, you can even find books in languages other than German. In a physical book store here, you normally have to wait for several weeks before receiving a book in French or English.

The BOL website also allows customers to create their personal profile ('My BOL'), which includes literary preferences,<sup>19</sup> payment mode and delivery address. To sign on to the personal profile, customers need to enter their email address and a previously specified password. Once this information is given, they are informed on a regular basis about publications in their preferred literary areas/subjects or by their favourite authors when they access the BOL website. Dr Christof Ehrhart, Vice President for Corporate Communications at BOL, explains:

Using your [i.e. the customer] profile in terms of preferred authors, topics, content, etc., 'My BOL' builds a store that is uniquely yours. This is a different level of personalization than sending out an individual email as some competitors do. Furthermore, through our 'Minisite' concept, we don't just show a book as a hypertext link that you click on, but we show a small-frame environment which contains additional content such as information about the author, reviews about the book, editorial recommendations, etc.

BOL gives customers the opportunity to submit book reviews, which are posted on the BOL website. Customers can also subscribe to a BOL newsletter, which provides customized news about preferred book types and authors. Furthermore, the purchasing process becomes easier, since all the necessary information about payment<sup>20</sup> and delivery mode

does not need to be entered each time a book is purchased. It is also possible to track the progress of orders from the time they are placed to the moment of delivery. Jörn Dopfer, a theology student at the University of Leipzig, Germany, explains:

I really like the layout of the BOL web site. Although I don't know much about the Internet and technology in general, it's very easy for me to find my way around on the BOL website. I also like the incredible selection of books they have. I am very interested in theology literature, and I can find very specific books on the subject. But at the same time I feel bad for the small book stores which have to face this new competition, and I still try to go there. But they [the traditional book stores] just cannot offer this kind of selection, nor the search and browsing capabilities that BOL and Amazon.com offer.

Once a customer has selected a book, they can place it into their personal shopping basket by clicking on the mouse button. At the checkout, the customer is asked for their name, address and credit-card details (unless they have set up a personal profile that already contains all these data). If preferred, it is also possible to give the credit-card number to a BOL representative over the phone or send a bank cheque. Jörn Dopfer prefers the mode of payment at BOL to that at Amazon.com; he said:

When I bought books at Amazon.com, I didn't like the fact that I had to pay by credit card. I really don't want to pass on credit-card information through the Internet. Who knows what might happen to it? At BOL, I can ask them to send me the bill and pay later. I have two weeks to pay. If I get the wrong book, I can send it back before paying.

At BOL, orders, personal information (name, address) and credit-card information are encrypted by means of Secure Socket Layers (SSL), a security standard that is supported by Internet browsers.<sup>21</sup>

In the future, BOL plans to build through its website a virtual community of book readers in order to facilitate communications among its customers through, for example, chat rooms. It also plans to expand its product range by including music CDs

19 The selection of preferences includes, among others, fiction, travel, education, business, computers and Internet.

20 BOL offers its customers three options: billing, payment by direct debit, and payment by credit card. While the first two options are most favoured by German and Swiss customers, British clients prefer to pay by credit card.

21 In case of misuse of credit-card information, BOL covers a deductible of up to DM100, provided that the error was not committed by the customer.

and videos. Furthermore, when it becomes technologically feasible, BOL intends to offer customers the possibility of downloading digitized content (book, music and film) through the Internet directly from the BOL website to the customer computer.

### Order fulfilment and delivery

Order fulfilment is done in Germany through Bertelsmann's distribution company. In France, it is performed by France Loisirs, a 50%–50% joint venture between Havas and Bertelsmann. In the UK, it is managed by BCA, the Bertelsmann's book club there; and in the Netherlands, it is done through a public distributor owned by book publishers.

Delivery within Germany is free of charge,<sup>22</sup> and the average shipping time is two to three business days. In Germany, both Amazon.de and BOL deliver their books through the postal service. Upon receipt of the book package, the customer needs to sign a delivery form. If the customer is not at home when the delivery takes place, the postman leaves the package at the nearest post office, from where the customer can pick it up at a later time.

### Strategic alliances

On 7 October 1998, Bertelsmann signed an agreement with Barnes & Noble, the largest physical book retailer in the USA, to establish a joint venture with its Internet subsidiary barnesandnoble.com. Bertelsmann paid US \$200 million for a 50% stake in the joint venture. Bertelsmann and Barnes & Noble also each contributed \$100 million to the capital of the joint venture. The arrangement between the two companies is that barnesandnoble.com focuses on the USA and Canada while BOL focuses on the rest of the world. Thomas Middelhoff explains the rationale for this strategic alliance:

Barnes & Noble has one of the most recognized and trusted names in book retailing and we share great hopes for the potential of this new medium. Books have always been our core business, and we believe our e-commerce initiatives will benefit consumers, publishers and the entire book industry ... Through our e-commerce initiatives, Bertelsmann will continue to adhere to our principles of decentralized operations, which we have consistently followed throughout our history. Neither our English language-book publishers nor our consumers' direct marketing book clubs will be involved in the management or operations of barnesandnoble.com.

Launched in May 1997, barnesandnoble.com has become one of the 25 fastest growing websites and

has over 700 000 customers. It offers a selection of 650 000 in-stock titles through the Barnes & Noble distribution centre and provides access to over 2.5 million titles from over 27 000 publishers. In the first six months of 1998, barnesandnoble.com generated sales of \$22 million<sup>23</sup>. It is the exclusive bookseller to AOL's 13 million subscribers and has strategic partnerships with the top 20 websites, including CNN and Lycos.

