

Barnes & Noble, Inc.: Maintaining A Competitive Edge In An Ever-changing Industry

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More Clicks at the Bricks: How retail stores are scrambling to catch up with the shoppers empowered by the Web.

The Internet hasn't destroyed brick-and-mortar retailing, as many once feared. But has it ever changed consumer behavior.

Headline and text from *Business Week* Magazine (December 17, 2007)

Barnes and Noble 4Q down, but forecast up.

Both Barnes and Noble and Borders have lost market share from aggressive discounting from online retailer Amazon.com and discounters like Target Corp. and Wal-Mart stores Inc.

Headline and text from *Associated Press* on-line (March 20, 2008)

ABSTRACT

On Christmas Eve in 2007, Barnes & Noble's Chief Executive Officer, Steve Riggio, sat in his Manhattan apartment overlooking the busy streets of NYC and was hoping that the last minute shoppers were making their Christmas purchases at the B&N Union Square flagship store. However, he could not help but worry about the increasing competition in the retail industry, specifically, the book industry. Riggio wondered if shoppers would even be in the stores or would they have already done their shopping on-line? If they had done their shopping on-line, would they have used Barnesandnoble.com or Amazon.com? In the midst of a struggling economy, would shoppers choose to shop at discount stores such as Costco or Target? These were just a few of the questions that Riggio was asking himself at the end of a very tough year. Riggio considered where Barnes & Noble would be in 5, 10, or even 20 years. Unfortunately, with the increasing competition, technological advances, and changes in book industry trends, Riggio knew that the answers were not only complex; they were yet to be determined.

Keywords: Competitive Strategy, Value Management, Performance Management

BACKGROUND

Barnes & Noble, Inc. (B&N) trades on the New York Stock Exchange under the symbol "BKS" and is considered the world's largest bookseller.¹ B&N currently owns B. Dalton bookstores, located mainly in large indoor shopping malls, as well as Sterling Publishing. In addition, B&N owns 74% interest in Calendar Club, L.L.C.² B&N also sells a large amount of books and music over the internet at www.bn.com.

¹ Barnes & Noble Press Release attached to their 2007 SEC Form 8-K, March 3, 2008

² Barnes & Noble's SEC 10-K 2007 Annual Report, April 2008

Currently, B&N has 798 stores in operation, 85 of which operate under the B. Dalton name.³ B&N plans to open 35 to 40 new stores in fiscal year 2008.⁴ In contrast, B&N plans to gradually close underperforming B. Dalton stores. Specifically, 882 B. Dalton stores have closed since 1982, 13 of which were closed in fiscal year 2007.⁵

Barnes & Noble opened the “Original” Barnes & Noble store in New York City in 1917 and the first “Superstore” in 1992.⁶ B&N stores are very large in size ranging from 10,000 square feet to 60,000 square feet, with most being on average of 25,000 square feet.⁷ Many Barnes & Noble stores include an in-store café that offers sandwiches, desserts, and Starbucks coffee products. Barnes & Noble is very much focused on community and allows each store to establish their own community events calendar, which includes events such as story time, fund raisers, book readings, book signings, and more.⁸

Barnes & Noble’s sales consist mainly of adult trade, magazines, children’s books, mass market paperback, gifts, music, and movies. On March 3, 2008, B&N opened Barnes & Noble Studio (www.bn.com/studio), an on-line multimedia site intended to lure readers, publishers, and writers.⁹ Mike Skagerlind, Vice President of Digital Media for B&N, said, “Our programming celebrates the diversity and creativity that surround the world of books, authors and readers in a way that is useful, entertaining, and accessible. Barnes & Noble Studio will do for the book what the cooking show did for the recipe.”¹⁰ On March 24, 2008, B&N launched a new how-to website called “Quamut.com” (www.quamut.com).¹¹ Quamut.com is published by Barnes & Noble, Inc. and offers how-to information on more than 1,000 topics.¹² Dan Weiss, publisher and managing director for Quamut.com said in a press release on March 24th, “Quamut.com positions Barnes & Noble as a leader in digital how-to publishing.”¹³

BOOK INDUSTRY TRENDS

Barnes & Noble is not the only company affected by changes in the book industry. Significant changes in the book industry, including the increase in audiobooks, the internet, piracy of books, music, movies, and the newly invented “e-reader”, which allows consumers to read books electronically on a reading device about the size of a blackberry, are having companies within the book industry all along the supply chain taking a closer look.¹⁴ The Book Industry Study Group (www.bisg.org), which is considered an authoritative association within the industry, has been researching and providing the industry with a comprehensive collection of data on the trends in the book industry for over thirty years.¹⁵ In September of 2007, the BISG released its latest “Book Industry Trends 2007” book which includes data from 2005 through 2011. The BISG projects that total consumer expenditure will increase only by 2.9% by the year 2010, down from 2007, which was projected at a 3.9% increase from 2006 (see Exhibit 1). The BISG gathers data from numerous sources, including the U.S. Census, 10-Ks/Annual Reports, Wall Street reports, U.S. Department of Education, Retail Data, Publishers, and more.¹⁶ A time series forecasting tool is used by the BISG to project industry trends. The “Auto Regressive Integrated Moving Averages” model or the “ARIMA” uses historical data to look for patterns and project future trends.¹⁷

³ ibid

⁴ ibid

⁵ ibid

⁶ www.barnesandnoble.com/aboutus.html Accessed on April 17, 2008

⁷ Barnes & Noble’s SEC 10-K 2007 Annual Report, April 2008

⁸ ibid

⁹ http://www.barnesandnobleinc.com/press_releases/2008_march_4_bn_studio.html , Accessed on April 17, 2008

¹⁰ ibid

¹¹ <http://biz.yahoo.com/bw/080324/20080324005133.html?v=1> . Accessed on March 25, 2008

¹² ibid

¹³ ibid

¹⁴ Greco and Wharton webcast “The State of the Book Industry”, found at the Library of Congress website http://www.loc.gov/today/cyberlc/feature_wdesc.php?rec=4110 6/28/2007

¹⁵ <http://www.loc.gov/loc/lcib/0709/booktrends.html> . Accessed on April 17, 2008

¹⁶ http://www.bisg.org/conferences/BEA07_TRENDS2007.ppt . Accessed on April 27, 2008

¹⁷ ibid

Exhibit 1: Summary of Data from the BISG showing Growth Projections through 2010¹⁸

