

# UC Irvine

## I.T. in Business

### Title

Competing in Book Retailing: The Case of Amazon.com

### Permalink

<https://escholarship.org/uc/item/67p057vv>

### Authors

Shrikhande, Aarti  
Gurbaxani, Vijay

### Publication Date

1999-11-01



## **COMPETING IN**

# **BOOK RETAILING: THE CASE OF AMAZON.COM**

**CENTER FOR RESEARCH  
ON INFORMATION  
TECHNOLOGY AND  
ORGANIZATIONS**

**University of California, Irvine  
3200 Berkeley Place  
Irvine, California 92697-4650**

**and**

**Graduate School of  
Management**

**NOVEMBER 1999**

**AUTHORS:  
Aarti Shrikhande  
and  
Vijay Gurbaxani**

#### **Acknowledgement:**

This research has been supported by grants from the CISE/IIS/CSS Division of the U.S. National Science Foundation and the NSF Industry/University Cooperative Research Center (CISE/EEC) to the Center for Research on Information Technology and Organizations (CRITO) at the University of California, Irvine. Industry sponsors include: ATL Products, the Boeing Company, Bristol-Myers Squibb, Canon Information Systems, IBM, Nortel Networks, Rockwell International, Microsoft, Seagate Technology, Sun Microsystems, and Systems Management Specialists (SMS).

The authors would like to thank Asish Ramchandran for his assistance on this project.

# TABLE OF CONTENTS

<b>INTRODUCTION.....</b>	<b>1</b>
<b>INDUSTRY ENVIRONMENT AND COMPETITION .....</b>	<b>2</b>
<b>FIRM LEVEL ANALYSIS .....</b>	<b>9</b>
<b>BUSINESS MODEL .....</b>	<b>9</b>
<b>Strategy.....</b>	<b>9</b>
First to market / Innovation.....	9
Customer focus.....	10
Advertising and Branding.....	12
Choice of products .....	13
<b>Structure.....</b>	<b>14</b>
Value added partnerships.....	14
Distribution .....	16
Associates program .....	18
<b>Execution.....</b>	<b>18</b>
The Web site.....	18
Use of Information Technology .....	20
<b>CHALLENGES IN THE FUTURE.....</b>	<b>21</b>
<b>FIRM FINANCIAL PERFORMANCE.....</b>	<b>22</b>
<b>CONCLUSIONS.....</b>	<b>23</b>
<b>APPENDIX .....</b>	<b>24</b>
Highlights of 1998 .....	24
Goals for 1999 <sup>x</sup> .....	25
Net Revenue .....	26
Net Income .....	27
Schematic of distribution .....	28
Financial Statements.....	29
<b>REFERENCES .....</b>	<b>31</b>

## Introduction

Amazon.com Inc., the leading online retailer of books was incorporated in 1994 in Seattle, Washington. Since opening for business as the "Earth's Biggest Bookstore" in July 1995, Amazon.com has become one of the most widely known, used and cited commerce sites on the World Wide Web(WWW).

Operating as an online book retailer, Amazon.com has grown rapidly since first opening its Web site in July 1995. The company experienced a surge in sales of 313% from \$147 million in 1997 to \$610 million in 1998. These sales numbers were supported by approximately 8.4 million customer accounts in over 150 countries<sup>i</sup>. Repeat customers currently account for over 60% of orders. International sales represented 25% of net sales in 1997 and 22% of sales in the quarter ended December 31, 1997. But it seems like although the company has grown rapidly; percentage growth rates experienced to date are not sustainable. The company has been incurring losses every year and has reported net losses of approximately \$120 million for 1998.

Amazon.com strives to offer its customers compelling value through a broad selection of products, high-quality content, a high level of personalized customer service and competitive pricing. Innovative uses of technology and the Internet, enable the online book seller to offer a catalog of more than 4.7 million titles, easy-to-use search and browse features, email services, personalized shopping services, Web-based credit card payment and direct shipping to customers. The company has already expanded business to products other than books, such as CDs and videos, and intends over time to expand its catalog into other information-based products. It also offers services like an online auction, electronic greeting cards and so on. The number of items for sale at the online retailer's site, as of May 1999 is 16 million. Amazon.com then, has virtually unlimited online shelf space and offers customers a vast selection through an efficient search-and-retrieval interface.

Amazon.com is often referred to as the "Wal-mart of the Internet"; since it has brought online retailing to a new level, just as Wal-mart did in the physical retail world; and this paper attempts to describe how this online retailer has received all this acclaim. The first section of the paper delineates the evolution of the book-selling business starting from traditional book selling methods to mail order retailing and then to online retailing. Then the overall book-retailing industry is assessed on the basis of Porter's (1985)<sup>ii</sup> five-forces framework; which helps us put Amazon.com into the perspective of this overall industry scenario. The next section provides a firm-level analysis of Amazon.com's business model. This section illustrates Amazon.com's strategy and the corresponding business structure. The paper further describes how this strategy is executed by an efficient use of information technology. The facts and analysis attempt to

portray the effective alignment between strategy, structure and the use of information technology that contribute to Amazon.com's success.

## Industry environment and competition

In this section, we take a look at the book-selling industry beginning with traditional book selling, mail-order retailing to the online book selling business. We analyze these different phases of the industry and study its evolution.

### Traditional Book-selling

The traditional distribution model can be illustrated by the following graphic (see figure 1). The publisher publishes and prints books and sells them to wholesalers. The wholesalers usually buy or lease warehouses to store the merchandise, from where they sell their wares to retailers or to end consumers. Usually, there may be a number of levels or layers of distribution between the wholesaler and the end customer. For instance, a large retailer might purchase books from the wholesaler and sell them to smaller retailers, who in turn would sell to end consumers.

In general, the model depicted below suffices to explain the flow of the product from the producer to the consumer.

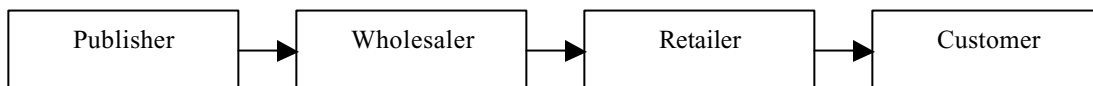


Figure 1

One of the good features of this model was the fact that customers could browse in bookstores, and examine any book that they were interested in or had heard of. And if the customer did not find the book available in the retailer's store; he/she could place an order immediately for the book. The retail store would then arrange for the book to be sent to their location from the wholesaler/publisher. Book readers

and customers could also attend events such as book-signings at the book retailer's outlet and socialize with other readers and fans. The disadvantages of this model of book-selling were the number of books that any single bookstore could stock and that the reader had to be present physically at the book store to gain all the advantages mentioned above. Besides, the price that would be charged for the book would reflect not just the publisher's price, but also all the overhead costs that the wholesaler and the retailer may have incurred. Also built into the price for the book would be the cost of holding all that inventory at the retailer's store. Thus, the customer would be paying for the advantages that the physical book store might be offering him/her by paying a higher price for the book.

### **Mail- order book-selling**

The next interesting development in this industry was the mail-order book business. This business introduced another distribution channel to the customer- the mail/postal system. Under the mail-order concept, the customer was allowed to order books of his choice from the comfort of his home, using a catalogue sent by the bookseller. The selected books were then mailed to the customer. Mail-order companies also provide value-added services provided such as reviews and recommendations about the books, and information about the best-selling books in the market. The mail-order system is illustrated in the following figure.

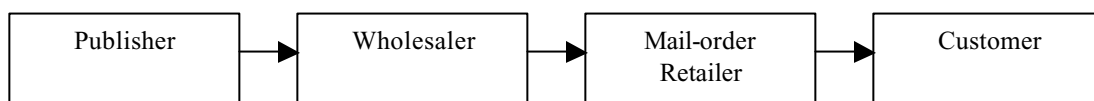


Figure 2

It is apparent from the figure, that although the process by which the customer ordered and received the book is different from the traditional one, the basic model has remained the same. The physical retailer has been replaced by the mail-order retailer in this case. Only the front-end of the process uses another channel for distribution to reach the customer.