Leonard Riggio, President and Chief Executive Officer of Barnes & Noble Inc., elaborates further:

We are delighted to enter this exciting new phase of our e-commerce expansion with a partner of Bertelsmann's status. Their extensive expertise in direct marketing and their prominent position as a media company will strengthen our capital structure, enhance the quality of our offer, and most profoundly, provide barnesandnoble.com with immediate access to global markets.

In Germany, BOL signed an agreement with *Focus*, the German weekly news magazine, through which readers of the online version of *Focus* are connected directly with the BOL website. Heinz Wermelinger explains: 'The co-operation with *Focus* helps us to achieve a strong presence in the Internet right from the start. With its wide selection of books and the easy usage, BOL will be very attractive for *Focus* Online readers.' Jörg Buerosse, editor-in-chief of *Focus* Online, states his rationale for the decision: 'With BOL we have found the ideal partner to expand the services for our readers even further.' *Focus* has been offering its online service for four years; with 12 million hits a month, it is one of the most successful German websites.

Regarding BOL future plans, Christof Ehrhart said:

For the short term, we'll add music products to our book selection. By the coming Christmas season, we'll have 500 000 music titles on sale through the Internet in Germany, France, the Netherlands and the UK. For the long term, we want to become a full-fledged online media store that offers any media product online, be it a book, a newspaper, a magazine, a music CD, or a video, and not only Bertelsmann products. Also, we want in the future not only to offer the opportunity to order online, but also to distribute online through the 'Rocket book' technology [i.e. the portable electronic book].

22 In countries such as the UK where book prices are not fixed, BOL offers discounts of up to 40% of the book price but charges for the delivery.

23 Barnesandnoble.com launched an initial public offering on 25 May 1999.



## Amazon.com: the US Internet bookseller and music store

I buy my books at Amazon.com because I am busy, and it's convenient. They have a big selection and they have been reliable.

Bill Gates, President and Chief Executive Officer Microsoft

### Company history

In 1994, Jeff Bezos, a computer science and electrical engineering graduate from Princeton University, was the youngest senior vice-president in the history of D.E. Shaw, a Wall Street-based investment bank. During the summer of that year, an Internet statistic caught Jeff Bezos's attention: Internet usage was growing at 2300% a year! His reaction was that anything that is growing that quickly is going to be ubiquitous very soon. 'It was my wake-up call', recalls Bezos.

Jeff Bezos left his job and drew up a list of 20 possible products that could be sold on the Internet and quickly narrowed the prospects to books and music. Both had a potential advantage for online sales: there are far too many titles for any single store to stock. To start his venture, Bezos moved to Seattle, rented a house in a suburb, and started working out of his garage. He explains his rationale for having chosen Seattle as the company's headquarters:

It sounds counter-intuitive but physical location is very important for the success of a virtual business. We could have started Amazon.com anywhere. We chose Seattle because it met a rigorous set of criteria. It had to be a place with lots of technical talent. It had to be near a place with a large numbers of book publishers. It had to be a nice place to live in – great people won't work in places they don't want to live in ... Obviously, Seattle has a great programming culture. And it's close to Roseburg, Oregon, which has one of the biggest book warehouses [operated by the book publisher Ingram] in the world.

Initially, Bezos chose the name 'Cadabra' for his new store, but he later dropped this because too many people mistook it for 'Cadaver'! He then selected the name of the river that carries more water than any other river in the world: Amazon. The new online store was incorporated in July 1994 in the state of Washington, and its website was launched in July 1995.

Currently, Amazon.com offers 2.5 million book titles, including most of the 1.5 million English-language books in print. Its virtual music store has 125 000 music titles, more than ten times the number

of an average music store. The virtual video store offers more than 60 000 theatrical and general-interest videos and more than 2000 digital video disks (DVDs). Altogether, the Amazon.com store offers more than 4.7 million books, music CDs, videos, DVDs, computer games and other products.

As of 31 December 1998, Amazon.com had served 6.2 million customer accounts, up from 1.5 million accounts a year earlier. In the fourth quarter of 1998 alone, Amazon.com added 1.7 million new customer accounts. Repeat customer orders represented over 64% of orders placed on Amazon.com during the fourth quarter of 1998.

During the Christmas shopping season (from 17 November through 31 December 1998), Amazon.com achieved the following sales figures:

- More than one million new customers shopped for the first time with Amazon.com.
- Over 7.5 million items were shipped, more than the total company shipments during the entire year of 1997.
- During peak times, more than \$6 million worth of parcels were shipped in a single day.

In addition to the corporate headquarters located in Seattle, Amazon.com has subsidiaries in Germany (Amazon.de) and the UK (Amazon.uk). In March 1999, Amazon.com signed an agreement with Samsung, the South Korean electronics manufacturer, to sell books in South Korea. This agreement allows Amazon.com to sell books through the Internet shopping website of Samsung. It also allows it to have large quantities of books in South Korea in order to reduce shipping time and costs. International sales, including export sales from the USA, represented approximately 20% in 1998, compared with 25% in 1997 and 33% in 1996.

### Amazon.com website

The Amazon.com website (see Exhibit 2) offers the following features:

- *Browsing.* The website offers visitors a variety of subject areas and special features arranged in a simple and easy-to-use manner intended to facilitate book search, selection and discovery. It also presents a variety of products and information of topical interest or related to current events. To enhance the shopping experience and increase

## Exhibit 2 Amazon.com website



sales, Amazon features throughout the virtual store a variety of books on a rotating basis.