ALL BOOKS	ESTIMATES		PROJECTIONS			
	2005	2006	2007	2008	2009	2010
Publishers' Net Dollar Sales						
Millions USD\$	34,628.90	35,686.10	37,085.20	38,298.00	39,595.90	40,732.50
% change		3.2%	3.9%	3.3%	3.4%	2.9%
Publishers' Units						
Millions	3,085.80	3,102.70	3,148.10	3,180.00	3,205.70	3,223.20
% Change		0.5%	1.5%	1.0%	0.8%	0.5%
Domestic Consumer Expenditures						
Millions USD\$	51,919.80	53,615.50	55,695.80	57,455.10	59,332.80	61,053.70
% change		3.3%	3.9%	3.2%	3.3%	2.9%

Professors Albert Greco and Robert Wharton of Fordham University, lead researchers for the BISG, discussed their predictions for the book industry during a lecture at the Library of Congress in June of 2007. Professor Wharton stated, “Overall, the industry is growing but only at a rate slightly greater than inflation. Publishers are profitable and sales are increasing, but the bar is being raised higher and higher for profit margins”.¹⁹ The major categories in the book industry are Adult Trade, Juvenile Trade, Mass Market Paperback, Religious, Professional Publishing, College Textbooks, and Elhi (Elementary and High School) and College. Religious books appear to be the most successful sector and predicted to increase to \$3.07B by the year 2010, which is a 50% increase from 2006.²⁰ Wharton and Greco attribute this increase in Religious books to “the significant number of publishers active in this field, the rise of mega churches, increased church attendance and expanded offerings on this topic at large secular bookstore chains”.²¹ Greco and Wharton also predict the Juvenile sector to be strong based on the huge success of the final installment of the Harry Potter series. Another big title such as Harry Potter could drive sales in the Juvenile sector to \$6.8B by 2010.²² Another significant finding in the College Textbooks sector is that there is an increase in the demand for used books and electronic access to textbooks.²³

One disturbing trend is the increasing amount of piracy of books, music, and movies. In 2006, the United States Trade Representative (USTR) released their annual Special 301 Report that detailed the increase of piracy worldwide.²⁴ The Association of American Publishers (AAP) estimates that more than \$600 million is lost each year due to piracy.²⁵

Who is Reading Books?

According to the BISG’s latest report, the total amount of time spent using media has increased, but the hours spent actually reading books is decreasing.²⁶ The book industry has to compete with each person’s time, and books are not a priority. Exhibit 2 shows the total estimated time and money spent by consumers on media from the year 2000 to 2010, as reported by the U.S. Census Bureau and used as the basis for the BISG’s findings. Consumer books, magazines, and newspaper categories are all experiencing a decline, while electronic media, including television, is seeing an increase.

¹⁸ *ibid*

¹⁹ <http://www.loc.gov/loc/lcib/0709/booktrends.html> . Accessed on April 17, 2008

²⁰ http://www.loc.gov/today/cyberlc/feature_wdesc.php?rec=3891 . Accessed on April 17, 2008

²¹ <http://www.loc.gov/loc/lcib/0709/booktrends.html> . Accessed on April 17, 2008

²² http://www.loc.gov/today/cyberlc/feature_wdesc.php?rec=3891 . Accessed on April 17, 2008

²³ *ibid*

²⁴ http://www.publishers.org/main/PressCenter/Archives/2006_April/April_03.htm , Accessed on April 17, 2008

²⁵ *ibid*

²⁶ Greco and Wharton webcast “The State of the Book Industry”, found at the Library of Congress website http://www.loc.gov/today/cyberlc/feature_wdesc.php?rec=4110_6/28/2007

Exhibit 2: U.S. Census Data on Total Media Usage and Consumer Spending to 2010²⁷

Table 1098. Media Usage and Consumer Spending: 2000 to 2010

[Estimates for time spent were derived using rating data for broadcast television and cable and satellite television, survey research for radio, mobile, out-of-home media and yellow pages, and consumer purchase data (units, admissions, access) for books, home video, Internet, newspapers, consumer books, consumer magazines, recorded music, videogames, and box office. Adults 18 and older were the basis for estimates for newspapers, consumer books, consumer magazines, out-of-home media, yellow pages and home video. Persons 12 and older were the basis for the estimates for broadcast television, cable & satellite television, radio, recorded music, box office, videogames, Internet and mobile content]

Item	2000	2003	2004	2005	2006, proj.	2007, proj.	2008, proj.	2009, proj.	2010, proj.
HOURS PER PERSON PER YEAR ¹									
Total ²	3,340	3,508	3,530	3,543	3,553	3,567	3,592	3,601	3,620
Television	1,502	1,615	1,620	1,659	1,673	1,686	1,704	1,713	1,733
Broadcast television ³	812	729	711	679	684	672	666	657	650
Network stations	717	629	612	576	579	567	558	546	538
Independent stations ⁴	95	100	100	101	105	105	108	110	112
Cable & satellite television ³	690	886	909	980	989	1,014	1,038	1,057	1,083
Basic cable and satellite television	568	728	753	807	823	840	862	880	902
Premium cable and satellite television ⁴	122	157	156	173	166	174	176	176	181
Broadcast and satellite radio ³	784	834	821	805	794	786	785	778	776
Recorded music ³	259	189	195	189	191	191	188	187	180
Newspapers ³	201	194	191	184	181	177	173	169	165
Pure-play Internet services ³	100	155	165	172	177	180	181	182	183
Out-of-home media	118	123	126	130	134	137	141	145	150
Consumer magazines ³	135	122	125	124	122	121	122	120	119
Consumer books ³	107	109	108	108	107	107	107	108	108
Videogames ³	65	76	78	73	75	78	80	84	86
Home video ⁵	43	60	67	63	63	64	65	66	67
CONSUMER SPENDING PER PERSON PER YEAR (dol.)									
Total ²	610.35	739.65	772.58	787.44	817.06	850.61	880.87	909.37	933.52
Television	173.58	236.82	258.73	283.47	306.70	329.39	350.03	368.55	384.55
Cable and satellite television ³	173.58	236.79	258.63	283.08	305.70	327.55	347.26	364.79	379.92
Broadcast television (Z)		0.03	0.09	0.40	1.00	1.84	2.77	3.75	4.63
Home video ⁵	81.41	122.28	125.45	115.24	114.24	115.54	116.78	118.33	119.36
Consumer books ³	87.45	91.84	92.49	95.62	97.04	100.32	101.85	104.05	106.38
Pure-play Internet services ³	45.43	59.72	59.60	57.11	55.84	56.29	57.26	58.67	59.77
Recorded music ³	61.20	49.46	52.03	51.18	52.00	52.25	52.23	51.87	51.08
Newspapers ³	51.92	53.62	51.97	50.56	49.65	48.65	47.53	46.29	44.94
Consumer magazines ³	47.58	46.56	47.38	47.64	47.30	47.28	47.93	47.35	47.73
Box office ³	32.72	39.10	38.88	36.38	37.15	36.30	35.67	35.39	35.29
Videogames ³	28.01	32.98	33.59	32.23	33.59	35.55	37.38	39.98	41.52

