

Analyse the economics of the dot com model versus the multi-channel mode with focus on a particular industry. Do you think the future will see a thriving dot com sector?

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Introduction

This essay will examine the economics of the online book-selling industry. This industry was chosen largely because of Amazon.com, and the way it has irrevocably changed the way customers purchase books. According to Steinfield et. al., “Traditional booksellers have ... been affected ... due to the enormous influence of Amazon.com. In no other industry has the very survival of a particular type of traditional business been called into question.” (Steinfield, Adelaar, & Lai, 2002, p. 4). The essay will see how more traditional businesses in the market have adapted and to judge how successful they have been at developing an online presence in competition with Amazon.

A ‘dot-com’ business sells to its customers exclusively using the Internet, usually through a website store. A multi-channel business sells both in the traditional manner (i.e. physical stores, sales staff, a supply chain of authors, publishers, printers and distributors etc.) *as well as* over the Internet.

Specific examples of businesses will be given with some brief background information. These will be Amazon, WHSmith, and Barnes & Noble. It will be demonstrated that Amazon achieves efficiencies of scale and scope. How it adds value for customers as an e-business will be considered using the framework of novelty, lock-in, efficiency and complementary goods and services (Amit & Zott, 2001). How the dot-com and the multi-channel companies differ in their online offerings will be addressed. Opportunities for further cross-channel integration will be briefly proposed. As for the future of the sector, the growing eBook market will be pointed to as a more evenly matched competitive environment. The essay will

conclude by expressing confidence that the dot com book selling sector will continue to thrive and grow in the future.

Amazon.com was founded by Jeff Bezos in 1994 and started business in 1995 selling books on-line (Amazon.com Website). Although Amazon originally only sold books, it has since entered into many other online markets and now offers books, audio-books, eBooks, films, music, electronics, garden equipment, groceries and many other products. At time of writing it is the largest-selling Internet retailer in the United States (Internet Retailer Website). Amazon only sells on-line, having no physical outlets or customer-facing stores. It is therefore classified as a 'dot-com' business. While there do exist some other online-only book stores, Amazon is by far the largest and most popular, so for the purposes of this essay no other dot-com firms will be considered.

WHSmith is a well-established British book-store and newsagent, founded in the 18th Century. Today it has hundreds of stores throughout the United Kingdom, as well as a website which sells books, magazines, stationary and electronics (WHSmith.co.uk Website). It is, therefore, a multi-channel business and the extent to which it manages those channels effectively will be reviewed later in this essay.

Barnes & Noble, based in the United States and founded at the end of the 19th Century, is the world's largest bookseller (Barnes and Noble Inc. Website). Barnes and Noble launched its e-commerce website in 1997, sold more than half of it in 1999 and bought it back in 2003-4 (Barnes & Noble Inc. Website, 2003) (Gross, 2003). Today, barnesandnoble.com sells books,

audio-books, eBooks, films and music online alongside many hundreds of physical stores in the United States, meaning that it is a multi-channel retailer.

Amazon.com

Amazon, as a dot-com business, does not have a network of branch stores, with all the overheads those entail. Rather, it has only one store-front (per country) and a number of regional warehouses which have the capacity to hold a huge number of items. Although this means that it is not possible for customers to walk into an Amazon shop on the high street, there are numerous offsetting advantages to the customer (explained below). The results of this business model are demonstrated in Table 1, below.

