2000

Battling Over Books (and More): The Internet Based Competition Between Berelsmann Online and Amazon.com

Tawfik Jelassi
Euro-Arab Management School, jelassi@eams.fundea.es

Albrecht Enders
Leipzig Graduate School of Management, enders@hhl.de

search

Battling Over Books (And More): The Internet-based Competition Between Bertelsmann Online and Amazon.com

Tawfik Jelassi
Euro-Arab Management School
(EAMS)
Calle Carcel Baja, 3
18001 Granada
Spain
e-mail: jelassi@eams.fundea.es

and

Albrecht Enders
Leipzig Graduate School of Management
(HHL)
Jahnallee 59
D-04109 Leipzig
Germany
e-mail: enders@hhl.de

***Abstract*- This case study contrasts the business strategies of two Internet-based retailers: Amazon.com, a young Internet start-up, and Bertelsmann Online (BOL), a subsidiary of a traditional mass-media firm. It presents the global marketing approach followed by each firm for Internet-based book sales, with a particular emphasis on their operations in Germany. It analyzes how Amazon.com and BOL go about building customer relationships and loyalty and, more broadly, the strengths and weaknesses of their competitive strategy. The case concludes by highlighting the future outlook of each firm and some critical success factors in launching an Internet-based venture. Lessons learned from this comparative study are also presented.**

I. The Book Industry in Germany

A. Industry Overview

In 1998, the book industry in Germany had sales of DM11.2 billion. (On 6 January 2000, the exchange rate between the Deutsche Mark and the US Dollar was: US$1=DM1.892). Around 5,500 bookstores operate in the highly fragmented German market. The eighty largest bookstores (as measured by sales) only had 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) [1]. Hugendubel operates twenty branches throughout Germany with a total selling surface of 24,000 square meters and 740 employees. Industry-wide, annual sales per employee averaged DM288,500 and annual sales per square meter of selling surface were DM9,120. In Germany, 3,200 publishing houses published 78,000 new publications in 1997. One local bookstore serves about 17,000 customers (compared to 270,000 customers in the US), and the average purchase amounts to approximately DM27.

B. Price Fixing in the German Book Industry

A unique feature of the German book retailing industry is the way book prices are fixed, requiring book retailers to sell their books at pre-determined prices set by publishers. The book price 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 small bookstores. The supporters of book price fixing argue that it is necessary for a variety of reasons: First, it protects the smaller bookstores that cannot generate the same economies of scale as the large bookstore chains, such as Hugendubel or Phonix. If book price fixing were to be abandoned, they argue, it would be impossible for the small bookstores 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 bestsellers. Publishers argue that they would not be able to provide such a wide variety of different books if they could not cross-subsidize, and this is only possible because of the high prices they can charge for their best-selling books. Currently, the economics in the book retailing industry in Germany are as follows: Out of DM 100 paid by the customer for a book, the retailer paid about DM60-75 to the wholesaler, who in turn paid about DM50 to the publisher. Critics of price fixing argue that it undermines competition, which ultimately hurts the customers, who pay more for their books than necessary. It is expected that price fixing will eventually be abandoned as the European Union continues to loosen up regulations within member states.

C. 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 5,500 book retailers in Germany, only 1,200 are present on the Internet [2]. In addition to Amazon.de, Bertelsmann Online (Bol.de), and other virtual bookstores that ship their books through the postal service, there are other online bookstores, which rely on traditional retail outlets for distribution. For instance, customers of Buchhandel.de choose their books from a selection of 800,000 titles displayed on its web site, and are then directed to a nearby physical bookstore to pick up their purchase.

Other bookstores are more skeptical about the possibilities of the Internet. Torsten Brunn, Director of

search

purchasing at Hugendubel, 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 fulfill 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."* [3]

At present, 42% of all German households own a PC. Twenty two percent 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. Approximately 400,000 German Internet users purchased books online in 1998. The average purchasing amount for Internet book buying is approximately DM60-70 [4].

II. The Media Company Bertelsmann AG

A. Company Overview

Bertelsmann was set up a hundred and sixty four 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: book/magazine and newspaper publishing, music, radio, television, and 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 (near Hannover), are mainly responsible 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 portfolio of products and services, its human resources, operating targets, etc.) and is responsible for its own business results. Due to its decentralized organizational structure, one of Bertelsmann's challenges is to link effectively the different divisions of the company. Compared to 1997, 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 US for 30.5%. The remaining turnover was generated in other countries. After tax, income for 1998 increased by 9.8% to DM1.122 billion.