Z Less than \$.005 ¹ Can include concurrent use of media, such as watching television and reading e-mail simultaneously. Does not include media use at work. ² Includes other media, not shown separately. ³ Online and mobile use and spending on traditional media platforms, such as downloaded music, newspaper Web sites, e-books, cable modems, online video of television programs and Internet radio were included in the traditional media segment, not in pure-play Internet services or pure-play mobile content. Pure-play Internet services and pure-play mobile content included telecommunications access, such as DSL, Internet-only Web sites such as Yahoo!, GameSpy, eHarmony, and mobile-only services, such as MobiTV or text messaging services from telecommunication providers. ⁴ Telemundo and Univision affiliates included in independent and public stations. ⁵ Pay-per-view, interactive channels, home shopping and audio-only feeds included in premium cable & satellite services. ⁶ Playback of prerecorded VHS cassettes and DVDs only.

Source: Veronis Suhler Stevenson, New York, NY. *Communications Industry Forecast & Report*, annual (copyright).

In 1992, 60.9% of adults were reading, which dropped to 56.6% in 2002.²⁸ In addition, it appears that females are reading more than males.²⁹ Exhibit 3 provides a breakdown of the number of male and female adults reading from 1992 to 2002. Although this data is for the years 1992 to 2002, this trend is likely to continue into the future.³⁰ Another interesting trend to note is that adults between the years of 45 and 54 read the most, on average, followed by those between 55 and 64 years old.³¹ Young adults between 18 and 24 read the least, but it is suggested that the increase in technological advances and the competition for time from the internet and television is to blame.³² Finally, the U.S. Census reports that those adults making an annual income of more than \$75K per year read more than those making less; in other words, the more you make, the more likely you are to read.³³

²⁷ <http://www.census.gov/compendia/statab/tables/08s1098.pdf>. Accessed on April 17, 2008

²⁸ Greco and Wharton webcast “The State of the Book Industry”, found at the Library of Congress website http://www.loc.gov/today/cyberlc/feature_wdesc.php?rec=4110 6/28/2007

²⁹ ibid

³⁰ ibid

³¹ <http://www.census.gov/compendia/statab/tables/08s1100.pdf>. Accessed on April 17, 2008

³² Greco and Wharton webcast “The State of the Book Industry”, found at the Library of Congress website http://www.loc.gov/today/cyberlc/feature_wdesc.php?rec=4110 6/28/2007

³³ http://www.census.gov/compendia/statab/cats/information_communications.html, Accessed on April 17, 2008

Exhibit 3: Reading Patterns of Males vs. Females³⁴

	1992	2002
Males	47.4%	37.6%
Females	60.3%	55.1%

The Internet Phenomenon

According to the U.S. Census Bureau the adjusted Q42007 estimates for e-commerce retail sales were reported at \$36.2 billion (note: total retail sales for Q407 were \$1,037.7B).³⁵ The total e-commerce estimated sales for 2007 were \$136.4 billion, which represents an increase of 19% from 2006.³⁶ The National Retail Federation reports that on-line retail sales have gradually increased year after year. Additionally, in January 2008, a Nielsen Global On-line Survey found that 41% of items purchased on-line were books, the most popular product purchased over the Internet (second-most popular in US behind shoes, clothes, and accessories).³⁷

Print on Demand

Print on Demand or POD is a new technology emerging in the Publishing industry where books can literally be printed on demand based on demand. However, this technology is fairly new and therefore more costly than traditional printing. For example, the cost to print a typical Hardback bestseller is approximately \$3.50 per copy using traditional printing versus \$5 - \$8 per copy for Print on Demand.³⁸ Nonetheless, the BISG predicts that POD will be “the Library of the future”.³⁹ This technology is beneficial to publishers because they can decrease the amount of returns from the wholesalers and it is beneficial to the retailers because it allows a more efficient use of shelf space. But POD is particularly beneficial to on-line retailers like Amazon.com where they do not have shelf space to worry about. In fact, Amazon.com has included a POD subsidiary, BookSurge, in their corporate portfolio to cut down on costs of printing.

A STRUGGLING ECONOMY

In early 2007, Wall Street and the media began rumblings that the U.S. Economy was in trouble and questioned whether or not a recession was inevitable.⁴⁰ The U.S. had not experienced a recession since the aftermath of September 11, 2001 terrorist attacks and the failing dot.com industry.⁴¹ Experts attributed the troubled economy mostly to the deteriorating housing market and the increase and subsequent defaulting subprime mortgages.⁴² In an effort to fix the failing economy, President Bush announced on Friday January 18, 2008 his proposal for a \$145M economic stimulus package designed to get consumers to spend more money.⁴³ By Monday January 21, 2008, Wall Street and foreign markets all over the world experienced the worst decline in five years, roughly 850 points in the Dow.⁴⁴ This hit in the market had a ripple effect on the economy including billions of dollars of losses by the major U.S. banks, including Citigroup and Merrill Lynch.⁴⁵ Statistics show that consumers

³⁴ Table created by Wendy Hall with information obtained from Greco and Wharton webcast “The State of the Book Industry”, found at the Library of Congress website http://www.loc.gov/today/cyberlc/feature_wdesc.php?rec=4110 6/28/2007

³⁵ <http://www.census.gov/mrts/www/data/pdf/07Q4.pdf>, Accessed on April 27, 2008

³⁶ *ibid*

³⁷ <http://www.bookbusinessmag.com/story/story.bsp?sid=91856&var=story>, Accessed on April 17, 2008

³⁸ Greco and Wharton webcast “The State of the Book Industry”, found at the Library of Congress website http://www.loc.gov/today/cyberlc/feature_wdesc.php?rec=4110 6/28/2007

