

BUSINESS PROBLEM-SOLVING CASE

Can This Bookstore Be Saved?

Borders Group (including many former Waldenbooks rebranded as Borders Express) liquidated its assets and closed all of its locations in the second half of 2011. The previous year had already seen the demise of B. Dalton, a Barnes & Noble subsidiary since 1987. Since 1991, eleven major U.S. bookstore chains have been whittled down to six, and nearly 3300 stores to just over 2200 in 2011.

Still in the lead after over 20 years of domination, Barnes & Noble was often painted as the bully, driving both regional chains and small independent bookstores out of business with its aggressive pricing tactics and unbeatable inventory. Before e-commerce reshaped the landscape, its superstores forced smaller rivals into "most titles offered" wars. As smaller chains struggled to keep pace, support from publishers was not forthcoming. This short-term, bottom-line strategy would come back to haunt publishers.

B&N kicked around the idea of selling books online, experimenting with Trintex, a 1980s Web-retail prototype, selling books on CompuServ in the mid-1990s, and opening an online shop on AOL. However, it was not until 1997, fully two years after the arrival of Amazon, that it launched its first Web site. Data from numerous emerging e-commerce markets now verifies that books are an ideal initial product to draw first-time buyers. B&N was already behind the curve.

Amazon, launched initially as an online bookstore, upended the titles war. While B&N might be able to offer over 200,000 titles in its bricks-and-mortar stores, Amazon offered an inventory limited only by publisher availability. Shrewd financial moves, including selling 50% of its Internet operation to German giant Bertelsmann in 1998, kept B&N in the game. It established a new industry standard of 750,000 titles on-hand and bragged that it could procure over 8 million new, out-of-print, and rare books for customers from suppliers. However, Amazon continued to trump B&N on innovation. When B&N launched its online music store in 1999, several months after taking barnesandnoble.com public and refurbishing its cash reserves, it was again playing catch-up with Amazon, which had pioneered the concept a year earlier.

In early 2009, when B&N purchased Fictionwise, one of the biggest electronic book proprietors in North America, it was again behind the technology curve. Amazon had already unveiled its Kindle e-reader sixteen months earlier. What's more, Amazon would offer New York Times bestsellers and other popular e-books for less than \$10.

While publishers fretted that readers would be reconditioned to devalue the worth of the printed word and that offline stores would be strained to their limits discounting print books to compete, B&N scrambled. It took until July 2009 (two months after the Fictionwise purchase) to finally unveil B&N's e-bookstore. Its Nook e-reader was released in October, again more than two years behind Amazon. Ironically, as early as 1998, B&N had partnered with software companies such as Nuvo-Media to develop a prototype e-reader called the Rocket, but it had nixed the project in 2003 because there didn't appear to be any money in it. Now it had to hustle to refashion itself as a seller of e-books, e-readers, and apps to enhance the reading experience.

Critically well-received, the Nook began to scrape market share from the Kindle when it sparked a price war a year later. Dropping the price from \$259 to \$199 and releasing a WiFi-only model for \$149, B&N took aim at the giant. Amazon quickly countered by slashing the Kindle to \$189 eight hours later and releasing the WiFi-enabled 3G Kindle3 within a month, again at \$10 below the Nook.

With titans such as Apple (iPad) and Google (originally with the iRiver Story and in 2012 with the Nexus 7) providing additional competition, the tables had been turned on the former bookstore baron. Will B&N be able to survive against these tech giants?

The answer remains to be seen. B&N was the only bookseller with the resources to complete the considerable task of developing an e-reader, marketing it, and setting up manufacturing and retail operations for the device. Its closest competitors were already succumbing to the contraction of the chain bookstore market, victims of both B&N and the e-commerce revolution. Books-A-Million, with approximately 250 stores compared to 1,363 (689 retail and 674 college) for B&N, is its closest remaining competitor.

While B&N still depends on its physical, brick-and-mortar stores to drive its business, the e-book market is a horse of a different color. The economics of e-book sales are very different from traditional book sales. Customers who visit B&N's Web site buy three digital books for every one physical book, but booksellers still make more money on print books than e-books. And while having a competitive e-reader seemed essential to successfully vying for market share, it came at a steep cost. Moreover, it is not the pivotal factor in controlling the e-book market. Content is.

Since the price war, the reality is that in order to compete with Amazon, e-reader hardware must sell at or

near cost, with profits derived from the sale of digital content, including e-books, music, videos, apps, and games. Once Amazon had wrung all the profit it could from Kindle hardware, it quickly maneuvered into adding apps and app features and aggressively pursuing a cross-platform strategy. It began marketing its e-books for tablets, smartphones, and PCs using Android, Windows, and OS X operating systems. Moreover, Amazon, along with Apple, and another competitor, Kobo, are global competitors; B&N is not.

Despite spending hundreds of millions of dollars to compete with Amazon.com Inc. and Apple Inc. in the market for tablets and e-readers, B&N continued to lose money on the Nook, as well as e-book market share. Analysts estimated in 2011 that B&N controlled approximately 27% of the U.S. digital book market while Amazon led with 60%. Since then, Amazon has held steady, and B&N has steadily ceded ground to Apple. B&N's digital book market share has dropped to 25%, and is still falling.