B. Bertelsmann's Buch AG

In the 1997-1998 business year (ending June 30, 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 to DM7.1 billion for the previous year. Sales revenues breakdown was 34% in German-speaking countries, 28% in the US, and 36% in other European countries. During the same period, the number of employees at Buch AG rose from 17,800 to 18,400. Recent acquisitions by Buch AG include Random House, which consists of the autonomous publishing divisions of Bantam, Doubleday, Dell, and Random House itself with its 27 publishing companies. In 1997, Bantam Books alone had 32 best sellers in the New York Times' books rating. Random House now operates publishing houses in the US, Canada, the UK, Australia and South Africa, and currently offers 25,000 titles. Its acquisition 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 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. The China Book Club *"Shanghai Culture Company"* alone has a membership of more than 600,000 subscribers. Overall, the Bertelsmann book clubs have a total of 26 million members. Through its book clubs and magazines as well as America Online and CompuServe, Bertelsmann has direct contact with more than 44 million consumers.

III. Bertelsmann Online Venture

A. Company History

On February 25, 1998, Bertelsmann announced that it had launched a project to develop an online bookstore in 1999. 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 book and music club members in North America and Europe.
- Access to a global inventory of 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.

BOL was launched on February 4, 1999, simultaneously in Germany (through www.bol.de) and in France (through www.bol.fr). Thomas Middelhoff, Chief Executive Officer of Bertelsmann, elaborated on the online strategy of his company: *"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!"*[5]

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. Currently, it is looking for partners in Japan and Asia.

B. The BOL.de Web Site

In Germany, BOL currently offers a selection of 500,000 book titles through its virtual store. Its web site provides customers with information about best selling books as well as abstracts, contents, reviews and editorial recommendations about all listed books. The BOL web site also allows customers to create their personal profile ("My BOL"), which includes literary preferences (such as Fiction, Travel, Education, Business, Computers and Internet), payment mode and delivery address. To sign on to the personal profile, customers need to enter their e-mail address and a previously specified password. Once this information is given, they are informed about publications in their preferred literary areas/subjects or by their favorite author(s) when they access the BOL web site. 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 e-mail as some competitors do. Furthermore, through our 'Mini-site' 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."* [6]

BOL gives customers the opportunity to submit book reviews, which are posted on BOL web site. Customers can also subscribe to a BOL newsletter, which provides customized news about preferred book categories and authors. Furthermore, the purchasing process becomes easier, since the necessary payment and delivery information does not need to be entered every time a book is purchased. BOL offers its customers three options: billing, payment by direct debit, or by credit card. While the first two options are most favored by German and Swiss customers, British clients prefer to pay by credit card. It is also possible to track the progress of orders from the time they are placed to the moment of delivery. Once a customer has selected a book, he/she can place it into his personal shopping basket by clicking on the mouse button. At the checkout, he is asked for his name, address and credit card details (unless he has set up a personal profile that contains this data). If preferred, it is also possible to give the credit card number to a BOL representative over the phone or to send a bank check. At BOL, orders, personal information and credit card information are encrypted by means of Secure Socket Layers (SSL), a security standard which is supported by Internet browsers. In case of misuse of credit card information, BOL covers a deductible of up to DM100, provided that the customer did not cause the misuse.

Regarding BOL's 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]."* In addition, BOL plans to use its web site to build a virtual community of book readers, thereby facilitating communication among its customers (through, e.g., chat rooms).

C. The IT System of BOL

Bertelsmann formed a partnership with Oracle 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, which can be easily adapted to new market needs, new products, new currencies and new languages. Heinz Wermelinger, Chief Executive Officer of BOL, explains: *"Our e-commerce platform is international. The individual stores, however, are adapted to the needs of the specific countries in which we operate."*[7] The high quality of this platform enables BOL to set up a new store within six to eight weeks.

D. Order Fulfillment and Delivery

Order fulfillment 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, Bertelsmann's British book club, and in the Netherlands, by a public distributor owned by book publishers. Delivery within Germany is free of charge and the average shipping time is two to three business days. 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. 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 at the time of delivery, the package is left at the post office nearest to his home.