³⁹ Greco and Wharton webcast “The State of the Book Industry”, found at the Library of Congress website http://www.loc.gov/today/cyberlc/feature_wdesc.php?rec=4110 6/28/2007

⁴⁰ http://www.usatoday.com/money/economy/2006-12-26-econ-cover-usat_x.htm. Accessed on April 27, 2008

⁴¹ http://topics.nytimes.com/top/reference/timestopics/subjects/u/united_states_economy/index.html?scp=1-spot&sq=united+states+economy&st=nyt, Accessed on April 27, 2008

⁴² *ibid*

⁴³ <http://www.washingtonpost.com/wp-dyn/content/article/2008/01/18/AR2008011800429>. Accessed on April 27, 2008

⁴⁴ http://www.nydailynews.com/money/2008/01/22/2008-01-22_its_a_black_monday_as_stock_markets_tank.html, Accessed on April 27, 2008

⁴⁵ <http://www.pbs.org/newshour/extra/>. Accessed on April 27, 2008

are spending less due to other factors such as increasing gas prices, increasing GDP (Gross Domestic Product), increased unemployment, and a general fear of the unknown⁴⁶. The National Retail Federation predicts retail sales to increase only 3.5% in 2008, which is considered “the weakest pace of growth in six years.”⁴⁷ As of April 2008, many organizations began to publish their Annual Reports and First Quarter Results, which in many cases stated slow growth for the future and less than desirable results for the periods being reported.⁴⁸ Barnes & Noble, Inc. was among one of these companies warning the investment community in a March 3, 2008 Press Release that “recessionary pressures in this uncertain economic environment will make 2008 an especially challenging retail year”.⁴⁹

COMPETITION

The book industry is extremely competitive. Barnes & Noble’s sources of competition include other traditional bookstores (Borders, Books-A-Million), other on-line retailers (Amazon.com, Borders, Books-A-Million), independent booksellers, new technology (downloadable mp3 audiobooks and new e-readers, etc.), and other supply chains (Target, Wal-Mart, Costco, etc.). The American Booksellers Association reports that while 200 to 300 independent booksellers are closing each year, 115 new and independent bookstores opened in 2007, showing consistent growth since 2005.^{50 51} In addition, alternate suppliers of books are on the rise.⁵² Specifically, Target, Wal-Mart, Costco, Sam’s Club, drugstores, and grocery stores are stocking bestsellers at deep discounts.⁵³

Barnes & Noble’s annual 2007 store sales were reported at \$4,648 million, while Borders’ annual 2007 store sales were reported at \$3,774 million. Books-A-Million’s total Net Revenue for FY07 was \$535,128, (including \$26.9M for on-line sales), which represents an increase from FY06 net revenues of \$520M.

On-line sales for Barnes & Noble were reported at \$476 million in 2007, while Amazon.com’s 2007 revenues were reported at \$14,835 million. Barnes & Noble considers Amazon.com to be their biggest competitor.⁵⁴ Borders Group has an agreement with Amazon.com to operate their websites.⁵⁵ Under this agreement, Amazon.com is responsible for setting prices, terms and conditions, and order processing, as well as recording the sale on their books. Therefore, Borders has not recorded internet sales in their most recent 2007 annual report. This agreement is up for renewal on a monthly basis and the company’s strategic plan is to finalize their own proprietary website (<http://beta.bordersstores.com>), at which time the agreement with Amazon.com would be cancelled.⁵⁶ Exhibit 4 summarizes in-store and on-line sales for Barnes & Noble (B&N), Borders, Books-a-Million (BAM), and Amazon.com.

Exhibit 4: Summary of Revenues for Barnes & Noble and their Major Competitors⁵⁷

	B&N	Amazon.com	Borders	BAM
In-Store Sales*	\$4,648M	n/a	\$3,211M**	\$528.6M
On-line Sales	\$476M	\$14,835M	***	\$26.9M

*In-stores sales excludes B&N’s subsidiary B. Dalton Books and Borders’ subsidiary Waldenbooks

**Borders Group Sales include domestic and international sales

***Borders Group uses Amazon.com for internet sales and therefore did not report internet revenues in their 2007 Annual Report.

⁴⁶ <http://cnmmoney.printthis.clickability.com/pt/cpt?action=cpt&title=Retail+sales+cool+in+...> Accessed on April 27, 2008

⁴⁷ *ibid*

⁴⁸ <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=afyTNDrETJcU>, Accessed on April 27, 2008

⁴⁹ Barnes & Noble Press Release attached to their 2007 SEC Form 8-K, March 3, 2008

⁵⁰ <http://www.wired.com/print/techbiz/media/new/2006/10/71924>, Accessed on May 1, 2008

⁵¹ <http://www.bookbusinessmag.com/story/story.bsp?sid=91856&var=story>, Accessed on April 17, 2008

⁵² Greco and Wharton webcast “The State of the Book Industry”, found at the Library of Congress website http://www.loc.gov/today/cyberlc/feature_wdesc.php?rec=4110 6/28/2007

⁵³ *ibid*

⁵⁴ Barnes & Noble’s SEC 10-K 2007 Annual Report, April 2008

⁵⁵ Borders Group, Inc.’s SEC 10-K 2007 Annual Report, April 2008

⁵⁶ *ibid*

⁵⁷ Chart created by Wendy Hall with information obtained from 2007 Annual Reports/10-Ks for B&N, Borders Group, Books-A-Million, and Amazon.com, April 2008

Borders Group, Inc.