- **Searching.** A primary feature of the Amazon website is its interactive electronic catalogue. Search capabilities for finding books and other products are based on the title, subject, author, keyword, publication date or ISBN<sup>24</sup>.
- **Reviews and content.** There are several forms of content to entertain and engage readers and to encourage purchases. These include cover content, synopses, annotations, interviews of authors and reviews by other readers, the *New York Times*, the *Atlantic Monthly* and Amazon's staff. Customers are encouraged to write and post their own reviews, and authors are invited to 'self-administer' interviews by answering predefined questions.
- **One-click ordering.** Customers can store their addresses and payment preferences with Amazon.com. During subsequent orders, this information can be accessed through one click of the mouse, thus shortening the ordering process.
- **Recommendations and personalization.** This includes greeting customers by name and providing them with instant and customized recommendations. Through the so-called 'eye service', customers are notified by email about new publications that might interest them.
- **Gift-recommendation centre.** This feature, also called Gift Matcher, suggests gifts based on customer's interest. Amazon.com also offers paper and electronic gift certificates so that recipients can make their own gift selection. Instant email

gift certificates, sent within an hour, can solve the problem of last-minute shopping.

- **Virtual community.** The establishment of an online community is intended to invite customers to interact with each other. It also aims at encouraging them to visit Amazon's website frequently, hence promoting customer loyalty and repeat purchases.
- **Electronic auction.** This allows customers and small merchants to post and buy goods in 800 categories, including antique scientific instruments, animation art, Star Wars trading cards and digital cameras. Amazon.com charges users a fee for posting items and takes a small commission on each sales transaction. Amazon.com's auction guarantee covers purchases of up to \$250 in the event that the buyer does not receive what the seller promised. Jeff Bezos comments on the auction site that was launched in March 1999:

Our community of shoppers is the largest one online worldwide. Now for the first time, anyone can introduce products to that community. Whether you are a professional retailer or an individual with one item to sell, there's no other way to reach eight million pre-registered online buyers.

Sellers have their auctions automatically cross-merchandized across Amazon.com's book, music CD and video product pages. For example, a chair from Rick's Café in the movie *Casablanca* was auctioned at Amazon.com. This chair will be displayed simultaneously on the website pages where the *Casablanca* soundtrack, books, DVDs and videos are sold.

## Marketing and sales

Word of mouth remains the most powerful acquisition tool we have, and we are grateful for the trust our customers have placed in us.

Jeff Bezos

Amazon.com offers discounted prices resulting in relatively low gross product margins. It offers discounts of 20%–40% on more than 400 000 books, including 40% on selected feature books, 30% on hardbacks and 20% on paperbacks. Prices are discounted for up to 40% on music CDs, including 30% off Amazon.com's 100 best-selling CDs. Amazon.com also invests heavily in marketing in order to strengthen its brand name, increase visits to its website and build customer loyalty.

<sup>24</sup> International Standard Book Number.

Marketing and sales costs mainly include advertising, promotion and public relations, as well as payroll and related expenditures of staff engaged in marketing, sales and fulfilment activities. These expenditures, which rose from \$40 486 million in 1997 to \$133 023 million in 1998, were due mainly to increases in advertising and promotional expenditures,<sup>25</sup> higher payroll and greater credit-card fees resulting from stronger sales. The increase in 1998 was also due to Amazon.com's entry into the music and video online sales and the launch of the new venture in Germany and the UK.

For advertising, Amazon.com uses both paper-based outlets as well as the Web. Print advertisements appear in large circulation newspapers, such as the *Wall Street Journal* and *The New York Times* in the USA, and magazines, such as *Der Spiegel* and *Focus* in Germany (see Exhibit 3). Web advertising is made through Internet search engines such as Excite and Yahoo! as well as the websites of Amazon.com's online partners (see p.000). It provides the company with information to assess the success of an advertisement based on the number of visits to Amazon.com's website and the number of visitors who actually made a purchase.

### Customer service

Amazon.com seeks to achieve frequent communication with, and feedback from, its customers to

continually improve its virtual store and online services. It offers a number of email addresses to enable customers to request information (e.g. information on the status of their book shipment and information for investors) and to encourage feedback and suggestions.

The books return policy of Amazon.com is quite unique in the industry. It allows customers to return any book they purchased through its website, even after it has been read. Jeff Bezos explains: 'It doesn't matter how dog-eared or worn it [the book] is. Even if you ripped out the pages because you thought the book was so bad, you can still return the pieces to us for a full refund.'

Amazon.com clearly marks on its website which feature placements on its site are paid for and which are not. The company stresses that recommendations are not and have never been for sale to anyone. Only books selected by Amazon.com qualify for publisher-supported placement. Bezos explains:

We have the largest staff of book editors online or offline, and for a book that does not meet our standards, there is no amount of money that would cause us to feature it. As a Web-based store with a real community of book lovers, we're being held to a much higher standard than physical stores. And you know what? That's the way it should be.

### Warehousing and order fulfilment

Many titles are available for shipment within 24 hours; others are available within 48–72 hours, and the remaining in-print titles within four to six weeks. Out-of-print titles are generally shipped within one to three months. Customers can choose from a variety of delivery possibilities, including overnight and various international shipping options, as well as a gift-wrapping service. Amazon.com uses email to notify customers of order status under various conditions.

Total delivery time depends on the availability of the item that is ordered and the shipping option that is selected. For domestic delivery within the USA, customers can choose from the following shipping services:

- **Standard shipping service**, with three to seven days shipping time and a charge of \$3 per shipment plus \$0.95 per item.
- **2nd day air service**, with two business days shipping time (no weekend delivery) and a charge of

Exhibit 3 Amazon.de magazine advertisement.