The advantage of this system was that it proved to be a more convenient option for the customer. Now the customer did not have to drive or walk to the store to buy a book. Information about new books and their prices was sent to the customer by mail, and subsequently the payment for the book and the delivery of the book was done using the postal system. This allowed the retailer to pass along the reduction in costs (of not having to hold the books in inventory etc.) to the customer as a discount on the price of the book. The other advantage of this method was that the reader received a catalog containing reviews about books and information about popular books in the market. This added value to the already convenient experience of ordering a book from home. In spite of all these advantages, there were distinct limitations. The selection of books that the reader could get information about was typically limited, browsing a book was not possible and customers were forced to rely on the reviews that the mail-order retailer included in the catalog.

### **Book-selling chains and super stores**

One of the biggest changes in book retailing has been the introduction of chain stores over the past twenty-five years. These chains opened primarily in malls and subsequently hurt the business of the small, privately owned bookstores that had dominated the industry up to that point. These booksellers did not have a very big advantage in terms of floor space, but they had access to many more titles and typically had in-store databases that allowed them to “special-order” nearly any title in print.

The last decade has seen another transformation in the traditional book-selling industry. The sales of mall-based bookstores have declined as new “super stores” have opened all around the US. These super stores are much larger than the mall-based bookstores and stock many more titles. They typically offer discounts of thirty to forty percent on hardcover bestsellers. Some of the other value added features they offer are coffee bars, comfortable seating for browsers and huge magazine racks. They cater to a new and wholesome reading “experience.” There are computer terminals that provide access to the store’s

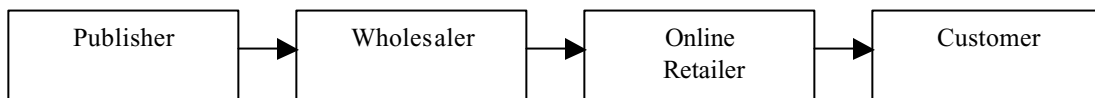
database, and assist the user in searching for a particular book's location in the store. They also enable the user to special order any book that is in print.

To summarize, the traditional book-selling industry has gone through a number of value-added changes, which have effectively segmented the market for books based on which model of distribution is used. Some of the changes that the industry has seen are listed below.

- New channels for distribution
- Rapidly increasing inventories and store-sizes
- Introduction of databases at the point of sale, as the number of books offered by the bookstore increases
- Change in the store's ambience, where customers are encouraged to browse and enjoy the reading experience.

### **Online Book-selling**

Supporting this trend in the book industry towards offering more value and convenience to the customer is the advent of online book selling. The Internet is yet another channel for distribution and is being used widely to service customers. Amazon.com competes in this marketplace. Amazon.com is one of a number of online book sellers that have exploited the use of the Internet as a channel to reach consumers. The online model can be depicted as follows.



The customer places his order over the Internet from the convenience of his/her home, and this order is sent to the online book retailer. The main difference between the traditional model and the online model is that, similar to mail-order companies, the online retailer does not have a physical presence. All



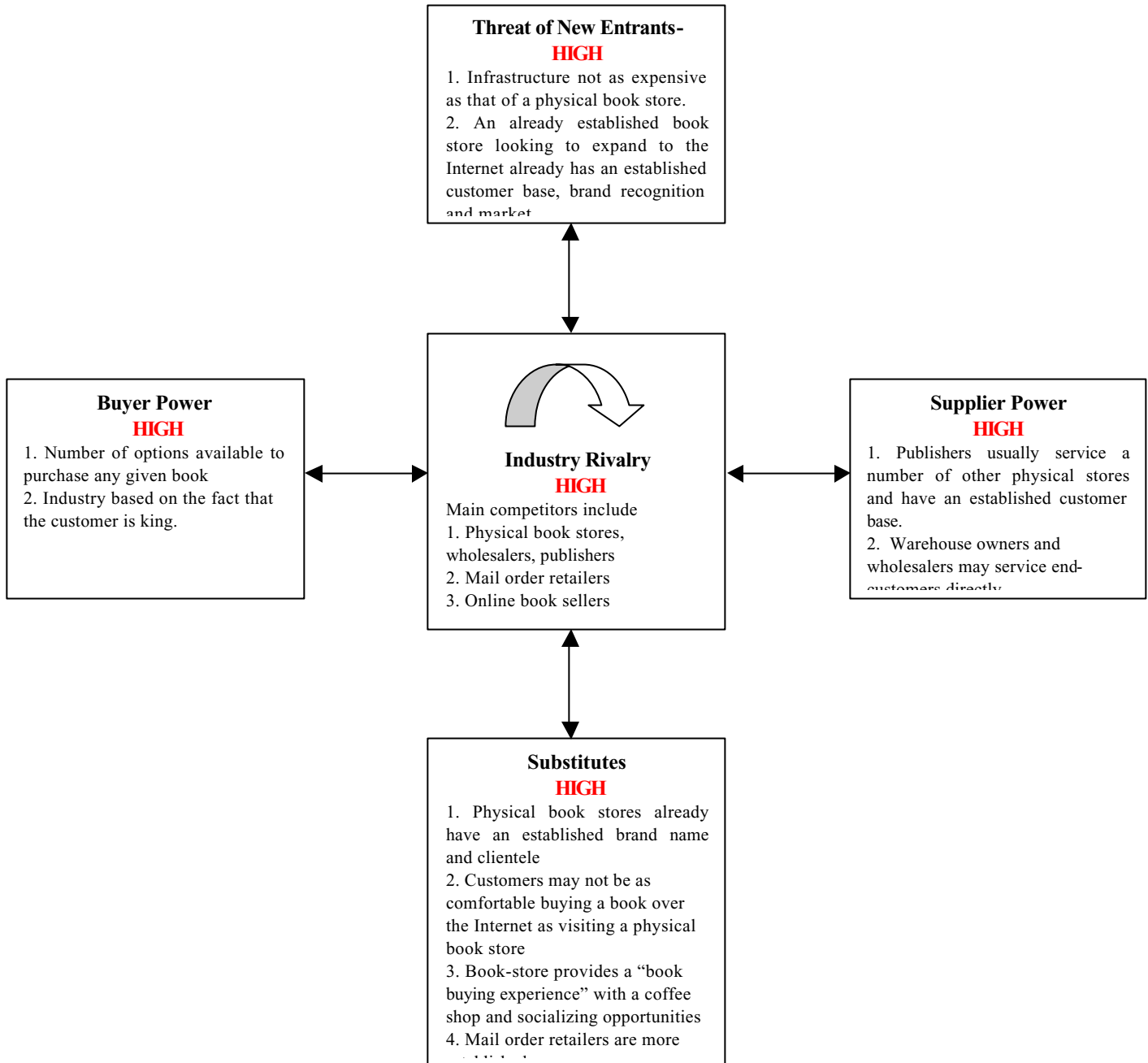
interaction with the customer occurs on the Internet, where reviews and recommendations are provided and orders are accepted. These orders are electronically forwarded to wholesalers or directly to publishers in some cases. The ordered books are often shipped from the wholesaler directly to the customer thereby eliminating the need to have a physical inventory of books. There are a number of characteristics and advantages of using the Internet as a channel for selling books. Some of these include:

- *Large existing industry wide database:* Book retailers already maintain huge databases of the books in print. But the customer needs to visit the book store physically to access this database. This information can be easily accessed now that it is on the Internet.
- *The nature of the product being sold:* As a product to be sold on the Internet, books are portable and have a relatively low cost. They are not high-risk or major purchases that need to be scrutinized physically before purchase, and can be stocked and shipped easily.
- *Existing mail-order concept:* Many readers are already used to the concept of ordering books and other goods using the mail-order system. The open and easily navigable nature of the Internet makes the product being sold more accessible.
- *Cost-effectiveness:* Internet booksellers can cut a considerable amount of overhead expenditure by eliminating inventories and shipping directly from wholesalers to consumers.
- *Faster delivery time:* The use of the Internet makes the distribution cycle faster, since the intervention of the retailer is minimized when the products are shipped directly from the wholesaler to the consumer.