Borders is considered the second leading bookseller behind Barnes & Noble.⁵⁸ Unlike Barnes & Noble, Borders does business internationally with superstores in Singapore, New Zealand, Australia, and Puerto Rico. Similar to B&N, Borders owns the Waldenbooks subsidiary, located mainly in large indoor shopping malls, but also includes locations in airports and outlet malls. Borders also owns 97% of Paperchase, a leading stationary store retailing in the United Kingdom. Borders operates a total of 1,143 stores including 509 domestic superstores, 32 international superstores, 490 Waldenbooks stores, and 112 Paperchase stores. Borders superstores are similar in design to Barnes & Noble superstores in that they are very large in size, averaging 24,700 square feet, and also include an in-store café featuring Seattle's Best coffee, a subsidiary of Starbucks.⁵⁹ In an effort to upgrade its superstores, Borders opened its first "Concept" store in February 2008.⁶⁰ The concept store allows customers to do a wide variety of multimedia activities, including creating their own custom CD, making photo books, downloading music, books, and movies, and more.⁶¹ Borders believes that the Concept store is important for long-term success especially in the current competitive environment and plans to open 14 additional concept stores during fiscal year 2008.⁶²

When Borders' President and Chief Executive, George L. Jones took over in 2006, the company was in debt.⁶³ With increasing reports that consumer spending will decrease along with the fact that Borders was short on cash, a deal was made on April 9, 2008 with Pershing Square Capital to free up some much needed cash.⁶⁴ Borders carries a large inventory of music and movies and relies on sales of these products to meet their fiscal goals.⁶⁵ According to their 2007 Annual Report, Borders has suffered a loss for the past 3 years and predicts that trend to continue due to competition with other brick-and-mortar booksellers, internet retailers, and from companies that offer the downloading of media.⁶⁶ On March 20, 2008, the same day as Barnes & Noble's Earnings Call, Borders announced plans to start a "Strategic Alternative Review Process"⁶⁷ that would include the sale of the company. JP Morgan and Merrill Lynch have been hired to provide financial consultation during this review. Barnes & Noble Chief Financial Officer, Joseph Lombardi stated on their March 20, 2008 Earnings call that "they had not yet been approached by Borders, but that they would definitely take a good look and put it under review."⁶⁸ With e-commerce and technology hard upon the heels of traditional booksellers, Borders cannot afford to not compete in this market; however, attempts to do just that failed in 2001 and led to the agreement with Amazon.com to sell Borders' products for them.⁶⁹ Borders advised in their 2007 Annual Report that they were uncertain if they would make another attempt at retailing over the internet.⁷⁰

Books-A-Million

Books-A-Million (BAM) started as a corner newsstand in 1917 and currently operates 208 stores in the United States, mainly the Southeastern part of the U.S. Of these stores, 184 are superstores while the remaining stores are traditional stores.⁷¹ BAM also retails through their website at www.booksamillion.com.⁷² In the fiscal

⁵⁸ http://www.brandweek.com/bw/news/recent_display.jsp?vnu_content_id=1003728986, Accessed on March 25, 2008

⁵⁹ Borders Group, Inc.'s SEC 10-K 2007 Annual Report, April 2008

⁶⁰ *ibid*

⁶¹ *ibid*

⁶² *ibid*

⁶³ http://www.businessweek.com/print/investor/content/mar2008/pi20080320_725958.htm

⁶⁴ http://www.businessweek.com/print/investor/content/mar2008/pi20080320_725958.htm and Borders Group, Inc.'s SEC 10-K 2007 Annual Report, April 2008

⁶⁵ Borders Group, Inc.'s SEC 10-K 2007 Annual Report, April 2008

⁶⁶ *ibid*

⁶⁷ *ibid*

⁶⁸ Barnes & Noble FY07 Earnings Conference Call, held on March 20, 2008 at 10:00 a.m. EST. The call can be accessed free of charge as of April 28, 2008 from the company's corporate website: www.barnesandnobleinc.com

⁶⁹ Borders Group, Inc.'s SEC 10-K 2007 Annual Report, April 2008

⁷⁰ *ibid*

⁷¹ Books-A-Million's SEC 10-K 2008 Annual Report, April 2008

⁷² *ibid*

year 2008 (February 2007 to February 2008), BAM opened nine stores, closed seven, relocated three, and converted one traditional store to a superstore format.⁷³ BAM is focused on markets of high growth, particularly in the Southeast.⁷⁴ BAM reported great results in bargain books and gifts, which includes toys and games, and reported in their most recent 2008 Annual Report, “Our investment in new fixtures in the gift departments paid off and we continue to adjust our store model to exploit the growth areas of our business.”⁷⁵

Books-A-Million’s fiscal year ended February 2, 2008. Although Books-A-Million’s net income decreased by 12.5% from FY07 to FY08 they experienced an increase in revenues by 5.1%.⁷⁶ BAM attributes this decline in net income to the fact that FY07 included one more week than FY08 and in FY07, a one-time sales income of \$2.3M was recorded for gift card breakages from the previous year.⁷⁷ Books-A-Million’s corporate portfolio includes, Bookland, “traditional” sized bookstores; Joe Muggs Newsstand, selling coffee and eats alongside a wide variety of magazines, newspapers, and periodicals; American Wholesale Book Company, a wholesale and distribution services; and Book\$mart, Inc., which distributes bargain books throughout the country.⁷⁸ Booksamillion.com was established in 1998 and through acquisitions of American Internet Services and NetCentral, BAM considers themselves “a value leader in book e-tailing”.⁷⁹ Books-A-Million does not carry an extensive inventory in music and movies (although they do sell seasonal music). Many of the Books-A-Million stores include an exclusive section called “Testaments Shoppe” that provides reference material and new writings for the Christian market.⁸⁰

Amazon.com

Amazon.com was founded in 1994 by Jeffrey P. Bezos, current CEO, as an on-line bookstore, but expanded its product line and is now considered the world’s largest on-line retailer.⁸¹ Amazon offers millions of products in more than just the books category. Specifically, Amazon.com offers products either through their own subsidiaries or through third party arrangements with other merchandisers in the following categories:

- Books*
- Electronics & Computers
- Toys, Kids, & Baby
- Sports & Outdoors
- Movies, Music & Games*
- Home & Garden
- Apparel, Shoes, & Jewelry
- Tools, Auto, & Industrial
- Digital Downloads
- Grocery
- Health & Beauty

**Barnes & Noble competes with Amazon.com for these products*

Amazon does not separate the financial data, (revenues, profits, etc.), for their Books or Movies, Music & Games categories in their annual 10-K, so it is difficult to compare against their big competitors such as Barnes & Noble, Borders, or Books-A-Million. However, Amazon did reveal in their first quarter results that the sales of books and movies increased 28% or \$2.54 billion, while their top sellers were Electronics, Toys, Baby, Consumable

⁷³ ibid

⁷⁴ ibid

⁷⁵ ibid

⁷⁶ ibid

⁷⁷ ibid

⁷⁸ http://www.booksamillioninc.com/profile/profile_main.html , accessed on April 29, 2008

⁷⁹ ibid

⁸⁰ <http://www.booksamillioninc.com/profile/index.html> , Accessed on April 29, 2008