Table 1 (Laffey, 2004) taken from (Katz, 2002)

	Land-based	Amazon.com
Superstores	439	1
Titles per superstore	175,000	2,500,000
Occupancy costs (% of sales)	12%	<4%
Sales per operating employee	\$100,000	\$300,000
Inventory turnover	2-3X	50-60X
Sales per square foot	\$250	\$2,000
Rent per square foot	\$20	\$8.00

Clearly, by abandoning the traditional branch network, Amazon is able to drastically reduce their fixed costs and operating expenses (staff, rent, organisational costs). Furthermore, by unifying the store-front and item selection, the choice and variety of consumer goods offered can far outstrip those of an offline bookstore chain. For each physical branch store it can only be economical to stock the most demanded titles. Valuable shelf space must be allocated to

the products most likely to be demanded. On Amazon, similar principles may apply to home-page screen space or promotions. However, the customer may far more easily find and purchase the uncommon titles, simply by searching. While a branch store might at best be able to order a copy of an uncommon title, the marginal cost to Amazon of holding a greater variety of titles in stock is comparatively low. Therefore, Amazon can offer a wider variety of different book genres, sub-genres and titles, all easily searchable. This is a benefit of economies of scale. In addition, Amazon's increasing width of item types offered, departing from the original book market, is an "economies of scope" approach to lowering their costs and increasing Amazon's value as an online retailer (Laffey, 2004, p. 20).

Not being located in high streets actually reduces the transaction costs for many consumers. Assuming Internet access, the customer need do little more than turn on his PC at home and register with an email address and debit/credit card. It is not necessary for the customer to travel to the store, or carry his purchases home. With more recent advances in technology, iPhone users can use the Amazon App to shop at Amazon from practically any location whatsoever (Amazon.co.uk). This is a novel way to shop, using technology, that creates value for customers (Amit & Zott, 2001).

The Amazon website is able to give personalised recommendations for products a customer might be interested in, based on the past viewing and purchase history of that user as well as others with similar interests. These are displayed when the customer views an item or adds it to his shopping basket. Similarly, users can save items in their basket or create item wish-lists to be purchased later. In this way, Amazon's website is able to offer a shopping experience that is more individually tailored to the customer's preferences than any normal store could

offer, despite the lack of human interaction (Laffey, 2004) (Mendelson & Meza, 2001). This demonstrates how Amazon creates value as an e-business through the novelty of their services (Amit & Zott, 2001).

In some traditional book stores, certain titles will be presented as the staff recommendations of the week, with a brief review by a named staff member. This can provide information (more than the cover image and 'blurb') to customers about how to discriminate between suitable and unsuitable titles. Amazon takes this further by allowing its user base themselves to share reviews of titles that they own. Benefits to the reviewer can be to persuade others of their opinion or to share their strong opinions. Amazon's own customers, therefore, are involved themselves in creating valuable information for each other. This benefit is due to the network effects of the existing Amazon decentralised customer base (Amit & Zott, 2001), rather than the tastes or knowledge of its staff as gatekeepers.

Amazon has also brought together its existing database of book titles with its large user base network to deliver the extra functionality of the Amazon marketplace. Essentially, this allows Amazon users to sell their own second hand copies of books. So Amazon here is also more efficiently fulfilling that market with services previously performed by second-hand bookstores. Although Amazon marketplace sellers may try to undercut the Amazon listed price, Amazon takes a commission for facilitating the trade.

Amazon is able to offer complementary services (Amit & Zott, 2001) to its original book-selling. It has (especially in its original US market) expanded into selling many other items,

in particular audio-books, eBooks and an eBook reader (the Kindle). These are all ways to experience books in other media. Amazon's Kindle Reader and Kindle store well integrate the existing paper store with the new eBook format. The hardware unit is a complementary good, so where Amazon first sold books, now they are in the market of distributing electronic books. To stimulate demand for those products, they have entered into the hardware market.

Amazon adds value by making book purchasing far more efficient than off-line. Without leaving his home, a user can extremely quickly preview and purchase books simply by searching for genres, keywords, authors or titles. They will be offered other items similar to their interests. User reviews will often tell the consumer what the consensus is on a book's quality. Items can be saved for later, or purchased immediately. Delivery is quick, cheap and painless. Discovery, search and delivery costs are minimal whereas there are various value-adding features discussed above to improve the experience.