The online commerce market, particularly over the Web, is rapidly evolving and intensely competitive. The advent and popularity of the Internet has lowered barriers to entry into the online retail book industry.

## Industry Competitive Analysis

Having reviewed the trends and changes in the book selling industry, we now turn to an analysis of the industry as it exists at present. We focus on the online book selling industry and study the various forces of competition that affect it, based on Porter's (1985) five forces analysis.



An analysis of the online book industry reveals that it is not difficult for a competitor to launch an online bookstore to compete with already established companies like Amazon.com. What is difficult is establishing and maintaining a loyal customer base. Considering the high buyer power and the large number of substitutes, attracting customers and keeping them is a challenge.

There is already a significant amount of rivalry in the industry with three major players -- Amazon.com, BarnesandNoble.com and Borders.com. Amazon.com was the first to market the idea of selling books online on a huge scale. The other followed suit, but had already conceded market share in terms of the customers that Amazon.com had obtained.

A list of the significant competitors for Amazon.com is given below.

- (i) Online retailers of books such as BarnesandNoble.com and Borders.com.
- (ii) Publishers, wholesalers and other physical book store chains and super stores, many of which possess significant brand awareness, sales volume and customer bases.
- (iii) Mail order retailers that have established and repeat customers.
- (iv) A number of indirect competitors that specialize in online commerce or derive a substantial portion of their revenues from online commerce through the sale of other products like videos, CDs and so on. These companies have access to customers who buy their products repeatedly, and therefore the companies possess information about the online-buying habits of their customers.

The principal competitive factors in Amazon.com's market are brand recognition and customer focus. Many of Amazon.com's competitors have longer operating histories, larger and established customer bases, greater brand recognition and greater financial, marketing and other resources than the company. Some of these competitors may be able to secure merchandise from vendors on more favorable terms, devote greater resources to marketing and promotional campaigns, adopt more aggressive pricing or inventory stocking policies and devote substantially more resources to Web site and systems development than Amazon.com.

Also, the competitors that do not compete for the same segment of customers as Amazon.com, may seek to leverage their market power and enter other segments as well. In addition, new technologies and the expansion of existing technologies may increase the competitive pressures on online retailers.

## **Firm level analysis**

### ***Business Model***

In this section, we analyze Amazon.com's business strategy and its competitive advantage. We try to identify certain key elements of the company's strategy that have made it one of the most powerful online retailers with formidable brand equity. We then discuss the structure of Amazon.com's business model and highlight how the structure derives from the strategy. Finally we take a look at how Amazon.com ensures execution of the business strategy by the use of information technology to their advantage.

### **Strategy**

#### **First to market / Innovation**

Amazon.com pioneered the concept of selling books online in 1994, and has been distinctly innovative ever since. This online retailer that started with selling books on the Internet, has expanded now to selling CDs, videos, gifts, toys, electronics and so on. The company has carefully devoted efforts at ascertaining what the customer wants and then worked towards fulfilling the customer's expectations. It is not surprising then, that Amazon.com has almost 8.4 million registered customers and almost 60% of their business is from repeat customers. But most of all - Amazon.com has achieved all this success and established its foothold in the online retailing market much before its competitors have; and that is one of the biggest reasons for the company's success.

Amazon.com is one of the first few online retailers that has a continuously growing customer base and brand equity that it becoming more and more powerful everyday. The company is often cited for its burgeoning sales (\$ 610 million in 1998) and sky-high market valuation. In March 1998, Amazon.com was ranked among the top 20 across all Internet sites in all major market surveys. Not only is Amazon.com the leading online bookseller, but it is the leading online shopping site according to these market surveys.<sup>iii</sup>

Based on all the above factors, and its strong stock-price, the company is considered to have a lot of potential for growth in the future, not just in the book-selling business but also in online retailing of a number of other products and services. Amazon.com has been involved in a number of partnerships and acquisitions of companies that are either product sellers or service providers on the Internet and that serve a niche market. Examples of such companies are PlanetAll (online calendar and scheduler) and

Junglee.com ( online price comparison service); which were acquired by Amazon.com, in its pursuit to becoming one of the most powerful and diverse retailers on the Internet.

Having observed Amazon.com's progress over the past couple of years, it is worth noting that they usually are the first to consider selling a new product or service on the Internet, and if they are not the first ones to have thought of the idea, then they either buy or partner with the the pioneering company in that space. It takes a considerable amount of dominance and first-mover advantage in the online retail market to be able to identify and subsequently acquire such niche and specialized companies to expand your empire. And Amazon.com seems to possess that advantage.

### **Customer focus**

Amazon.com has been a customer-centric company since its inception. They have innovated new ways of defining value to the customer and focused on getting the customer experience right. According to Jeffrey Bezos, CEO and founder of Amazon.com.<sup>vii</sup>

*“ We want to build a place where people can come to find and discover anything that they might want to buy online.”*

A good example of their customer focus is their excellent use of e-mail communication with the customer before and after the customer has made a purchase. It is widely recognized that customers shop at Amazon.com for its wide product selections, its easy-to-navigate site, its excellent use of e-mail for marketing and customer service, and its skill at tailoring product recommendations to individuals. The site is built with the visitor experience in mind.<sup>i</sup> The objective is to increase customer lifetime value by increasing customer loyalty and minimizing customer defections.

As the information-distribution<sup>iv</sup> power of the Internet increases, customers are increasingly getting products/services that they want. Online companies like Amazon.com now maintain comprehensive records of customer preferences, and then use that information to provide value to the customer. Amazon.com has tried to create that value by way of the one-click shopping, recommendations and notifications for new books. A customer's preferences regarding certain topics, authors etc. are collected and studied and when a new book or information on the customer's preferred subject becomes available, the customer is notified by e-mail.

The customer enjoys the convenience of getting access to the latest information tailored to his/her needs, without any additional effort. The online book seller in turn reaps the benefit when the customer continues to visit their site for continued purchases in the future. This benefit is also passed on to Amazon.com's suppliers like publishers and authors. In February, Amazon.com launched Amazon.com Advantage, an innovative new program designed to increase the visibility and sales of titles from independent publishers and authors. This helps level the playing field for smaller publishers and authors by providing the tools and framework to ensure their books appear more often, more prominently, and with 24-hour availability throughout Amazon.com's catalog of 4.7 million book, music, and other titles.

It is also interesting to note how Amazon.com has gradually progressed from being just an online retailer of books, to an online "super-market" for a number of products and services. Since the customer literally "rules" as far as online retailers are concerned, it is fairly important to understand what the customer's needs are; and model the business around those customer requirements. And Amazon.com has been successful in following this principle. They do not just have books and CDs, but also videos, gifts, gift certificates, toys, greeting cards, an auction store and so on. It seems that they are trying to create a one-stop shop on the Internet by offering a gamut of products at the Amazon.com store, where customers can purchase all that they want from just one retailer. Amazon.com registered almost 1 million customers in 1998, for products other than books, according to a recent press release at their web site. The online retailer also shipped 7.5 million items during the holiday season, which ran from November 17<sup>th</sup> through December 31, 1998.<sup>v</sup>

Another tool that Amazon.com uses to establish relationships with customers is "virtual communities". Virtual communities enhance relationships between companies and their customers. This is because media like the Internet enable customers to take control of their value as potential purchasers of products and services.<sup>vi</sup> Such communities facilitate better communication between members; thereby increasing the value to the entire community. Also, since there is a significant amount of member-generated content (recommendations, reviews about music/books), the community provides a more complete and vendor/advertiser independent perspective to the service. In a nutshell, the community serves the purpose of creating value for the members, by providing a platform for members to share their experiences, interact with each other and gain from the communication. Amazon.com has used this concept very successfully by encouraging readers of books and authors to share their experiences through their web site.

These gains are not just limited to the customer. Amazon.com also benefits from the inherent nature of the community and the medium of communication (the Internet in this case).