E. Strategic Alliances

On October 7, 1998, Bertelsmann signed an agreement with Barnes & Noble, the largest physical book retailer in the US, 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 each contributed $100 million to the capital of the joint venture as well. The two companies have made an arrangement for barnesandnoble.com to focus on the US and Canada while BOL focuses on the rest of the world. Launched in May 1997, barnesandnoble.com has become one of the 25 fastest growing web sites and has over 700,000 customers. It offers a selection of 650,000 in-stock titles through the Barnes & Noble distribution center 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. It is the exclusive bookseller to America Online's 13 million subscribers and has strategic partnerships with the top twenty web sites, including CNN and Lycos.

search

IV. AMAZON.COM: THE US INTERNET RETAILER

A. Company History

In 1994, Jeff Bezos, a computer science and electrical engineering graduate from Princeton University, was Senior Vice-President of D.E. Shaw, a Wall Street-based investment bank. During the summer of that year, an Internet statistic caught his attention: Internet usage was growing at 2,300% a year! His reaction was that anything growing that quickly would soon be ubiquitous. *"It was my wake-up call"*, recalls Mr Bezos [8].

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, Mr. Bezos moved to Seattle. *"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."*[9]

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 2,000 digital videodisks (DVD). All together, the Amazon.com store offers more than 4.7 million books, music CDs, videos, DVDs, computer games, and other products.

During 1998, Amazon.com's staff increased from 614 employees to 2,100. In addition to its own staff, the company also employed independent contractors and other temporary employees in its editorial, fulfillment and finance departments. As of December 31, 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 November 17 through December 31, 1998), Amazon.com achieved the following sales figures:

- More than 1 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 in the UK (Amazon.uk). In March 1999, it 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 Samsung web site. 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 US, represented approximately 20% in 1998, compared to 25% in 1997 and 33% in 1996.

B. The Amazon.com Web Site

The Amazon.com web site offers the following features: browsing, searching, reviews and content, one-click ordering, recommendations and personalization, a gift recommendation center, a virtual community, and an electronic auction. Sellers have their auctions automatically cross-merchandized across Amazon.com's book, music CD and video product pages. For example, an actual chair from Rick's café in the movie Casablanca was auctioned at Amazon.com. This chair was simultaneously displayed on the web site pages where the Casablanca soundtrack, books, DVDs and videos were sold. A continuing increase in the level of personalization for customers who come to shop at Amazon.com is one of Jeff Bezos' central goals: "*I am hopeful that there will be a lot of innovation from Amazon.com in the future around the notion of personalization and customization of the store for each and every customer.[...] We know 2% of what we will know 10 years from now, and most of that learning is going to revolve around personalization - the notion of making the store ideal for a particular customer, not for the mythic average customer."*[10]

C. Marketing and Sales

Amazon.com offers discounted prices, resulting in relatively low gross product margins. For books, it offers discounts of 20% to 40% on more than 400,000 books, including 40% on selected feature books, 30% on hard covers, and 20% on paperbacks. Prices are discounted 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 web site, and build customer loyalty.

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 US, and magazines such as *Der Spiegel* or *Focus* in Germany. Web advertising is made through Internet search engines such as Excite and Yahoo!, as well as the web sites of Amazon.com's partners. The company is thus provided with information to assess the success of an advertisement based on the number of visits to Amazon.com's web site and the number of visitors who actually made a purchase.

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 e-mail addresses to enable customers to request information (e.g., on the status of their book shipment) and to encourage feedback and suggestions.

search

D. Warehousing and Order Fulfillment

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. In order to ensure timely delivery and quality service, Amazon.com is continually expanding its warehousing and order fulfillment operations [11]. *"The Internet is a wonderful of interacting with the consumer and bringing parties together that couldn't be brought together before. But you still have a lot of places where human beings intervene into these supply chains. While we are in the middle of this market that is only four to five years old, there is going to be growing pains. There will be times when supply and demand are out of whack. If we can plan our little piece of the economy perfectly, we think it will be more consistent",* explains Jeffrey Wilke, Chief Operating Officer at Amazon.com. *"It is our abilitiy to feel absolutely safe and secure that we can control and deliver the best possible experience for our customers"*[12]. From 1998 to 1999, the Amazon.com's fixed assets, which consists largely of physical infrastructure, increased from a mere $29 million to over $317 which represents more than a tenfold increase.