⁸¹ Amazon.com Inc.’s SEC 10-K 2007 Annual Report, filed February 2008

items, Apparel, Shoes, and Jewelry increasing 56% or \$1.48 billion making up 36% of total sales.⁸² While the consensus within the media and the retail industry is that consumers are spending less due to the weak economy, Morningstar analyst Joseph Beaulieu told Bloomberg radio in a recent interview, “If the customer is curbing their spending, they’re still continuing to spend heavily with Amazon.”⁸³

In addition to selling their own products, Amazon.com operates websites for other companies, such as Target, Sears Canada and UK, Timex, and many more.⁸⁴ Consumers can access Amazon.com to buy almost anything either through Amazon or by accessing the third party’s site through the Amazon.com site. Amazon offers free shipping for qualified orders over \$25. Amazon’s business model is to offer millions of products that are in-stock, at very competitive prices.⁸⁵

When consumers shop for books on-line, there are a few differences and similarities between the Barnes & Noble site and the Amazon site. For example, both sites allow consumers to shop by category, such as Books/Children’s Books/Baby to Preschool. Both sites then offer further options for drilling down to subcategories. Amazon.com created the idea to allow consumers a sneak peak into the book, called “Search Inside™”, which is done through an arrangement with the publisher with strict rules for protecting copyright information. Barnes & Noble now offers a similar service called “See Inside”, which is powered by Zinio, though it is not available for as many titles as available on Amazon.com. Another similarity between the B&N and Amazon sites are the suggestions and review features. Both companies offer customer reviews, suggestions for other types of books related to the ones being viewed, as well as data on what other customers have bought similar to the product being viewed. Exhibit 5 shows screen views of both Barnes & Noble and Amazon websites at the individual product selection level, comparing pricing and features available for the consumer by each company. On April 30, 2008, the price for Eric Carle’s *The Hungry Caterpillar* was \$17.59 (\$15.83 for members) on www.bn.com and \$14.95 on www.amazon.com (no membership required).

Amazon reported shipping revenues, which included membership sales from Amazon Prime and Fulfillment, of \$192M, an increase of 27% from last fiscal year. Fulfillment is a service provided by Amazon where they will pick, pack and ship orders for other merchandisers.⁸⁶ Sellers own their inventory at all times and shipping is available at a discounted rate or at the rates offered under the Amazon Prime membership program (details on memberships are provided later in this case).⁸⁷ Amazon invests a significant amount of money into technology.⁸⁸ Specifically, Amazon invested a net amount of \$715M in technology, including internal software systems and new product lines.⁸⁹

Competing with Technology

An increase in advanced technology has affected the way booksellers do business. Print media is in danger of being replaced by digital media and booksellers are looking for ways to compete. Professor Wharton with Fordham University and leading contributor to the BISG says, “The electronic distribution of content has become the 600-pound gorilla in the room.”⁹⁰ Exhibit 5 below shows the timeline of events affecting B&N and their main competitors.

Physical books and magazines have been replaced by audiobooks in CD and mp3 format as well as the newly invented e-books and e-magazines that can be downloaded and viewed on a personal electronic reading device. In 2006, annual sales of audio books were estimated at \$1 billion. On November 19, 2007, Amazon.com released “Amazon Kindle” a portable, personal electronic reading device for \$399, and it sold out in five and a half

⁸² <http://www.bloomberg.com/apps/news?pid=20601103&sid=a5zT.caCZcqM> , Accessed on April 28, 2008

⁸³ *ibid*

⁸⁴ <http://en.wikipedia.org/wiki/Amazon.com> , Accessed on April 29, 2008

⁸⁵ <http://biz.yahoo.com/bw/080423/20080423006176.html?.v=1&printer=1> , Accessed on April 28, 2008

⁸⁶ <http://www.amazonservices.com/fulfillment> , Accessed on April 30, 2008

⁸⁷ *ibid*

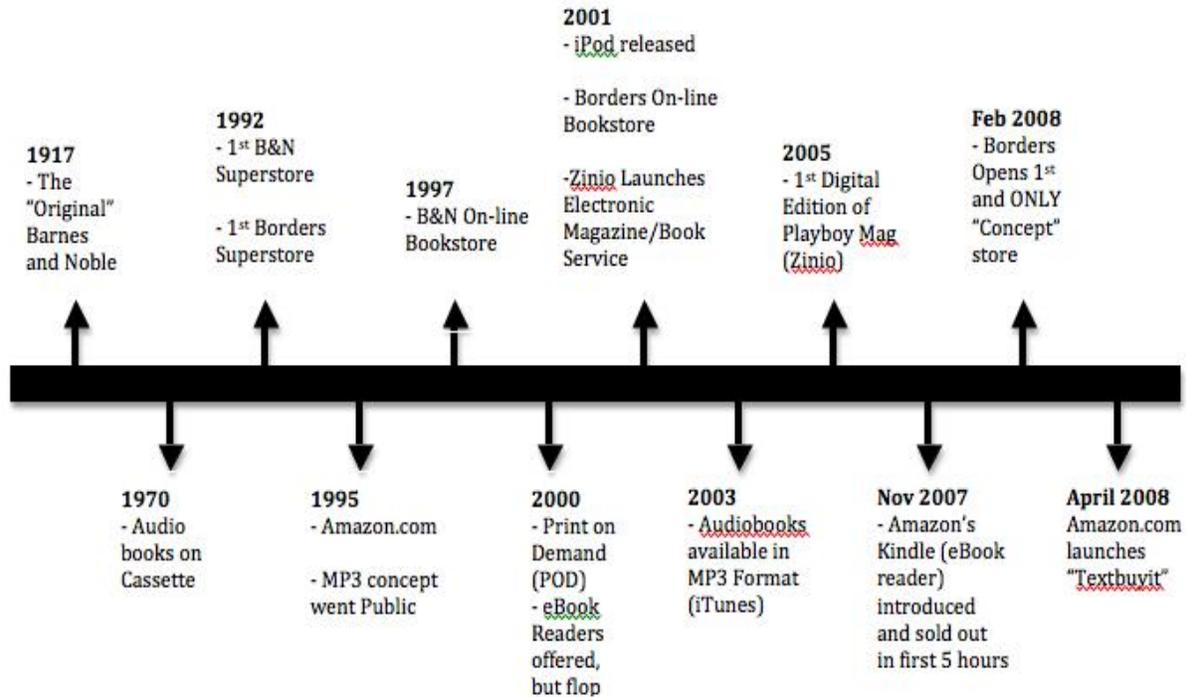
⁸⁸ <http://biz.yahoo.com/bw/080423/20080423006176.html?.v=1&printer=1> , Accessed on April 28, 2008