Lower investment : The level of capital investment for retail outlets is lower in the case of the virtual community, since there is no physical presence.

Better reach: A virtual community broadens the “reach” of the company, as it inherits the structure of the Internet. More customers can be reached and retained.

Disintermediation: The role and importance of the traditional intermediaries like brokers, wholesalers and retailers diminishes as the virtual community increases direct communication between the buyer and seller.

In a nutshell, Amazon.com seems to have been quite successful in identifying products that would appeal to the online customer, and attracting and retaining the customers, thus building a solid clientele. But most importantly, they have learnt the art of keeping the customer happy and ensuring that he/she keeps coming back to the Amazon.com store again and again.

### **Advertising and Branding**

The criteria for successful advertising on the Internet are different from those in traditional advertising. In the case of the Internet, the objective shifts from merely stimulating recall of the product, to keeping the customer engaged for a longer time at the web site which is the only medium of communication between the buyer and the seller at that point. The idea is to trigger the customer to ask for further information and assistance, generate curiosity and interest in the customer and subsequently encourage him/her to make a purchase. At the least, this exercise helps in identifying information about potential customers, their interests based on how deep they would drill into the web site, the nature of the information they would request and so on.

The skills needed to advertise on the Internet are different as well. Sites that are valuable in content and functionality, and that ease the communication between the customer and the buyer succeed at getting repeat customers. Therefore, web sites need to be rich in content, easy to surf, and also be transaction-enabled. Visibility of the advertisement at other relevant and popularly visited sites improves chances of catching the customer’s attention.

Amazon.com has advertising *banners* at their partners’ sites like Yahoo, Altavista and so on. When the potential customer searches for a topic; and clicks on the Amazon.com advertisement alongside the hits for the search, Amazon.com provides the customer books related to his/her search. The customer is offered a valuable experience and information at the web site, at no extra cost. The objective here is to induce the customer to make a purchase by holding his/her attention to the site for a long time. Amazon.com also uses radio and the print media to communicate with customers. The advertisements usually tend to be quite catchy and easily secure the attention of a potential customer.

The increase in visibility that Internet advertising brings can be harnessed to create and maintain a brand image in the minds of consumers. This is one of the reasons that companies like Amazon.com have graduated from being obscure virtual businesses to those that score very high in brand-recognition surveys.

One of the main characteristics of branding on the Internet is to provide the customer with significant functionality online. The customer is allowed to do a number of things other than just reading the information on the web site. Amazon.com and its competitors like Barnes and Noble have figured out a way to make customers enjoy the experience of visiting their site and being offered a host of other services like book recommendations, chat sessions with other readers, authors and so on.

As the power and influence of the Internet increase with the computer-savvy generation of today, building customer loyalty on the Internet is becoming more and more significant. Amazon.com acquired a web-based service called Junglee.com to provide a price-comparison service. A customer can get different price-quotes for the product (not restricted to books) that interests him/her from different vendors for that product. Services like these make the experience of “buying” over the Internet easy and convenient. The customer’s importance increases with the entry of more service providers. The focus is on establishing a relationship with the customers, studying their requirements, and enhancing the value-addition to their experience.

The battle between Amazon.com and its competitors like Barnes and Noble and Borders is based on the delivery of value, and the building of a brand image in the minds of the customer. Amazon.com, like most net-based brands, achieved dominance since it was the first to offer a high quality online service. This has created tremendous brand equity for Amazon.com (52% which translates to about 101 million U.S. adults<sup>vii</sup>). But now it is faced with a rival, Barnes and Noble, which has a strong brand name along with the financial wherewithal and marketing skills to match. Thus when Amazon cites its ability to provide superior selection and online know-how, Barnes and Noble plays up its authority as the No. 1 Bookseller in the United States with an established clientele for their physical book stores.

### **Choice of products**

The choice of books as an item for sale over the Internet was a strategic decision too. Amazon.com identified books as an item that does not need to be touched and felt (in most cases) before the purchase is made. Also, books are small ticket, impulse items that are easy to ship and handle. Now



Amazon.com also provides excerpts from books which the potential customer can browse through before making the purchase. Also, the value of purchasing the book over the Internet increases when the customer is given reviews from other customers(who have read the book) and recommendations from authors and best-seller lists. Amazon.com has now diversified into selling videos, music, toys and so on. Similar to books as a product category, the characteristics of these products makes the experience of buying them online easy and convenient.

The music store offers more than 125,000 titles, 10 times the CD selection of the typical music store, and everyday savings of up to 40%. Music fans can now search for their favorite music by CD title, artist, song title or label and listen to more than 225,000 song samples. In addition, the online music store features expert recommendations and customer reviews, interviews, essential lists, the hottest and best selling CD's from around the world and so on.

## **Structure**

As we have discussed, Amazon.com's strategy is very focused on customers and the company has constantly evolved to ensure that they continue to drive the strategy. A very important component of their success lies in the fact that the company's structure is designed around their strategy. This section draws on this alignment of the business strategy and structure of the Amazon.com business model, and attempts to highlight why this concept succeeds for the company.

## **Value added partnerships**

As discussed in the previous section, Amazon.com's business strategy revolves around creating brand equity for the company through excellent customer-convenience ideas. In CEO Jeffrey Bezos' words<sup>vii</sup>,

*“You realize very quickly that you can't sell everything people might want directly. So instead you need to do that in partnership with thousands and indeed millions of third-party sellers in different ways. To try to do that alone, in strictly a traditional retail model, isn't practical.”*

The company has tried to provide a valuable experience to their customer; not only by offering him/her value-added features like reviews and recommendations about the book, excerpts from the book, but also ease of ordering. Gradually the company has extended their product line, in an attempt to offer a one-stop shopping site where customers could choose from a variety of products like CDs, Videos, DVDs, toys, gift articles and even participate in an auction. Besides this convenience, it is also very easy to locate Amazon.com on the Internet, due to their increased visibility through advertisements on other

high-profile web sites like Yahoo!, Altavista, AOL, Geocities, Netscape and so on. Both the product expansion and better visibility are possible only through Amazon.com's alliances, partnerships with and acquisitions of strategic product and service providers on the Internet.

These partnerships not only help Amazon.com broaden the range of products and services that the company can sell on the Internet, but also increase the scope of the company's business and amplify the customer base. This increased visibility helps Amazon.com succeed in one of their primary strategic goals; which is creation of brand awareness. The brand recognition brings more customers to Amazon.com's doors, and as its popularity increases, it becomes more and more powerful among online retailers.

We take a look at some of these alliances and acquisitions below. As of May 1999, Amazon.com is associated with 200,000 web sites on the Internet. The company spent \$39 million, which is more than a quarter of its total revenue, on marketing and selling in 1998. This amount included \$21 million for banner placement on Yahoo! and Excite.<sup>v</sup> The strategy here is focused on increasing the customer base, by teaming up with another service provider on the Internet; thereby increasing the benefit to both the partners.

In September 1998, Yahoo! and Amazon.com announced one of the most extensive global merchant programs on the Internet, featuring Amazon.com as the premier book merchant throughout many of Yahoo!'s world sites including Asia, UK and Ireland, France, Germany, Denmark, Sweden, Norway, Canada, Australia and New Zealand, Japan and Korea. This program is an expansion of the existing relationship between the two companies. Amazon.com merchant buttons are now placed on all the Yahoo! sites worldwide. Amazon.com allows Yahoo! users to browse through the largest online catalog of books and quickly and conveniently purchase titles relevant to their interests from anywhere in the world. With the far-reaching network of Yahoo!'s globally-branded properties this alliance provides Amazon.com the ability to simultaneously reach a variety of markets and audiences.

Besides the convenience of the Amazon web-site, the customer also encounters its presence elsewhere on the Internet. For instance, when a customer tries a Web-based search with Yahoo! or Excite or Altavista, Amazon.com (which has partnered with these search engines) offers books on its site pertaining to the customer's search.