American Books at Scottish prices

Large selection      Free delivery      30-day return guarantee

<sup>25</sup> Advertising expenditures alone increased from \$21 million in 1997 to \$60 million in 1998.

\$6 per shipment plus \$1.95 per book/video (\$0.95 per CD).

- *Next-day air service*, with one business day shipping time (no weekend delivery) and a charge of \$8 per shipment plus \$2.95 per book/video (\$1.95 per CD).

For international delivery, Amazon.com offers three shipping services:

- *Standard shipping service*, with 2–12 weeks of shipping time and a charge of \$4 per shipment plus \$1.95 per item.
- *World mail service*, with 7–21 business days shipping time and a charge of \$7 per shipment plus \$5.95 per book/video (\$0.95 per CD).
- *International priority*, with one to four business days shipping time and a charge of \$30 per shipment plus \$5.95 per book/video (\$2.25 per CD).

Shipping time varies widely, depending on the destination. For example, standard shipments take about two to three weeks to Canada, six weeks to the UK, six to eight weeks to Japan and Australia, and 10–12 weeks to Brazil. For orders that contain multiple items with different availability dates, customers can choose to receive readily available products first and wait for later shipments or, in order to save shipping fees, to receive only one shipment once the complete order is ready.

Customs forms for all international packages list the value of an order's contents by product type. Orders containing books, music CDs and video titles will be listed, for instance, as follows:

Book value: \$29.55  
CD value: \$ 9.95  
Video value: \$39.95

If the order is a gift, then the package is marked 'Gift'; however, the items' costs are still stated on the customs form. Any customs or import duties are levied once the package reaches its destination country. Additional charges for customs clearance have to be covered by the recipient of the package.

Amazon.com uses IT systems to process and ship customer orders. Through its proprietary software, it selects the orders that can be filled via electronic interfaces with suppliers and forwards the remaining orders to its special orders group. Suppliers often ship

the electronically ordered books to Amazon.com's warehouse within hours of receipt of the order. Bezos elaborates further: 'In 1999, we intend to build a significant distribution infrastructure. We must ensure that we can support all the sales that customers demand, with speedy access to inventory.'

Until recently, all shipping was done through the company's Seattle distribution centre (which has 93 000 square feet of space). In January 1999, Amazon.com set up a mechanized distribution facility in Fernley, Nevada, thus reducing the shipping time to key markets in the Western US region by one day. The new 322 560-square-foot facility will also allow Amazon.com to increase significantly the number of books, music CDs and videos kept on hand for immediate delivery to customers. By the end of the year, the Fernley centre is expected to employ more than 300 people. Amazon.com also has a 202 000-square-foot centre in New Castle, Delaware (near Philadelphia), which has been operational since November 1997.

Continuing its expansion, Amazon.com leased a distribution facility in Coffeyville, Kansas, which will enable faster delivery to Amazon.com customers across the mid-west and south-eastern USA. Plans for the existing 460 000-square-foot facility include expansion to over 750 000 square feet and the addition of automation, allowing the company to increase significantly the number of products kept on hand for immediate shipment to customers. The result is that customers in places such as Chicago, St Louis, Dallas and Minneapolis will receive their orders much more quickly, thanks to deeper inventory, faster processing and shorter delivery times. The Coffeyville facility is expected to begin operations during the second half of 1999.

Regarding the 1999 expansion plans of Amazon.com, Bezos said:

We have begun and will continue to build out a significant distribution infrastructure. This will give customers greater availability, faster shipping times, and even better service. We will also continue to invest in systems, people, and product expansion, each of which helps us better serve customers. For the rest of 1999, we expect to invest more heavily than we have in the past. Our goal remains to build the world's most customer-centric company.

### Amazon.com's IT systems and technology

Amazon.com developed not only its website but also its IT applications for order processing, invoicing,

payment, shipment, inventory management and procurement in-house. Its current strategy is to focus its IT development effort on creating and enhancing the specialized, proprietary software that is unique to its business, and to license commercially available technology, if judged appropriate, for other applications.

The company uses three Internet service providers (UUNet Technologies, InterNAP Network Services and Interconnected Associates) to connect to the Internet over multiple dedicated lines. All of Amazon.com's computer and communication hardware is located at a single facility in Seattle.

In the past, the company has experienced some system interruptions. For example, on 1 October, 1998, its Internet bookstore was shut down for ten hours for, according to company officials, 'maintenance work on the IT system'. Customers, who wanted to visit the website, and possibly make purchases, were greeted on the opening page with the following message: 'We are sorry. Our store is currently closed. If you leave us your e-mail address, we will notify you when we are open again.'

## Employees

During 1998, the number of employees working at Amazon.com increased from 614 to 2100. In addition to its own staff, Amazon.com also employed independent contractors and other temporary employees in its editorial, fulfilment and finance departments. None of the employees is represented by a labour union. Part of the employee's salary consists of stock options on Amazon.com's shares.

Amazon.com's executives include eight people with an average age of only 37 years (their ages range from 33 to 46 years). Amazon.com does not have long-term employment agreements with any of its key personnel and maintains no 'key person' life insurance policies.

Jeff Bezos explains what he expects from Amazon.com employees:

It's not easy to work here. When I interview people I tell them: 'You can work long, hard or smart, but at Amazon.com you can't choose two out of three.' But we are working to build something important, something that matters to our customers, and that we can tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com.

However, competition for qualified personnel is intense, particularly for software development and other IT skills.