⁸⁹ Amazon.com’s SEC 10-K 2007 Annual Report, April 2008

⁹⁰ <http://www.loc.gov/loc/lcib/0709/booktrends.html> . Accessed on April 17, 2008

hours.⁹¹ Jeff Bezos, founder and CEO told the press, "The Kindle is outpacing our expectations, which is something that we are very grateful for. We are super excited by the very strong demand."⁹² Amazon is not the only company marketing an e-reader. To date, there are eight companies that market their version of the e-book reading device, including Sony.⁹³

Exhibit 5: Timeline of Events for the Big 4 Booksellers and Technological Inventions⁹⁴



Similar to the e-book reader is the Zinio reader technology. Zinio reader is not a portable reading device, but rather a service (software package) that can be downloaded to your computer or portable reading device, like the Sony Reader, for a fee. Zinio offers textbooks, magazines, and classic book titles on their web at www.zinio.com. Magazines such as Business Week, Cosmopolitan, Readers Digest, Playboy and more have all signed up to have their magazines converted to digital format with Zinio in an effort to reach their market.⁹⁵

Text messaging via cell phones has become very popular, and companies like Amazon and ShopText are creating ways for consumers to buy product via text messaging. On April 2, 2008, Amazon.com launched their

⁹¹ http://en.wikipedia.org/wiki/Amazon_Kindle , Accessed on May 1, 2008

⁹² Holahan, Catherine, Business Week Online; 2/1/2008, p18-18, 1p. Accessed on May 1, 2008 through the LC library database

⁹³ http://wiki.mobileread.com/wiki/E-book_Reader_Matrix , Accessed on May 1, 2008

⁹⁴ Graphic was created by Wendy Hall with information obtained on April 18, 2008 from company websites www.barnesandnoble.com, www.amazon.com, www.borders.com, and <http://en.wikipedia.org>

⁹⁵ Kerwin, Ann Marie, Advertising Age; 11/14/2005, Vol. 76 Issue 46, p32-32, 1/5p. Accessed on May 1, 2008 through the LC library database.

TextBuyIt service so that its customers could text their orders over their cell phones.⁹⁶ ShopText launched its text buying service in 2005 offering a variety of products such as clothes, jewelry, perfume, CDs, movie tickets, and more, then in 2007 began to offer books with free shipping.⁹⁷ Mark Kaplan, ShopText founder and Chief Marketing Officer has said that ShopText would like to partner with bookstores and publishers but as of June 2007 had not made any such partnerships.⁹⁸ A ShopText customer said, “This is a system that deserves to succeed, and it probably will, considering what big, pampered kids I and my fellow boomers have become.”⁹⁹

MEMBERSHIP

Barnes & Noble, Borders, Books-A-Million, and Amazon.com all mention the importance of their respective membership programs. Barnes & Noble’s Chief Operating Officer Mitchell Klipper, stated in the March 2008 Investor Conference Call that one of the highlights of 2007 for B&N was a record growth in new memberships and membership renewals, in fact, the figures surpassed what was forecasted by B&N.¹⁰⁰ Barnes & Noble offers an annual membership that costs \$25. Membership entitles customers to 40% off list price of current hardback B&N Bestsellers, 20% off list price of all B&N identified adult hardbacks, and 10% off almost everything else, including café purchases.¹⁰¹

Amazon Prime is a membership that costs \$79 annually and provides free 2-day and discounted express shipping. Membership benefits only apply to qualified purchases defined as Amazon.com products and not third party merchandisers selling product through the Amazon.com web portal. There is no minimum purchase to get the shipping discount and members can share their membership benefits with up to four different people living at the same address. (Note: Amazon.com offers free shipping to all of its customers, regardless if they are members, for qualified orders over \$25.)

In 2006, Borders offered customers their Borders Reward loyalty program which was free of charge and did not require an annual fee. A percentage of each customer’s purchase was put into their membership account and offered as coupons off of Holiday purchases that year. In 2007, Borders changed the benefits of the Borders Rewards membership program by offering customers the opportunity to accrue “Borders Bucks”, which accrues in \$5 increments for each \$150 purchase, but expires if the customer doesn’t use within 30 days of qualifying. Purchases made in the in-store Seattle’s Best café can be used towards the \$150 accrual needed. Purchases made on-line, as of April 2008, do not count towards the accrual needed to get Borders Bucks. As a Borders Rewards member, you can also enroll free of charge into their “Borders Rewards Perks” program that offers members discounts on a number of products and services including Target, Lands End, Ann Taylor, Orbitz, and more. Borders also offers Borders Rewards members a membership program called “Borders Rewards Perks Plus” which offers even more discounts and access to special events and periodic savings; however, the cost for the Perks Plus membership is \$29.95 per year. As of March 2008, Borders had 25 Million members and claim that number increases each week by an average of 140,000.¹⁰² Borders’ Public Relations Representative, Anne Roman, says that “The loyalty program is a cornerstone of our marketing and branding efforts because it is a key communications avenue for us with heavy book buyers and those who love Borders.”¹⁰³

Books-A-Million also offers an annual membership called the Millionaire’s Club. For an annual fee of \$15, members enjoy 10% off all purchases, including purchases from the in-store coffee café Joe Muggs as well as on-line at www.booksamillion.com.

⁹⁶ <http://www.publishersweekly.com/article/CA6547222.html?q=textbuyit> , Accessed on May 1, 2008

⁹⁷ <http://www.publishersweekly.com/index.asp?layout=articlePrint&articleID=CA6465344> , Accessed on May 1, 2008

⁹⁸ *ibid*

⁹⁹ *ibid*

¹⁰⁰ Barnes & Noble FY07 Earnings Conference Call, held on March 20, 2008 at 10:00 a.m. EST. The call can be accessed free of charge as of April 28, 2008 from the company’s corporate website: www.barnesandnobleinc.com

¹⁰¹ www.barnesandnoble.com Accessed on April 28, 2008

¹⁰² http://www.brandweek.com/bw/news/recent_display.jsp?vnu_content_id=1003728986 , Accessed on March 25, 2008

¹⁰³ *ibid*

Exhibit 6 below provides a brief summary of each company's membership program.