Amazon.com has also been involved in the acquisition of certain niche-market serving companies like PlanetAll and Junglee. Amazon.com acquired these two companies in August 1998. PlanetAll provides a unique Web-based address book, calendar, and reminder service. Junglee is the leading provider of

advanced Web-based virtual database (VDB) technology that can help shoppers find and discover products on the Internet. Together, these acquisitions are intended to speed Amazon.com's enhancement of the e-commerce experience for its customers.

In April 1999, Amazon.com bought three other companies -- Exchange.com, Alexa Internet and Accept.com, in an attempt to further expand its business. Exchange.com operates the popular Bibliofind.com, a seller of used and antiquarian books, as well as Musicfile.com, which features music memorabilia and rare recordings. Amazon anticipates that this acquisition will add more than 12 million book and music items for sale. Alexa Internet offers a free advertising-supported Web navigation service. Accept.com is an e-commerce company developing technology for business and consumer transactions on the Internet.

Besides the partnerships and the acquisitions, Amazon.com has also invested and purchased a stake in companies like Pets.com, Drugstore.com and HomeGrocer.com, that offer specialized products and services on the Internet. This investment is yet another strategic move towards expanding the book-seller's business into a wider gamut of services and products.

## **Distribution**

Amazon.com is known for its disintermediation of the physical book seller. Customers that order books or other products online receive the merchandise through mail in a pre-determined number of days. One reason why customers take their business to Amazon.com, instead of going to a physical book store is the ease of ordering and receiving the merchandise. This section attempts to describe the distribution network which is another critical component of Amazon.com's structure. The customer-focused company needs to have a flawless distribution system that allows it to execute its strategy of creating value for the customer. This description focuses on the distribution of the company's first two offerings--books and music.

Amazon.com carries its own inventory of books; some of which is purchased directly from publishers. It also relies on rapid fulfillment from major distributors and wholesalers that carry a broad selection of titles. The online book seller purchases a substantial majority of its books from Ingram Book Group ("Ingram") and music from Baker & Taylor, Inc. ("B&T") and EMI Music Distribution (EMD). Ingram is the company's single largest supplier and accounted for 58% and 59% of the Company's inventory purchases in 1997 and 1996, respectively.

Ingram Book wholesales books to dozens of Internet booksellers, who depend on Ingram's huge, almost 500,000-title book list and its extremely fast shipments. However, there is a cost. Online book vendors, as well as regular bookstores, must pay Ingram Book a wholesale mark-up of about 2% per book over the publisher's direct sale price. To save costs, Amazon.com and other online book vendors are trying to disintermediate Ingram Book and distribute their own books. To this end, Amazon.com has enlarged its Seattle warehouse by 70% and leased a new warehouse in New Castle, Delaware, expanding its warehouse capacity by a factor of six times. The company also rented a 300,000 square foot distribution center in Nevada in 1999, which is expected to decrease delivery times in the south-west region of the United States by one day, and reduce the company's reliance on overnight delivery services. As a result of the disintermediation of the physical book-retailer, the company can adapt quickly to customer needs. According to Amazon.com, their inventory turnover is 26 times a year which is 10 times greater than that of rival Barnes and Noble; and leads to lower inventory carrying costs.

Amazon.com utilizes automated interfaces for sorting and organizing its orders to enable it to achieve the most rapid and economic purchase and delivery terms possible. The company's proprietary software selects the orders that can be filled via electronic interfaces with vendors and forwards remaining orders to its special orders group. Under the company's arrangements with distributors, electronically ordered books often are shipped by the distributor within hours of a receipt of an order from Amazon.com. The company has developed customized information systems and trained dedicated ordering personnel who specialize in sourcing hard-to-find books.

On the music side of the business, Amazon.com has become the first dedicated online retailer to buy direct from a major record company. EMI Music Distribution (EMD) services Amazon.com as a direct account, according to sources within the distribution company. Online merchants with full catalog offerings generally buy from either Valley Media, the main supplier to Internet retailers, Alliance One Stop Group, or Baker & Taylor.

The primary advantages of this distribution network, are the reduced handling costs of inventory for Amazon.com, and ease of ordering for the customer. This cost advantage can be further passed on to the customer in the form of price discounts. The customer is then faced with two features that offer more value compared to the physical book-store option. First, the customer can purchase the book from the convenience of his/her own home, and pays a lower price for the book despite the ease of ordering the book. This distribution structure thus bolsters the customer-focus strategy of the company.

A detailed picture of the distribution network can be found in the Appendix.

## **Associates program**

This program is focused on attracting customers and then maintaining their business with Amazon for their lifetime. This follows from the strategy of the company to not just attract customers but to ensure that they keep visiting Amazon.com again and again. The Associates program is another way to ensure repeat business of customers. It also serves to increase the customer base as current Amazon.com customers accept the onus of assisting with advertising and brand promotion of the company. In return, Amazon.com offers a customer an option to earn money and recognition through its “associates” program.

Once enrolled as an associate, a customer refers Amazon to other customers through his/her web site (that could be either professional or personal). The Amazon.com associate then earns a commission for any purchases that occur through his/her referral. In early September 1998, Amazon.com augmented its growing list of Associate relationships when it announced one of the most extensive global merchant programs on the Net, featuring Amazon.com as the premier book merchant throughout many of Yahoo’s world sites. Amazon.com associates now number more than 140,000; and according to internal Amazon.com records, web site operators continue to prefer Amazon.com for the powerful benefits they receive from the Amazon.com’s leading traffic, content, customer experience, brand, service and cross-product capabilities.

## **Execution**

After having discussed the business strategy and structure of Amazon.com’s business model, we take a look at how the company has used Information Technology to facilitate the execution of its business. This section first introduces the reader to some of the main features of the Amazon.com web site; and then proceeds to a description of the various application management tools that are used to support the structure of the company.

### **The Web site**

Amazon.com strives to offer an online shopping experience to users that is convenient and offers a number of advantages over traditional book-buying methods. The company believes that the sale of books and other products and services over the Web can offer attractive benefits to consumers, including enhanced selection, convenience, ease-of-use, competitive pricing, depth of content and information and personalization. Customers entering the Amazon.com web site can, in addition to ordering books and other products, purchase gift certificates, participate in auctions, conduct targeted searches, search for

books by subject category, read and post reviews, register for personalized services, participate in promotions and check order status. Ordering merchandise is also convenient and easy. When a users are ready to check out, they bring their electronic shopping cart to the cashier and pay by credit card. Most items are sold at a discount of up to 40% and in some cases up to 85% as well. The company also offers special promotions such as a recent one in mid-May 1999, where all titles on the New York Times best seller list were offered at 50% of their actual price. The key components of Amazon.com's offerings include the following:

Browsing: The Amazon.com site offers visitors a variety of highlighted subject areas and special features arranged in a simple, easy-to-use fashion intended to enhance book search and selection. In addition, the Amazon.com home page presents a variety of products and information of topical or current-event interest. To enhance the shopping experience and increase sales, the company features a variety of books on a rotating basis throughout the store. There are links to other Amazon.com partners as well, such as drugstore.com and so on.

Searching: A primary feature of the Amazon.com Web site is its interactive, searchable catalog of more than 2.5 million titles. This accounts for a significant percentage of most of the estimated 4.8 million books believed to be in print, more than one million out-of-print titles believed to be in circulation and a small number of CDs, videotapes, audio tapes and other products. The Company provides a selection of search tools to find books and other products based on title, subject, author, keyword, publication date or ISBN. Customers can also use more complex and precise search tools such as Boolean search queries. The Company licenses some of its catalog and other information from third parties.

Reviews and Content: The Amazon.com store offers numerous forms of content to entertain and help readers, enhance the customer's shopping experience and encourage purchases. Various types of content are available for particular titles, including cover art, synopses, annotations, interviews by authors or reviews by other readers. Customers are encouraged to write and post their own reviews and authors are invited to "self-administer" interviews by answering predefined questions.

Recommendations and Personalization: During its history, Amazon.com has continually sought to personalize its product and service offerings. These improvements have included greeting customers by name, instant recommendations, collaborative filtering and a number of other related features. The Company believes that personalization of a customer's shopping experience at the company's web site is an important element of the value proposition it offers to customers and intends to continue to enhance its personalized services.