## Relations with suppliers

### Large Publishers

Amazon.com purchases the majority of its products from two major vendors: Ingram and Baker&Taylor. In 1996 and 1997, Ingram accounted for, respectively, 58% and 59% of the inventory purchases. However, after Barnes & Noble announced in November 1998 its acquisition of Ingram, Amazon.com decided to diversify its supplier base and to increase its direct purchasing from publishers. In 1998, Ingram remained the largest supplier of Amazon.com but accounted for only 40% of purchases.

### Small publishers

In order to match the power of Amazon.com's global distribution, independent artists, bands, and labels would have to get their [music] CDs into an estimated 100 000 [physical] retail stores worldwide.

Mary Morouse, Vice-President of Merchandising,  
Amazon.com

The Amazon.com Advantage Program allows small publishers to appear more often and more prominently throughout the Amazon.com catalogue. In the publishing industry, a book must reach a certain critical mass before it makes it into existing wholesale channels. Amazon.com has thus redefined what critical mass means. The programme allows small publishers to place a limited quantity of books in Amazon.com's distribution centres for immediate availability to customers. Those titles will then be upgraded in the Amazon.com website to 'usually shipped within 24 hours', instead of the usual four-to six-week delivery promise for special-order titles. Participating titles are assigned subject classifications to help surface the book through Amazon.com's browsing features. The book cover is also scanned at no cost to the publisher. Jeff Bezos explains:

With more than 2.5 million titles in our catalogue from more than 50 000 publishers, Amazon.com has always provided an opportunity for small publishers to succeed. Now through Amazon.com-advantage, a title from an independent publisher can have the same prominence, immediate availability and level of exposure as a title from a larger publisher who typically has more resources at their disposal.



The Advantage Program also includes music. It offers independent artists, bands and labels a solution to the problem of widespread distribution of CDs. Traditionally, such artists have difficulty getting their CDs into stores and selling their music. Through the Advantage Program, they can place a limited quantity of CDs in Amazon.com's distribution centres for immediate sales and delivery. Robert Haber, President of *CMJ*<sup>26</sup>, elaborates further:

We are delighted to learn of Amazon.com's strategy for assisting these new artists in getting their music exposed to a potential audience in the millions. This is just the kind of programme that makes the new medium of the Internet so exciting.

It is now easier for independent artists and bands to sell their CDs to customers worldwide through Amazon.com. On the website, they benefit from the same level of exposure as CDs from major artists and labels. Dara Quinn, member of the rock music band Rockin' Teenage Combo, explains

No matter how slamming your band is, it is really hard to get distribution without being signed to a major label. Even if we could get our CDs stocked in stores in every city we play in when we're on tour, who has the time and money to print and distribute all those CDs? Now, whenever anyone hears the buzz about our music, they'll be able to buy our CD at Amazon.com. What could be easier than that?

### Acquisitions and online partnerships

#### *Drugstore.com*

In February 1999, Amazon.com acquired a 46% stake in the online drugstore Drugstore.com. This virtual store, based in Redmond, Washington, offers more than 15 000 brand-name personal healthcare products, extensive healthcare information, and a licensed pharmacy. Through this acquisition, Amazon.com aims to introduce customers to the new shopping experience at Drugstore.com. Peter Neubert, President and Chief Executive Officer of Drugstore.com, believes: 'People who like Amazon.com will like shopping at Drugstore.com. Amazon.com sets the standard for quality and excellent service and we at Drugstore.com are committed to matching that excellent service.'

#### *Pets.com*

In March 1999, Amazon.com agreed to obtain an ownership of approximately 50% in Pets.com, an

Internet-based company that specializes in popular and rare pet accessories, and products and food for all types of animals. Jeff Bezos comments: 'Pets.com has a leading market position and its proven management team is dedicated to a great customer experience, whether it's making a product like a ferret hammock easy to find, or help in locating a pet-friendly hotel.' The financing will be used to fund Pets.com's further growth, develop the Pets.com brand, and build distribution through partnerships and alliances. Julie Wainwright, CEO of Pets.com explains: 'This is marriage made in heaven and clearly positions us as the online category leader.'

#### *Bibliofind.com and MusicFile.com*

In April 1999, Amazon.com acquired Exchange.com, the premier online marketplace for hard-to-find, antiquarian and used books at [www.bibliofind.com](http://www.bibliofind.com) and hard-to-find recordings and music memorabilia at [www.musicfile.com](http://www.musicfile.com). The acquisition aims to enlarge and enrich Amazon.com's core book and music offerings. It also provides thousands of independent dealers and retailers with the opportunity to sell and auction their hard-to-find books, recordings and memorabilia to Amazon.com's growing customer base.

#### *LiveBid.com*

In April 1999, Amazon.com decided to purchase LiveBid.com, a provider of live-event auctions on the Internet. LiveBid.com is a Seattle-based company that pioneered live-event-based auctions on the Internet, allowing auction houses to broadcast their auctions over the Internet. Online bidders can participate in the live auctions in real time, competing directly with bidders physically present at the auction site. Jeff Bezos comments: 'The big winners here are the world's traditional auction houses. Appraisal and authentication are important, and no one can do it better than established and expert auctioneers.'

#### *Amazon.com online partnerships*

Through Amazon.com's Associates Program, operators of other websites can create links to the Amazon.com homepage, through which customers are directed to the Amazon.com bookstore. The web-

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<sup>26</sup> *College Music Journal*.

site operators that participate in this programme, receive referral fees of 8% of the book value for sales generated by their sites. By the end of 1998, there were 200 000 website operators participating in Amazon.com's Associates Program; this figure had increased to more than 260 000 by 31 March 1999.