E. Relationship with Suppliers

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 its acquisition of Ingram in November 1998, 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 only accounted for 40% of purchases.

The Amazon.com advantage program allows small publishers to appear more often and more prominently throughout the Amazon.com catalog. 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 program allows small publishers to place a limited quantity of books in Amazon.com's distribution centers for immediate availability to customers. Those titles will then be upgraded in the Amazon.com web site 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, so that the book appears with Amazon.com's browsing features. The book cover is also scanned at no cost to the publisher.

F. Acquisitions and Online Partnerships

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 personal health-care products, extensive healthcare information, and a licensed pharmacy. In March 1999, Amazon.com obtained 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. In April 1999, Amazon.com acquired Exchange.com, the premier online marketplace for hard-to-find, antiquarian, and used books (at www.bibliofind.com) and hard-to-find recordings and music memorabilia (at www.musicfile.com). In April 1999, Amazon.com purchased 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.

Through Amazon.com's *Associates Program*, operators of other web sites can create links to the Amazon.com homepage, thus directing customers to Amazon's site. The web site operators, who participate in this program, receive referral fees of 8% of the book value for sales generated by their sites. The purpose was to include as many partners as possible into the site, in order to allow customers to find exactly what they wanted. By the end of 1998, there were 200,000 web site operators participating in Amazon.com's Associates Program; this figure increased to more than 260,000 by March 31, 1999.

In March 1999, Amazon.com and Dell agreed to offer linked web sites and provide customized content for Amazon.com and Dell customers. Both companies provide links to each other's web sites from the checkout section of their respective sites. In addition, Amazon.com is present on several high-traffic web sites, 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 web site, and other selected properties in the MSN network of sites.

G. Financial Results

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 growth in sales resulted from the addition of a complete toy store and an electronics store, as well as the introduction of zShops. The latter allows any individual or business to sell through Amazon.com.

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. 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."* Jeff Bezos further

search

elaborates on his company's growth: *"This is a scale business. And what happens is that the fixed costs of doing this business are extremely low. As a result, our major strategic objective has always been to GBF [Get big Fast]. We need that in order to operate successfully what is a scale business."*[13]

Amazon.com reported net sales for the third quarter of 1999 of $356 million, an increase of 132% over the net sales of $154 million for the third quarter of 1998. Its third quarter operating loss was $86 million, or $0.26 per share, compared to a net loss of $24 million, or $0.08 per share in the third quarter of 1998. On a GAAP (General Agreed on Accounting Principles) basis, reported first-quarter net loss was $197 million, or $0.59 per share, and included $111 million of merger, acquisition, and investment-related costs and stock-based compensation charges. Customer accounts increased by 2.4 million during the third quarter of 1999, to more than 13.1 million on September 30, an increase of more than 190% over the 4.5 million customer accounts on September 30, 1998. Repeat customer orders represented more than 72% of orders during the third quarter, up from 70% in the previous quarter.

H. Amazon in Germany: Amazon.de

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 bookstore. Both Amazon.de and Amazon.co.uk opened their virtual stores on October 15, 1998.

Amazon.de is headquartered in Regensburg (near Munich) where it has its distribution center as well; the editorial and marketing offices are located in Munich. It offers 335,000 titles from German publishers and provides access to 374,000 US titles. The store in England carries 1.2 million UK titles and has 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 center 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 US). The average delivery time for most German and English books is 2-3 days; customers can return the purchased book within 30 days and receive a full refund. Like Bol.de, Amazon.de also delivers its books through the German postal service. Amazon.de is the exclusive bookstore of German and US titles on the search engines of Yahoo.de and Excite.de. Its web site provides service features similar to those of the Amazon.com web site.

V. Future Outlook

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."* [14]. 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 Centers 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 Centers to satisfy these customers and to acquire new customers. […] As of today [April 26, 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."* [15]

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..

VI. Lessons Learned

Several lessons can be drawn from the Internet battle between Bertelsmann and Amazon.com. In the case of Bertelsmann, one main lesson is the integration of the company's traditional businesses with its online venture. For Amazon.com, the main issue is whether the company will be able to become profitable in the near- to medium-term.