Gift Center: In November 1997, Amazon.com launched its Gift Center, including features such as gift recommendations from Amazon.com editors, dynamic personalized gift-matching services and both traditional and electronic gift certificates. Customers can select and order gifts, choose from a number of gift-wraps and have packages wrapped and sent with a personalized message.

Availability and Fulfillment: Many of the Company's titles are available for shipment within 24 hours, others are available within 48 to 72 hours and the remainder of in-print titles are generally available within four to six weeks, although some titles may not be available at all. Out-of-print titles generally are available in one to three months, although some titles may not be available at all. Customers may select from a variety of delivery options, including overnight and various international shipping options, as well as gift-wrapping services. The Company uses email to notify customers of order status under various conditions. The Company seeks to provide rapid and reliable fulfillment of customer orders and to continue to improve its speed of availability and fulfillment.

Some of the other features that have been recently added are Amazon.com auctions, where registered Amazon.com customers can buy and sell merchandise. Amazon.com certifies the authenticity of the products auctioned to the customers. Another new feature added in April 1999, is "electronic" greeting cards. These cards are free of cost and offer a number of different occasion, animated greetings for customers to use.

### **Use of Information Technology**

Amazon.com has implemented an array of site management, search, customer interaction, transaction-processing, order fulfillment services and systems using a combination of its own proprietary technologies and commercially available, licensed technologies. The company's current strategy is to focus its development efforts on creating and enhancing the specialized, proprietary software that is unique to its business and to license commercially developed technology for other applications where available and appropriate.

Amazon.com uses a set of applications for accepting and validating customer orders, organizing, placing and managing orders with suppliers, managing inventory, assigning inventory to customer orders and managing shipment of product to customers based on various ordering criteria. The company's transaction-processing systems handle millions of items, a number of different availability statuses, gift-wrapping requests and multiple shipment methods and allow the customer to choose whether to receive single or several shipments based on availability. These applications also manage the process of

accepting, authorizing and charging customer credit cards. The Amazon.com web site also incorporates a variety of search and database tools.

The continued uninterrupted operation of the company's Web site and transaction-processing systems is essential to its business. Amazon.com has an on-site staff who are charged with the responsibility of ensuring reliable service. Amazon.com uses three Internet service providers, UUNet Technologies, Inc., InterNAP Network Services LLC and Interconnected Associates, Inc., to obtain connectivity to the Internet over multiple dedicated lines.

In April 1999, Amazon.com acquired a company called Alexa Internet<sup>viii</sup>. Alexa has developed a Web navigation service that works with Internet browsers to provide useful information about the sites being viewed and suggest related sites. The tool, which Alexa says has some 600,000 users, provides traffic information on sites they are visiting and links to related sites. The company also is creating an archive of Web sites and pages. It is expected that Amazon.com will use Alexa's technology to monitor Amazon customers as they surf the Web. If a customer visits a golf-related site, for example, Amazon could use Alexa to market its golf-related goods to that customer.

Alexa's technology could improve customer loyalty at Amazon by making Amazon's site easier to navigate. Amazon could use the technology to alert music customers about related auctions or books and help them easily jump to those sites. A facility like this would help the online retailer manage the huge web of sites it plans to develop.

## **Challenges in the future**

The previous sections illustrate Amazon.com's success and delineate its path to its current powerful position as the number one online retailer. The company is cited frequently in business periodicals for its innovative use of technology and for its alignment of strategy, structure and information technology. But despite all this success, Amazon.com is still losing money. The company lost almost \$120 million in 1998, and has yet to register a single quarter of profit. Yet, it has a market valuation of almost \$22 billion currently. In recognition of its contribution to online retailing in 1998, Amazon.com received "E-retailer of the Year Award", sponsored by PriceWaterhouse Coopers<sup>ix</sup>.

The company faces a number of challenges in maintaining its number one position. Some of these challenges are mentioned in detail in this section.



While Amazon.com has done well in terms of creating brand awareness among consumers, despite expenses and difficulties frequently encountered by companies in new and rapidly evolving markets such as online commerce, there is considerable uncertainty as to whether it can sustain and evolve an unpredictable business model. Moreover, it must be able to manage the rapid growth in its business. To address these risks, Amazon.com must be able to maintain and increase its customer base, implement and successfully execute its business and marketing strategy. The company needs to continue to develop and upgrade its technology and transaction-processing systems, improve its web site, provide superior customer service and order fulfillment, respond to competitive developments and attract, retain and motivate qualified personnel. Given its limited history, it is difficult to predict whether the company can meet these challenges.

At its core, Amazon.com's revenues depend on the number of visitors who shop on its Web site and the volume of orders it fulfills. Successful management of the technology infrastructure is therefore critical. Any system failures that result in the unavailability of its Web site or reduced order fulfillment performance would reduce the volume of goods sold and the attractiveness of its product and service offerings. The company has deployed internally developed systems for its Web site, search engine and substantially all aspects of transaction processing, including order management, cash and credit card processing, purchasing, inventory management and shipping. Significant investments will be necessary to further develop and upgrade its existing technology infrastructure to accommodate increased traffic on its Web site and increased sales volume. Moreover as the company invests in its own distribution facilities to achieve quicker delivery times, its cost structure is changing so that it too, like its land-based competitors, is incurring significant costs associated with bricks-and-mortar.

## **Firm financial performance**

Amazon.com has incurred significant losses since its inception and as in the year ended December 31, 1998, Amazon.com registered a loss of \$120 million. The company's shares have split twice, a 2 for 1 split in April 1998 and a 3 for 1 split in December 1998. However, Amazon.com has still not posted a profit and is not expected to until late in the year 2001. The high market valuation for Amazon.com (\$22 billion in May, 1999) then exists on the expectation that the company will experience phenomenally high growth in the future; this growth being measured by the rapid increase in number of customers and total net sales generated each year.

## Conclusions

The future is uncertain for Amazon.com. With the competition in the “Web-retailing” industry growing, especially for products like books and music, there is a lot of uncertainty and speculation about the future of companies like Amazon.com. Other than the competition from the other major players in the book retailing industry like Barnes and Noble and Borders, staying abreast and ahead in terms of technological innovation to keep the company a leading player in E-commerce is a major hurdle that Amazon.com must overcome. The company will also have to invest considerable time and effort in convincing shoppers that buying books (and all the other products that they offer) online is convenient and cost-effective.

As has been discussed in detail in this paper, Amazon.com has a business model with an impressive alignment of its strategy, structure and execution. The company has used Information Technology (IT) to its advantage and has established a powerful presence on the Internet. The future then seems to be very promising with the increasing importance of the Internet in the business world. But a traditional assessment of the company’s financial position does not deem it to be a profitable venture. Ordinarily a company with no profit expected for the near future would either be over looked or punished by investors. But in the case of Amazon.com, the excitement over its game plan and the expectation of the growth in E-commerce have prevailed.

To remain competitive, the company must continue to enhance and improve the responsiveness, functionality and features of the Amazon.com online store. The Internet and the online commerce industry are characterized by rapid technological change, changes in user and customer requirements and preferences, frequent new product and service introductions embodying new technologies and the emergence of new industry standards and practices.

It will be interesting then, to watch this online retailer that professes to be the earth’s biggest selection of products on the Internet, marching ahead undaunted as the competition intensifies. It remains to be seen whether Amazon.com will be profitable as a business or not; what can be expected though, is the benefit to the Amazon.com customer who would definitely have enjoyed the experience of having been a valued shopper!