For industry analysts:

Amazon.com knows that it will probably never be the very best site for rock climbing information or quantum physics discussions, but that the sites specializing in such subjects could be great places to sell books. A link to Amazon.com is an easy, and potentially lucrative, way for such a specialist to do that at one remove; a click on the link takes a viewer to the Amazon.com relevant page.<sup>27</sup>

In March 1999, Amazon.com and Dell, a PC manufacturer, agreed to offer linked websites and provide customized contents for Amazon.com and Dell customers. Both companies provide links to each other's websites from the checkout section of their respective sites. Michael Dell, Chair and CEO of Dell Computer Corporation, elaborates:

Dell and Amazon.com have a shared vision of the future of online shopping. That vision is to deepen direct relationships with customers and deliver unique value and unparalleled service. Dell and Amazon.com will each offer our mutual customers customized services, competitive prices, and easy navigation.

Dell currently sells more than \$14 million in PC products over the Internet each day, which accounts for 25% of its business. Its website has over 25 million visits per quarter.

In addition, Amazon.com is present on several high-traffic websites, through marketing arrangements with Dell Computer Corporation, Microsoft and CBS SportsLine. Amazon.com is CBS SportsLine's online retail partner for books, videos and music in a co-branded store on the CBS SportsLine site. Through an agreement with Microsoft, Amazon.com functions as music merchant on Microsoft's MSN Shopping Channel, the MSN.COM website, and other selected properties in the MSN network of sites.

## Financial results

It's all about the long term. We believe that a fundamental measure of our success will be the shareholder value we create over the long term. This value will be a direct result of our ability to extend and to solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model.

Jeff Bezos

Net sales of Amazon.com for the 1998 fiscal year were \$610 million, which constitutes a 313% increase over net sales of \$147.8 million for the 1997 fiscal year. In the fourth quarter of 1998, sales reached \$252.9 million, which constitutes an increase of 283% over the net sales figure of \$66 million for the fourth quarter of 1997. The net loss in 1998 amounted to \$124.4 million, which included \$50.2 million of merger- and acquisition-related costs. The net loss for the fourth quarter of 1998 was \$46.4 million (see Tables 2 and 3). When asked about the continuing losses of Amazon.com, Jeff Bezos replied: 'We are going through a critical stage right now. We want to extend our offer on a global scale and we want to invest even more in customer service; that's all very expensive. This would be a miserable moment to make profits.'

According to industry analysts:

Amazon's shares grew 966% in value in 1998. Between the beginning of December 1998 and early January 1999, its share price climbed a further 150% and the company's market value surged past \$30 billion, overtaking Texaco, an oil company. Even now, Amazon is worth more than all America's bookstores, including Barnes & Noble and Borders Group Inc., put together.<sup>28</sup>

The following statements characterize the investment philosophy at Amazon.com:<sup>29</sup>

- We will continue to focus relentlessly on our customers.
- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.
- We will continue to measure our programs and the effectiveness of our investments analytically, to discard those that do not provide acceptable returns, and to step up our investments in those that work best. We will continue to learn both from our successes and failures.
- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.

<sup>27</sup> *The Economist* 10 May 1997.

<sup>28</sup> *The Economist*, 30 January 1999.

<sup>29</sup> As stated in the 1997 Annual Report of Amazon.com.

**Table 2** Amazon.com balance sheet

	December 31st		
	1998 (1000s)	1997 (1000s)	1996 (1000s)
<b>Assets</b>			
<i>Current assets</i>			
Cash (and cash equivalents)	\$25 561	\$1876	\$6248
Marketable securities	\$347 884	\$123 499	(included above)
Inventories	\$29 501	\$8 971	\$571
Prepaid expenses and other:	\$21 308	\$3 363	\$321
<b>Total current assets</b>	<b>\$424 254</b>	<b>\$137 709</b>	<b>\$7140</b>
Fixed Assets (net.)	\$29 791	\$9726	\$985
Deposits	\$626	\$169	\$146
Goodwill and other purchased intangibles	\$186 377		
Deferred charges	\$7412	\$2240	
<b>Total assets:</b>	<b>\$648 460</b>	<b>\$149 844</b>	<b>\$8271</b>
<b>Liabilities and stockholders' equity</b>			
<i>Current liabilities</i>			
Accounts payable	\$113 273	\$33 027	\$2852
Accrued advertising	\$13 071	\$3454	\$598
Accrued product development			\$500
Other liabilities and accrued expenses	\$34 547	\$6570	\$920
Current portion of long-term debt	\$684	\$1500	
<b>Total current liabilities</b>	<b>\$161 575</b>	<b>\$44 551</b>	<b>\$4870</b>
Long-term portion of debt	\$348 077	\$76 521	
Long-term portion of capital lease obligation	\$63	\$181	
<i>Stockholders' equity</i>			
Preferred stock			\$6
Common stock	\$1593	\$1449	\$159
Additional paid-in capital	\$300 130	\$66 586	\$9873
Note receivable from officer for common stock	-\$1 099		
Deferred compensation	-\$1625	-\$1930	-\$612
Accumulated other comprehensive income	\$1806		
Accumulated deficit	-\$162 060	-\$37 514	-\$6025
<b>Total stockholders' equity</b>	<b>\$138 745</b>	<b>\$28 591</b>	<b>\$3401</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$648 460</b>	<b>\$149 844</b>	<b>\$8271</b>

Source: Amazon.com Annual Report.