A. Lessons from the Bertelsmann Example

Bertelsmann's move to embrace the Internet demonstrates the importance for a traditional brick-and-mortar business, even if it is a leading and profitable firm such as Bertelsmann, to leverage the market potential and new information economics that the Internet offers. However, several key factors could help (or hinder) the company in its attempt to expand its role as an electronic commerce product/service provider.

On the one hand, Bertelsmann could benefit from its current organizational structure for a variety of reasons. As a group of companies each specialized in a different core business (such as books, newspapers, magazines, multimedia, and radio/TV programs), Bertelsmann could potentially leverage the synergies between these companies to better serve its mass-media market. These synergies can foster co-operation, co-ordination and the sharing of information and know-how about markets, products, customers and competitors. The overall result at the Bertelsmann level can thus be more than the mere sum of the different parts of the group. In addition, the network of companies that make up Bertelsmann may be an attractive feature for external firms that want to join forces with

search

Bertelsmann (e.g., through partnerships and strategic alliances) and benefit from such a globally operating network (e.g., the US bookstore Barnes&Noble). Second, because Bertelsmann controls all parts of the value chain, it can also achieve vertical integration from content generation (by the contracted authors and artists) to the retailing and distribution to the final consumer. Doing so would obviously amount to being much more than the intermediary between the two parties upstream and downstream of the value chain (which the case for Amazon.com). Third, Bertelsmann's decentralized organizational structure and its presence in more than 50 countries enable the group to be physically closer to the local market for logistics management, order fulfillment, goods delivery, and after-sale customer support. A fourth potential benefit is Bertelsmann's management structure, which provide a high degree of autonomy to the companies of the group. This autonomy in turn helps to encourage entrepreneurial initiatives by putting the CEO of each company in the position of owner and entrepreneur.

On the other hand, Bertelsmann physical structure and management processes could also prove to be a hindrance as the company tries to solidify its position in electronic commerce. First, the numerous companies that make up the Bertelsmann group and their departmentalized structure along product categories could prove to be more suitable for the traditional way of doing business than for electronic commerce. It may not be the best way to foster market segmentation, product customization and cross-selling between the various companies of the group. If it is not managed properly, the very same autonomy of managers mentioned above may not help achieve the targeted synergies for the overall group since every CEO may try to achieve the best possible results for his/her "company" within the larger Bertelsmann group. In order to realize the possible synergies between the traditional physical strategy and the Internet strategy, a large degree of cooperation between the different units (e.g., between warehousing, publishing and different distribution channels) is essential. Second, Bertelsmann's management processes which were defined for traditional business might not be suitable for the e-commerce business, where management decisions must be made within days or even hours, and strategy sessions are required on a weekly or perhaps daily basis, rather than once every semester or quarter. In order to operate successfully in electronic commerce, Bertelsmann will need to adapt its processes and decision making to match the flexibility and speed of other Internet-based competitors. In this context, it is questionable if Bertelsmann will be able to achieve the required change at the organizational and people levels considering the company 164-year history and its strong corporate culture. Thomas Middlehoff addresses the issue of speed and flexibility when he comments on the delayed launch of BOL: *"[For two years] we had tremendous discussions about retailing on the Internet. In the meantime Amazon.com took the market. On the Internet, three months is a year. They have two years' start on us. That means eight or ten years..."*[16]

B. *Lessons from the Amazon.com Example*

The Amazon.com example illustrates the following lessons. First, it demonstrates the rapid business growth and the new opportunities made possible through the usage of the Internet. In the relatively short period of five years, Amazon.com has reached annual revenues of $1.6 billion dollars in 1999 and built a customer base of over 16.9 million as of December 1999. The drivers of this rapid growth were four main value propositions (as mentioned in this paper): convenience, selection, service and price. In spite of this phenomenal growth, Amazon.com has yet to become profitable. A crucial question that arises here is what drives profits and losses of Internet-based retailers.

For now, it is quite reasonable to assume that financial profit is a long-term goal for most Internet-based retailers (especially for those who deal with physical products), since they first need to build scale and scope through geographic and product expansion. Amazon.com has been making losses since its launch in 1995, and there are no signs that it will become profitable in the near future. Instead, the absolute losses have continued to increase over the last three years, reaching $323 million in 1999, up from $124 million in 1998. In order to analyze whether these losses will continue in the future, we need to look at what drives the losses of Amazon.com and then to determine whether these loss-making components will continue to increase as quickly in the future as they have in the past. This, in combination with an analysis of sales development, will provide the basis for deciding whether Amazon.com can justify continuing their current strategy "in the long term."