On June 25, 2013 B&N announced that losses at its Nook digital business more than doubled in the quarter ending April 27, 2013, wiping out profits generated at its bookstores. As a result, the company decided to stop producing its own color tablets in favor of co-branded devices made by third-party manufacturers. Barnes & Noble will continue to design and make its own black-and-white Nook e-readers, which account for the majority of its e-book sales. But with e-reader sales declining, it is unclear how competitive Barnes & Noble can be long term without its own presence in the tablet market, which is forecast to keep growing.

B&N retail store closings continued to outpace new store openings as had been the case since 2009. CEO Michael Klipper projected a net reduction of one-third of B&N's stores over the next decade, reducing the total by about 20 stores per year until between 450 and 500 remain.

While B&N has its back against the wall, it does have a multipronged strategy for survival. It faces a principal opponent with an estimated value 121 times higher than its own (B&N has a market capitalization of \$1.062 billion; Amazon's is \$121.5 billion.). But it also has allies. Publishing companies have a vested interest in B&N's survival. Physical book retailers are indispensable for effectively marketing and selling books. Bookstores spur publisher sales with the "browsing effect." Surveys show that just one-third of bookstore visitors who make a purchase walked in with a specific book in mind. According to Madeline McIntosh, Random House president of sales, operations, and digital, a bookstore's display space is one of the most valuable places that exists for communicating to the consumer that a book is a big deal. Brick-and-mortar retail stores are not only essential for selling physical books, but also stimulate sales of e-books

and audio books, bring traffic into malls, and serve as social gathering places. The more visibility a book has, the more likely readers will want to purchase it. With the demise of B. Dalton, Crown Books, and Borders, B&N is the only retailer offering an extensive inventory of physical books. Book publishers need a physical presence.

Without B&N, the likely candidate to fill the void is Amazon, and publishers are not eager for that to happen. Amazon's goal for e-books is to cut out the publishers and publish books directly, selling books at an extremely steep discount to drive sales of its Kindle devices. Editors, publicists, and other entities within the publishing business view Amazon as an enemy. Selling books at Amazon's discounted prices is not a tenable business model for publishers in the long-term.

If B&N is to survive it must capitalize on its profitable retail stores, develop small, local community-based shops, expand digital content, lead the digital education market, and develop marketing techniques to drive e-book readers to purchase print books. B&N has been experimenting with ways to drive traffic to its physical stores. For example, if you connect to a Wi-Fi network in a B&N store with your Nook, you can get free extras in many apps and games like Angry Birds, where you can unlock a bonus character that normally costs a dollar. B&N has also expanded its store space for toys and games, which have higher profit margins, while reducing the range of book titles it stocks. There are also plans to experiment with slightly smaller stores in malls. Although that strategy is boosting the company's bottom line, publishers worry it may also drive book lovers to Amazon.com Inc., which says its physical book sales are still growing.

What will the future hold? Will B&N be able to succeed as a digital company and is there a future for its brick-and-mortar stores? Is there a way for e-books to help sell print books, just as print books have stimulated demand for their digital versions? Although B&N has made a spirited effort to revamp its business and go toe-to-toe with several tech titans, it's possible that it might be too tall an order for the storied bookseller.

Sources: Jeffrey A. Trachtenberg, "How to Rescue Barnes & Noble? Here are Ideas from Five Experts," *Wall Street Journal*, July 1, 2013; Leslie Kaufman, "Barnes & Noble Rethinks Its Strategy for the Nook," *New York Times*, February 28, 2013; Tom Gara, "Barnes & Noble: Stores Are Bad, But E-Books Are Worse," *Wall Street Journal*, February 28, 2013; Jeffrey A. Trachtenberg, "B&N Aims To Whittle Its Stores For Years," *Wall Street Journal*, January 28, 2013; Horace Dediu, "Apple eBooks at 24% Worldwide Ebook Market Share? One Analyst Thinks So," *Digital Book World*, February 28, 2013; Michael J. De La Merced and Julie Bosman, "Microsoft Deal Adds to Battle over E-Books," *The New York Times*, May 1, 2012; Shira Ovide and Jeffrey A. Trachtenberg, "Microsoft Hooks Onto Nook," *The Wall Street Journal*, May 1, 2012; Julie Bosman, "The Bookstore's Last Stand," *The New York Times*, January 29, 2012; Paul Vigna, "E-Books, Apple, Amazon: The Deadly Hallows for Publishers," *The New York Times*, April 11, 2012; Brian X. Chen, "Barnes & Noble Uses Apps to Lure Customers Into Stores," *The New York Times*, January 27, 2012; Alter, Alexandra, "Blowing Up the Book," *The Wall Street Journal*, January 20, 2012; Jim Milliot, "Tracking 20 Years of Bookstore Chains," *Publisher's Weekly*, August 26, 2011; and Jeffrey A. Trachtenberg and Martin Peers, "Barnes and Noble: The Next Chapter," *The Wall Street Journal*, January 6, 2011.

Case Study Questions

- 3-14** Use the value chain and competitive forces models to evaluate the impact of the Internet on book publishers and book retail stores such as Barnes & Noble.
- 3-15** How did Barnes and Noble change its business model to deal with the Internet and e-book technology?
- 3-16** Will Barnes & Noble's new strategy be successful? Explain your answer.
- 3-17** Is there anything else Barnes & Noble and the book publishers should be doing to stimulate more business?