Exhibit 6: Summary of Membership Programs for B&N, BAM, Borders, and Amazon.com

	B&N	Borders	BAM	Amazon.com
Cost	\$25	-Free for Borders Rewards -\$29.95 for Perks Plus*	\$15	\$79
Major Benefit	% Discount off	Credit \$\$s accrued after \$150 spent in 12 mo period, to be used on future purchases	% Discount off	Free 2-day or Discounted express shipping on qualified purchases** -No minimum purchase required***
Duration	Annual	Annual	Annual	Annual
% Discount	-40% off LIST for B&N Bestselling Hardbacks -20% off LIST for other B&N Adult Hardbacks -10% off B&N price of almost everything else	No additional discount	10% off All Purchases	No additional discount
May be used On-line	Yes	No	Yes	Yes
Applies to Café?	Yes	Yes	Yes	n/a
Rewards Credit Card Offer?	Yes	Yes	Yes	Yes
Other Benefits?	Periodic and Random Coupons	Perks and Perks Plus*, which offer special discounts on name brand products and services	No	Members can share their membership with up to 4 accounts in same household

*Borders Rewards Perks Plus is available for an annual fee of \$29.95 for Borders Rewards members only.

**Qualified purchases are defined as product sold by Amazon.com or their affiliates. Product sold by other companies through Amazon.com's website do not qualify.

***Non-members must purchase \$25 in qualified purchases before eligible for free standard shipping

THE "THIRD PLACE"

Wikipedia.com defines the Third Place as "a term used in the concept of community building to refer to social surroundings separate from the two usual social environments of home and the workplace."¹⁰⁴ According to USA Today, "an estimated 30 million Americans" work outside of the home and office and that number is increasing by 10% each year.¹⁰⁵ Companies such as Starbucks have said that they consider themselves to be American's third place and to support them; they announced on April 25, 2008 their plans to roll out AT&T Wi-Fi services nationwide.^{106 107} Kerri Sissney, a loyal Barnes & Noble customer who visits the Lynchburg, VA B&N store on a weekly basis admits, "I'm addicted to the Chai Lattes at the café, and while I'm here I like to browse the latest in children's books; I usually can't get out of here for less than \$30 dollars a pop!" If Borders' new concept store is a success, third placers could start to consider Borders a new location, since the store would have lounging chairs, a café and the ability to download music, books, movies, and more.

BARNES & NOBLE 2007 HIGHLIGHTS

On March 20, 2008, Barnes & Noble, Inc. reported their 2007 earnings results on an Earnings Call to investors. During the conference call, Chief Financial Officer, Joseph Lombardi summarized the key statistics, such

¹⁰⁴ http://en.wikipedia.org/wiki/Third_Place . Accessed on April 27, 2008

¹⁰⁵ http://www.usatoday.com/life/2006-10-04-third-space_x.htm . Accessed on April 27, 2008

¹⁰⁶ http://media.corporate-ir.net/media_files/irol/99/99518/2007AR.pdf, Accessed on April 27, 2008

¹⁰⁷ <http://www.starbucks.com/aboutus/pressdesc.asp?id=863> , Accessed on April 29, 2008

as number of stores, EPS, and dividend increases. Chief Operating Officer, Mitchell Klipper summarized the 2007 highlights, which include:¹⁰⁸

- A decrease in Gross Margin because of an intentional and strategic decision to decrease the overall price of books to their customers
- Recognition that price is not the only reason customers make purchases, but where they make them is important, especially on-line
- Disappointment in Holiday sales
- Decrease in music business
- Record comparable store sales, specifically an increase of 1.8% (*comp sales are defined as revenues for a store that has been in operation for at least 12 months and compares current revenues against historical data for the current year*)
- 31 new stores, indicating growth
- Record internet sales, increase by 13.4% or the highest in 5 years, attributable to a # of factors including: trust, price, selection, speed of delivery, and customer inquiry response
- Finalized their 2007 Distribution Network Optimization Strategy. Closed the Memphis, TN site, so that now 2 remaining locations provide the most efficient method, new record for inventory turnover
- Record new membership and renewal, in fact, more than forecasted

CONCLUSION

Barnes & Noble Outlook for 2008 and Beyond

Barnes & Noble has an ambitious yet cautious outlook for 2008 and beyond. B&N is concerned about the economy and how it will affect consumers buying behavior as well as how it will affect B&N's ability to grow their business. Nonetheless, Barnes & Noble plans to open 35 to 40 new stores in fiscal year 2008, which is in line with their expansion strategy of increasing and improving their real estate portfolio.¹⁰⁹ Additionally, Barnes & Noble will consider growing their Barnes & Noble College Booksellers division by opening a chain of University Superstores located on the campuses of major colleges and universities. B&N is hoping for another best seller similar to the Harry Potter series to boost sales, but is confident that in the absence of one, sales for 2008 will increase from 2007. One of Barnes & Noble's primary focus for the future is to increase the membership program and continue to manage expenses so that they can continue to offer lower everyday prices to all of their customers.

In addition to investments in their brick-and-mortar business, Barnes & Noble will not ignore investments in their internet business. B&N recognizes that the book industry is becoming increasingly technical and consumers are looking for more selection, faster searching, and ease of use when shopping over the internet; therefore, B&N plans to invest more money into improving and enhancing their website infrastructure and features. In addition, Barnes & Noble plans to grow their B&N Studio segment on their website to offer more features and selections for their internet customers who love books.

After the 2007 Christmas Holiday season was over, CEO Steve Riggio was still uncertain about the future of Barnes & Noble yet he had to remind himself that even in tough economic times and in an increased competitive atmosphere, Barnes & Noble managed to achieve better than expected results in FY07. But, what will Barnes & Noble's strategic plan for 2008, 2013 or 2030 be to continue their success and maintain a competitive edge? Will B&N have to think outside of the "brick-and-mortar" box and into the "click-and-mortar" space? Riggio was certain of one thing, the competition was fierce and the industry was changing, and Barnes & Noble would have to be bold to stay ahead of the game.

¹⁰⁸ The bullets listed are from the Barnes & Noble FY07 Earnings Conference Call, held on March 20, 2008 at 10:00 a.m. EST. The call can be accessed free of charge as of April 28, 2008 from the company's corporate website: www.barnesandnobleinc.com

¹⁰⁹ *ibid*

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