Amazon has a variety of benefits for its customers that incentivise them to make multiple purchases on the basis of their trust of the brand and good past experiences (Amit & Zott, 2001): "most customers of Amazon.com are loyal even though Amazon.com charges higher prices than some other online book retailers. Customers are prepared to pay more to use a reputable seller and will pay more for a seller they have visited previously. This point suggests that there are important unobserved quality characteristics for which brand name is a signal" (Kung, Monroe, & Cox, 2002).

Multi-Channel Businesses

It is important to remember that “The advantages discussed above are undoubtedly positive aspects of dot coms, but such services can be offered just as readily by established firms who set up Internet channels” (Laffey, 2004, p. 9). Indeed, it has been argued that “established firms have existing supplier and distributor relationships, experience in the market, a customer base, and other complementary assets that can enable them to take better advantage of an innovation like e-commerce” (Steinfeld C. , 2002).

The great potential of multi-channel book-stores would be to use their existing supply chain relationships, expertise and customer-facing branches with a complementary service that makes shopping a seamless experience across channels.

Realising those benefits, however, is easier said than done. Whether justified or not, there is a fear of channel cannibalisation or “channibalisation” (Laffey, 2004, p. 10) (Aarsonson, 2003) i.e. the online part of the business taking customers away from the offline part of the business.

Barnes & Noble’s website barnesandnoble.com was a good example of poor multi-channel strategy in the book-selling market. The website was launched years after Amazon, and was a completely separate company from the parent with practically no multi-channel interaction (Aarsonson, 2004). The website did not mount an effective challenge to Amazon and, despite

an enthusiastic public take-up, Barnes & Noble repurchased the website in 2003 for a fraction of the price at which it sold (Gross, 2003) (Barnes & Noble Inc., 2003).

Now Barnes & Noble has a better multi-channel approach. Staff recommendations, mentioned earlier, now appear on the website (Barnes & Noble). Users can get updates on local store events such as book-signings. There is an iPhone or mobile application for shopping anywhere. Barnes & Noble are even competing vigorously with Amazon in the eBook market with their selection of titles and the Nook reader.

In the UK, WHSmith's website has a store finder which includes opening hours and additional services offered in that store e.g. a post office branch. As at Barnes & Noble, there is also information about signing events at stores (WHSmith Website). However, prices and promotions in stores are not necessarily the same as online: "Although WHSmith.co.uk is a part of WHSmith Retail it offers its own prices, promotions and products." (WHSmith Website). In addition, books cannot be previewed on WHSmith's website, a feature that would certainly be available in the offline stores (and is possible on Amazon). This is perhaps evidence of a lack of integration between WHSmith's different channels.

Future Developments

In this market, it is Amazon that has been the innovator and trailblazer. Traditional firms have been catching up in the online channel out of necessity. However, that is not to say that a book-seller such as Barnes & Noble - which has now, it seems, decided to become properly a multi-channel company - cannot succeed in levelling the online playing field against Amazon in time.

An important growing market in this sector is eBooks and eBook readers. It would be rash to suggest that paper books will become obsolete any time soon, but eBooks are currently maturing as a substitute or replacement product. Both Amazon and Barnes & Noble are taking this opportunity seriously and are competing on the basis of both their players and the access to their online catalogue.

As for the future of the dot-com sector, it seems unlikely that Amazon will cease thriving. It has a high brand value, a large customer network, efficient service, history of innovation and significant economies of scale and scope. Other online-only firms will struggle to compete unless they can find some market niche or innovation that Amazon has overlooked.

Conclusion

This essay has considered the rise of dot-com company Amazon.com and the multi-channel responses of well-established firms Barnes & Noble in the USA and WHSmith in the UK. Economic reasons for Amazon's success have been given. Barnes & Noble was criticised for its initially half-hearted multi-channel offering, but it was noted that the firm's situation has improved. In the future, it was suggested that traditional firms have the opportunity to improve their multi-channel experience. The eBook market was identified as a key multi-channel growth area. Most likely the dot-com sector of the book-selling market will continue to thrive for several years.

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