**Table 3** Amazon.com statement of operations

	December 31st			
	1998 (1000s)	1997 (1000s)	1996 (1000s)	1995 (1000s)
Net sales	\$609 996	\$147 787	\$15 746	\$511
Cost of sales	\$476 155	\$118 969	\$12 287	\$409
<b>Gross profit</b>	<b>\$133 841</b>	<b>\$28 818</b>	<b>\$3459</b>	<b>\$102</b>
<i>Operating expenses</i>				
Marketing and sales	\$133 023	\$40 486	\$6090	\$200
Product development	\$46 807	\$13 916	\$2401	\$171
General and administrative	\$15 799	\$7011	\$1411	\$35
Merger and acquisition related expenses	\$50 172	(includes \$42.6 million in goodwill amortization)		
<b>Total operating expenses</b>	<b>\$245 801</b>	<b>\$61 413</b>	<b>\$9902</b>	<b>\$406</b>
Loss from operations	-\$111 960	-\$32 595	-\$6443	-\$304
Interest income	\$14 053	\$1901	\$202	\$1
Interest expense	-\$26 639	-\$326	-\$5	
<b>Net loss</b>	<b>-\$124 546</b>	<b>-\$31 020</b>	<b>-\$6246</b>	<b>-\$303</b>

Source: Amazon.com Annual Report.

- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.

Jeff Bezos elaborates further on his company's growth:

When Barnes & Noble went online, most people thought we [Amazon.com] were going to get burned, and they called us 'Amazon.toast'. But it turned out differently. Then we had sales of \$60 million a year. Today [in January 1999] we are up to more than \$600 million. We are 12 times bigger than our closest competitor.

On 28 April 1999, Amazon.com announced its financial results for the first quarter of 1999. Net sales for the first quarter were \$293.6 million, an increase of 236% over net sales of \$87.4 million for the first quarter of 1998. Amazon.com reported a first-quarter pro forma operating loss of \$30.6 million, or 10% of net sales, compared with an operating loss of \$10 million, or 11% of net sales, in the first quarter of 1998, and a first-quarter pro forma net loss of \$36.4 million, or \$0.23 per share, compared with a net loss of \$10.4 million, or \$0.07 per share, in the first quarter of 1998. On a GAAP basis,<sup>30</sup> reported first-quarter net loss was \$61.7 million, or \$0.39 per share, and included \$25.3 million of merger and acquisition-related costs.

Amazon.com announced that cumulative customer accounts increased by more than 2.2 million during the first quarter to more than 8.4 million on 31 March 1999, an increase of more than 250% from the 2.3 million customer accounts on 31 March 1998. Repeat customer orders represented more than 66% of orders during the quarter ending 31 March 1999.

### Amazon in Germany: Amazon.de

Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk. It requires serious investment and crisp execution against established franchise leaders.

Jeff Bezos

In April 1998, Amazon.com prepared its international expansion through the acquisition of the German online bookseller ABC Bücherservices/Telebuch (which had, at the time, 96 000 customers). In that period,

Amazon.com also acquired the UK-based Bookpages Ltd, also an online book store. Both Amazon.de and Amazon.co.uk opened their virtual stores on 15 October 1998.

Before launching Amazon.de in Germany, Amazon.com was also considering the possibility of entering a joint venture with Bertelsman. Jeff Bezos explains:

Thomas Middelhoff and I met four times to talk about a joint venture [of Amazon.com and Bertelsmann] in Europe. Mr Middelhoff is a very smart and aggressive businessman, who I respect very much. But he wanted to have control over the business in Europe, and we wanted that as well. I believe, that we know much more [than Bertelsmann] about electronic commerce, about the necessary customer service and the software.

Amazon.de is headquartered in Regensburg, near Munich, where it also has its distribution centre; the editorial and marketing offices are located in Munich. It offers 335 000 titles from German publishers and provides fast and easy access to 374 000 US titles. The store in England carries 1.2 million UK titles as well as fast and easy access to 200 000 US titles. Most popular US titles are ready for immediate shipment from the UK and from Germany, thus significantly reducing shipping time and cost. In March 1999, Amazon.de leased a new distribution centre in Bad Hersfeld, Germany; the facility is expected to begin operations during the second half of 1999.

The delivery of books within Germany is free. No additional taxes, customs or delivery fees apply (e.g. for books that are shipped from the USA). The average delivery time for most German and English books is two to three days; customers have a 30-day money-back guarantee. Like Bol.de, Amazon.de also delivers its books through the German postal service, which means that books that cannot be delivered because the recipient is not at home need to be picked up at the nearest post office.

Amazon.de is the exclusive book store of German and US titles on the search engines of Yahoo.de and Excite.de. Its website provides similar service features as the Amazon.com website. These include the following:

- **Search function:** allows searching the database of 900 000 titles in the Amazon.de online catalogue.
- **Browsing:** supports customers in their search for book titles in eight categories and 116 sub-categories.

<sup>30</sup> GAAP refers to the US generally accepted accounting principles.

- **Bestseller-list:** lists the best-selling hardback and paperback titles from the Amazon.de site.
- **Email service:** includes personalized book recommendations, articles, interviews and information on new book releases.
- **Reviews by experts and customers:** Munich-based staff of expert German editors develops reviews and recommendations of German-title books. Six editors review books and provide recommendations to customers.
- **Gift service:** picks out a book and selects the wrapping paper; gift certificates that the recipient can redeem at Amazon.de can also be ordered.