## Appendix

### Highlights of 1998<sup>x</sup>

- Sales grew from \$148 million in 1997 to \$610 million - a 313% increase.
- Cumulative customer accounts grew from 1.5 million at the end of 1997 to 6.2 million at the end of 1998 - an increase of over 300%.
- Despite this strong new customer growth, the percentage of orders placed on the Amazon.com Web site by repeat customers grew from over 58% in the fourth quarter of 1997 to over 64% in the same period in 1998.
- The company's first major product expansion, the Amazon.com music store, became the leading online music retailer in its first full quarter.
- Following their October launch under the Amazon brand and with Amazon.com technology, the combined fourth-quarter sales in the U.K. and German stores nearly quadrupled over the third quarter, establishing Amazon.co.uk and Amazon.de as the leading online booksellers in their markets.
- The addition of music was followed by the addition of video and gifts in November, and Amazon.com became the leading online video retailer in only 6 weeks.
- 25% of the company's fourth-quarter 1998 sales was derived from Amazon.co.uk, Amazon.de, and music, video, and gift sales on Amazon.com, all very new businesses.
- The company significantly improved the customer experience, with innovations like 1-Click(SM) shopping, Gift Click, store-wide sales rank, and instant recommendations.

1998's revenue and customer growth and achievement of continued growth in 1999 were and are dependent on expansion of the company's infrastructure. Some highlights:

- In 1998 the employee base grew from approximately 600 to over 2,100, and the company significantly strengthened its management team.
- The company opened distribution and customer service centers in the U.K. and Germany, and in early 1999, announced the lease of a highly-mechanized distribution center of approximately 323,000 square feet in Fernley, Nevada. This latest addition is expected to more than double Amazon.com's total distribution capacity and allows them to even further improve time-to-mailbox for customers.
- Inventories rose from \$9 million at the beginning of the year to \$30 million by year end, enabling Amazon.com to improve product availability for customers and improve product costs through direct purchasing from manufacturers.

## **Goals for 1999<sup>x</sup>:**

Amazon.com believes that the overall e-commerce opportunity is enormous, and 1999 will be an important year. Although Amazon.com has established a strong leadership position, it is certain that competition will even further accelerate. The company plans to invest aggressively to build the foundation for a multi-billion-dollar revenue company serving tens of millions of customers with operational excellence and high efficiency. The main highlights of the goals for 1999 are listed below.

**Distribution capacity** - Amazon.com intends to build out a significant distribution infrastructure to ensure that they can support all the sales their customers demand, with speedy access to a deep product inventory.

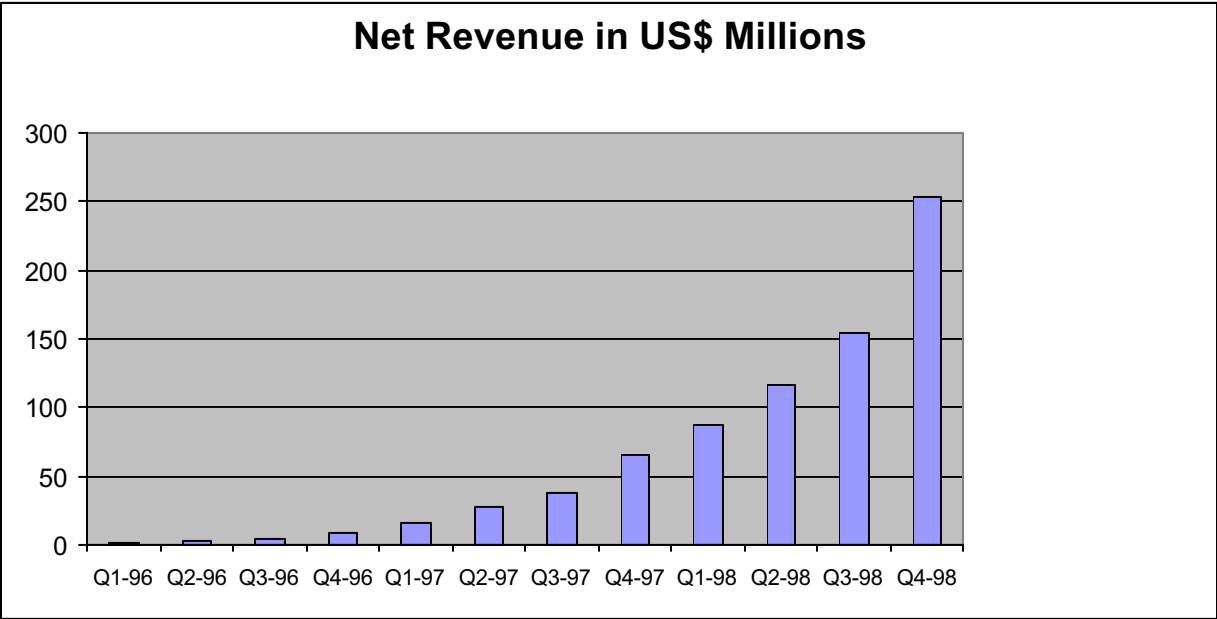
**Systems capacity** - They plan to expand their systems capacity to support similar growth levels. The systems group has a significant task: expand to meet near term growth, restructure systems for multi-billion dollar scale and tens of millions of customers, build out features and systems for new initiatives and new innovations, and increase operational excellence and efficiency. All while keeping a billion dollar, 8 million customer store up and available on a 24x7 basis.

**Brand promise** - Amazon.com is still a small and young company relative to the major offline retailers, and they must ensure that we build wide, strong customer relationships during this critical period.

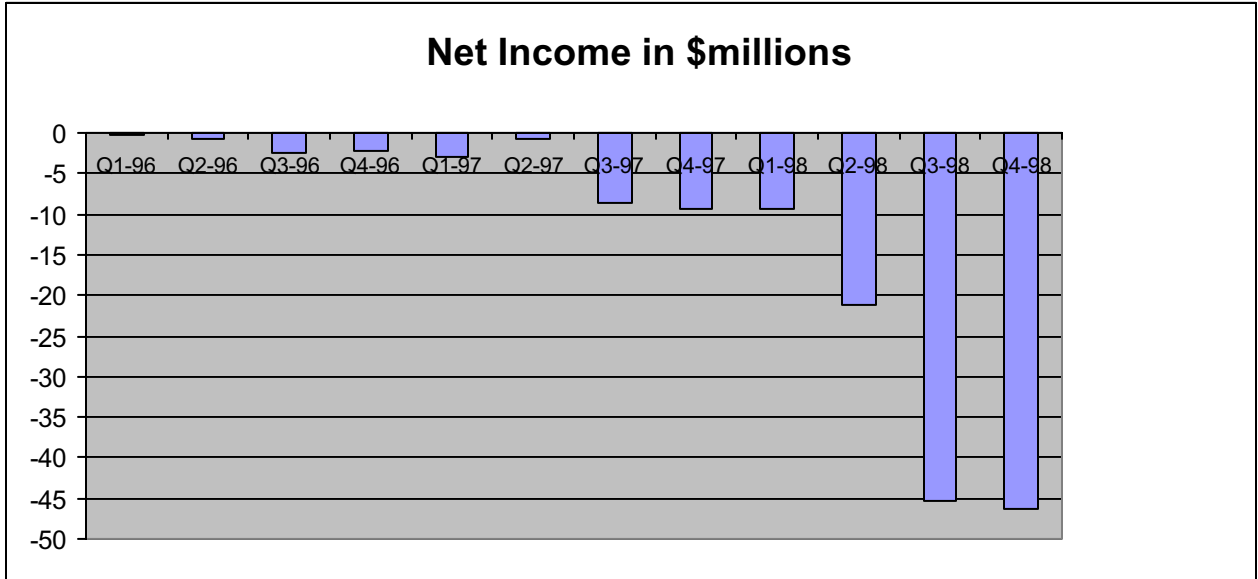
**Expanded product and service offerings** - In 1999, they plan on continuing to enhance the scope of their current product and service offerings, as well as add new initiatives.

**Bench strength and processes** - Amazon.com has grown its business dramatically with new products, services, geographies, acquisitions and additions to their business model. They intend to invest in teams, processes, communication and people development practices.