The strategy of Amazon.com is specifically future-oriented. *"It's all about the long term," says Jeff Bezos. "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."*[17] Bezos' view is supported by the growth of three important drivers at Amazon.com: the sales growth (which is an overall indicator of the appropriateness of the business model), the growth of the customer base, and the increase of repeat purchases (which is an indicator of customer loyalty). Amazon.com sales increased from US$511,000 in 1995 to almost $1.6 billion in 1999, while he customer base grew from 180,000 in 1995 to 16.9 million in 1999. The repeat purchase ratio reached 73% in the last quarter of 1999.

It is questionable, however, whether such a phenomenal growth will eventually suffice to bring about financial profitability, since expenditures have been rising almost as quickly as sales revenues. Marketing and sales expenditures have increased by 230%, from $40 million in 1997 to $133 million in 1998. Marketing expenses per customer were still $21 in 1998, while gross profits were a mere $22 [18]. Additionally, Amazon.com also invested heavily into physical infrastructure for warehousing and shipment facilities. Amazon.com argues that the losses are mainly due to the increasing investments in marketing, technology, people, product development, and mergers and

search

acquisitions. This can be seen as an investment in the future, since it is vital to gain market share and to win customer loyalty while the market is growing, and then to reap the benefits when the market matures and it becomes more difficult to attract new customers.

A crucial question for Amazon.com and for any Internet retailer is whether it will be possible in the future, once the market consolidates, to reduce expenditures in order to increase profitability, or whether this will cause an immediate decrease of sales volume. One of the key arguments in support of Internet-based business is that it improves the company's cost position. It certainly does so when we look at infrastructure or personnel expenditures. However, if we take

into account promotion and marketing costs, the cost savings become less obvious.

Another critical issue here is that future sales are forecasted to materialize in a business environment that is highly uncertain due to rapid and unforeseeable changes. Optimistic forecasts for the future profitability of Amazon.com are based on expectations for future sales growth. This growth, however, will depend to a large extent on Amazon.com ability to continue to attract and retain customers. In this context, the impact of the Internet on customer retention can be both positive (since highly customized products help to increase loyalty) or negative (since the availability of sophisticated search and comparison capabilities and wider geographical reach tend to affect customer loyalty negatively) [19].

Besides affecting customer loyalty, the Internet as a business channel also impacts the margins that retailers can realize through their sales. Intense price competition among Internet vendors and the possibility for customers to compare prices quickly and easily puts immense pressure on profitability margins. As it is pointed out in this paper, Amazon.com offers most of its products at large discounts (up to 40%). If this trend continues in the industry, it will become increasingly difficult to achieve financial profitability.

REFERENCES

[1] *Buchreport* 15, 1999.
[2] GFK (Gesellschaft für Konsum und Absatzforschung), a marketing research company.
[3] Hugendubel Company Newsletter, 1999.
[4] *Buchreport* 15, 1999.
[5] Bertelsmann Press Information, 1999.
[6] Personal interview with Dr. Christof Ehrhart in June 1999.
[7] Bertelsmann Press Release, April 2, 1999.
[8] Suresh Kotha, "Competing on the Internet: The case of Amazon.com", *European Management Journal*, April 1998.
[9] Tim Clarke, "Newsmakers: Jeff Bezos - Turning to a Global Page", *CNET News.com*, 8 April 1998.
[10] Tim Clarke (idem).
[11] John Hagel, Marc Singer, "Unbundling the Corporation", *Harvard Business Review*, March-April 1999.
[12] Jeffrey Wilke, "Guiding Amazon's Foray into Bricks and Mortar", *Business Week e.biz*, 21 October 1999.
[13] Tim Clarke (idem).
[14] Electronic Commerce, *The Economist*, 10 May 1997.
[15] Extract from "A Media Company's Strategies for the Next Millennium", a keynote speech given at the 7th German Multimedia Congress, Stuttgart, 26 April 1999.
[16] "Bertelsmann Bismarck", *The Economist*, 7 November 1998.
[17] Amazon.com Annual Report, 1998.
[18] Amazon.com Annual Report, 1998.
[19] Philip B. Evans, Thomas S. Wurster, "Strategy and the New Economics of Information", *Harvard Business Review*, September-October 1997.