Customers who buy books from Amazon.de can return them within 30 days of the purchase date without having to explain the reasons for the book's return. They will not be charged any shipping costs, as long as the book is still in a very good condition.

For Michael Ulbricht, an MBA student, the service features offered by Amazon.de have been very beneficial. He says:

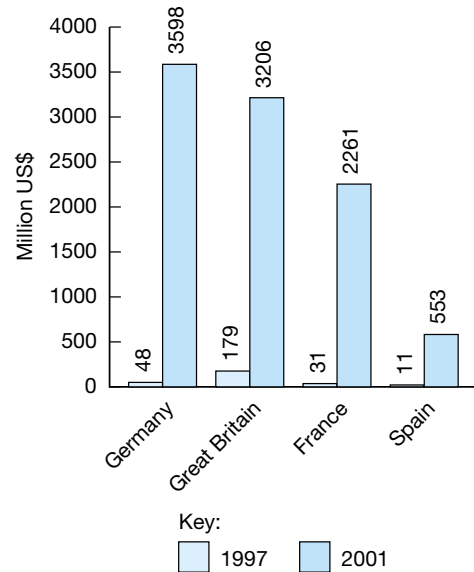
I am currently working on my MBA thesis. Amazon has helped me immensely with my literature search because it provides recommendations based upon what other people have read. There is no other place on the Internet where I can find this kind of information and analysis.

During the fourth quarter of 1998, combined sales on the European Amazon sites in Germany and the UK increased significantly over the third quarter of the same year.<sup>31</sup> They established Amazon.com as the number-one online bookseller in these markets.

## 6 Future outlook

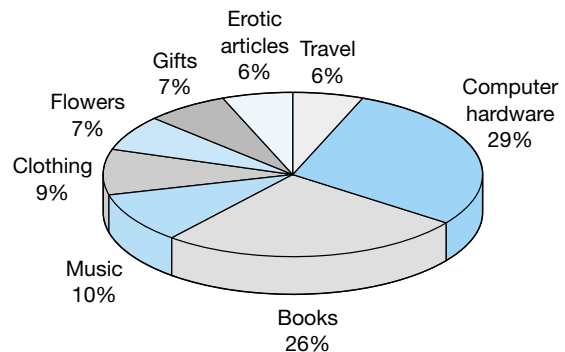
Generally, what will the future of electronic commerce look like? Will a large customer base embrace the Internet for commercial transactions (see Exhibits 4 and 5), or will traditional sales channels still dominate the business environment? Will the market confirm forecasts such as that of Dr Uwe Kamenz, Professor of Marketing at the University of Applied Sciences in Dortmund, Germany, for whom 'the potential market for mail-order purchases in Germany is only a mere 5%. With the Internet this might increase to 10%, which would present a huge increase. But this also means that 90% of all purchases will take place in traditional retail stores.'

**Exhibit 4** e-Commerce sales forecast for Europe



Source: EITO 1997, Roland Berger 1998, Bertelsmann.

**Exhibit 5** e-Commerce forecasts according to product categories.



Total volume in Europe (2001): US\$15.4 billion

Source: EITO 1997, Roland Berger 1998, Bertelsmann.

Will follower companies such as BOL be able to steal customers from first movers like Amazon.de? Will they be able to attract clients such as Carsten Schmitz, for whom:

There is no need to change since the service [of Amazon.de and Bol.de] is similar and the prices are iden-

<sup>31</sup> Separate financial data for Amazon.de and Amazon.uk are not made available through Amazon.com.



tical [due to price fixing in Germany]. I don't feel like learning how to use a new website and acquainting myself with a new content layout. I have been using Amazon.de since last year and don't plan to shift to BOL.

Will time prove that Jeff Bezos' business model is the right one? 'Ultimately, we [Amazon.com] are an information broker,' says Bezos. 'On the left side we have lots of products, on the right side we have lots of customers. We are in the middle making the connections. The consequence is that we have two sets of customers: consumers looking for products and [product] providers looking for consumers.' His objective, as stated in the 1998 annual report of the company, is to become the best place to buy, find and discover any product or service available online. He says:

Amazon.com will continue to enhance and broaden its brand, customer base and electronic commerce expertise with the goal of creating customers' preferred online shopping destination, in the United States and around the world.

For Thomas Middelhoff:

With over 300 profit centres in more than 50 countries, we [Bertelsmann] are the most international of media groups. We have the greatest treasure in the media world – over 44 million customers worldwide. And we do our best every day in the profit centres to satisfy these customers and to acquire new customers ... As of today [26 April 1999], we already hold second place, worldwide, in electronic commerce of media products with barnesandnoble.com, BOL and getmusic.com. Of all media enterprises, we are the most advanced on the Internet.

Clearly, for both chief executive officers, the sky is the limit. The global battle over virtual book sales and, more generally, Internet-based retailing is all but intensifying between Amazon.com and Bertelsmann Online. Both sides know that the business implications at stake are vital for their company's future. And this just makes the fighting today fiercer than ever before.

## DISCUSSION QUESTIONS

- 1 Is it justifiable for a company like Amazon.com to continue investing so much money and effort in a business operation that not only has never made a profit, but is incurring heavier losses?
- 2 Will Bertelsmann benefit (or be hindered) by its physical organizational structure and management processes in its attempt to strengthen its position as an electronic commerce product/service provider? Defend your arguments.
- 3 In your opinion, what industries/companies would constitute a threat to Amazon.com and/or Bertelsmann's BOL over the next three to five years? Explain.
- 4 What success factors do you think are critical for online books (and mass-media) sales and, more generally, for launching an electronic commerce business?