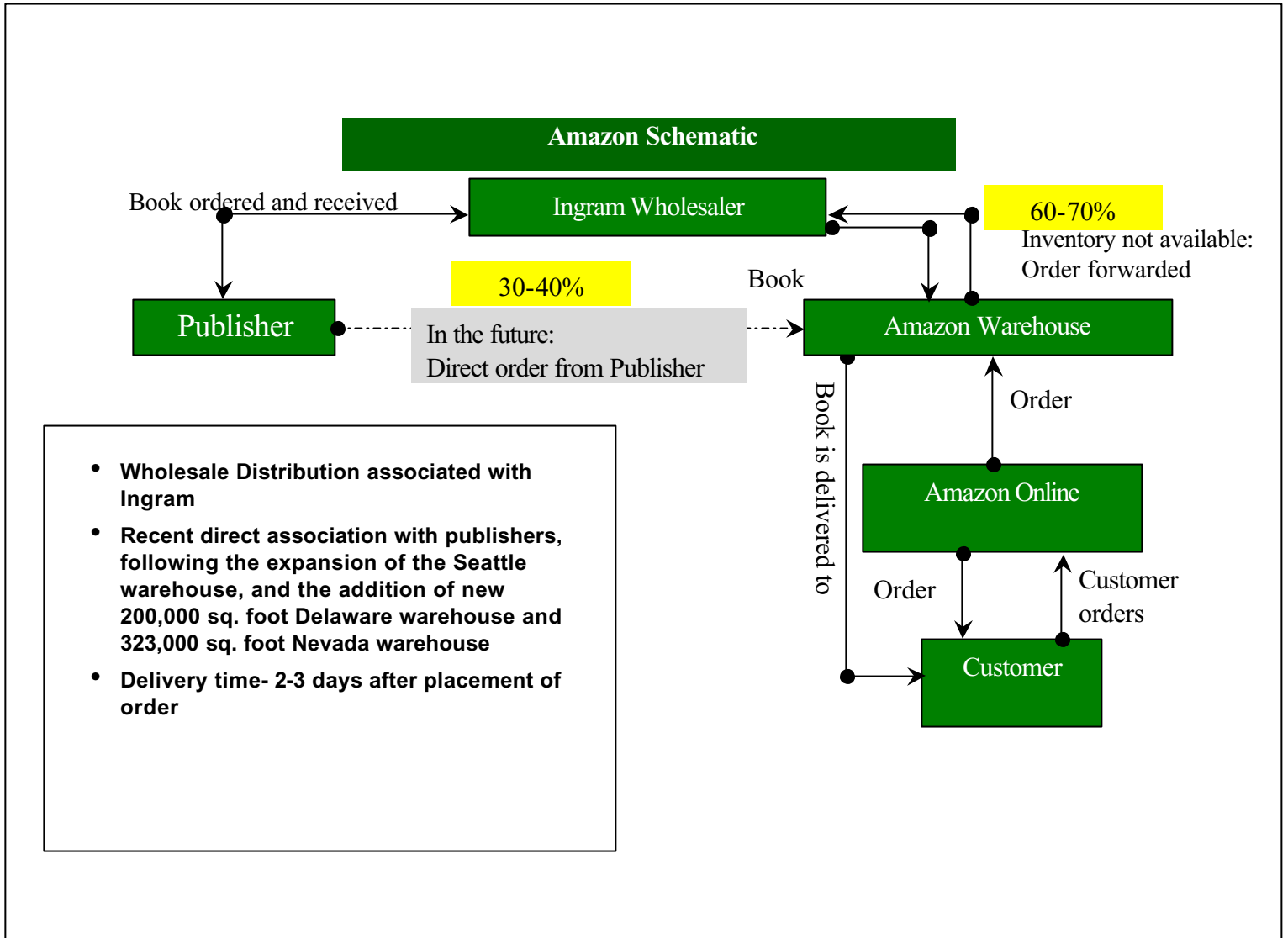
**Net Revenue**



**Net Income**



**Schematic of distribution**



- Wholesale Distribution associated with Ingram
- Recent direct association with publishers, following the expansion of the Seattle warehouse, and the addition of new 200,000 sq. foot Delaware warehouse and 323,000 sq. foot Nevada warehouse
- Delivery time- 2-3 days after placement of order

Financial Statements

AMAZON.COM, INC.

BALANCE SHEETS  
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	1998	1997
Current assets:		
Cash.....	\$ 25,561	\$ 1,876
Marketable securities.....	347,884	123,499
Inventories.....	29,501	8,971
Prepaid expenses and other.....	21,308	3,363
	-----	-----
Total current assets.....	424,254	137,709
Fixed assets, net.....	29,791	9,726
Deposits and other.....	626	169
Goodwill and other purchased intangibles, net.....	186,377	--
Deferred charges.....	7,412	2,240
	-----	-----
Total assets.....	\$648,460	\$149,844
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable.....	\$113,273	\$ 33,027
Accrued advertising.....	13,071	3,454
Other liabilities and accrued expenses.....	34,547	6,570
Current portion of long-term debt.....	684	1,500
	-----	-----
Total current liabilities.....	161,575	44,551
Long-term debt.....	348,077	76,521
Long-term portion of capital lease obligation.....	63	81
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.01 par value:		
Authorized shares -- 10,000		
Issued and outstanding shares -- none.....	--	--
Common stock, \$0.01 par value:		
Authorized shares -- 300,000		
Issued and outstanding shares --	1,593	1,449
Additional paid-in capital.....	300,130	66,586
Note receivable from officer for common stock....	(1,099)	--
Deferred compensation.....	(1,625)	(1,930)
Accumulated other comprehensive income.....	1,806	--
Accumulated deficit.....	(162,060)	(37,514)
	-----	-----
Total stockholders' equity.....	138,745	28,591
	-----	-----
Total liabilities and stockholders' equity.....	\$648,460	\$149,844
	=====	=====



**AMAZON.COM, INC.**  
**STATEMENTS OF OPERATIONS**  
**(IN THOUSANDS, EXCEPT PER SHARE DATA)**

	<b>1998</b>	<b>1997</b>	<b>1996</b>	<b>1995</b>	<b>1994</b>	
Net sales.....	609,996	147,787	15,746	511		
Cost of sales.....	476,155	118,969	12,287	409		
	<hr/>					
Gross profit.....	133,841	28,818	3,459	102		--
Operating expenses:						
Marketing and sales.....	133,023	40,486	6,090	200	--	
Product development.....	46,807	13,916	2,401	171	38	
General and administrative.....	15,799	7,011	1,411	35	14	
Merger and acquisition related costs, including amortization of goodwill and other purchased intangibles.....	50,172	--	--	--	--	
	<hr/>					
Total operating expenses.....	245,801	61,413	9,902	406	52	
Loss from operations.....	(111,960)	(32,595)	(6,443)	(304)	(52)	
Interest income.....	14,053	1,901	202	1	--	
Interest expense.....	(26,639)	(326)	(5)	--	--	
	<hr/>					
Net interest income (expense)....	(12,586)	1,575	197	1	--	
Net loss.....	(124,546)	(31,020)	(6,246)	(303)	(52)	
Basic and diluted loss per share	(0.84)	(0.24)	(0.06)	(0.00)	(0.00)	
Shares used in computation of basic and diluted loss per share	148,172	130,341	111,271	86,364	79,146	

## References

---

- <sup>i</sup> Fortune, May 24, 1999, 9 Ways to win on the Web
- <sup>ii</sup> *Competitive Advantage*, 1985, Michael Porter, Free Press.
- <sup>iii</sup> Media Metrix and Relevant knowledge survey
- <sup>iv</sup> LA times , November 1 1998: E-commerce gets personal
- <sup>v</sup> Media Investor, May 1999, Jewel in the Crown- Amazon.com
- <sup>vi</sup> *Net Gain*: John Hagel 3, Arthur Armstrong
- <sup>vii</sup> Business Week, May 31, 1999, eBay vs. Amazon.com
- <sup>viii</sup> C-Net news.com, May 13, 1999, Amazon details its shopping habits
- <sup>ix</sup> C-net news.com, May 17, 1999, Amazon.com voted Retailing Times “E-retailer of the year”
- <sup>x</sup> Amazon.com investor relations: [www.amazon.com/investor](http://www.amazon.com/investor)