KINDLING THE BOOK INDUSTRY

AMAZON.COM TEACHING CASE

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Abstract

The increasing attention that the novel concept of Dynamic Capabilities has gained in the strategic management study field triggered a problem of definition. In this study the author shortly reviews the current and most important literature about the concept and identifies a possible definition, then, illustrates this theoretical concept with a real-life managerial example. The firm chosen to exemplify the successful application of the Dynamic Capabilities construct is Amazon.com the online bookstore that decided to invest on digital books with the launching of the Kindle concept. Through the analysis of this case, the author evidenced that in volatile environments doing the "same (old) right things" is not enough and it is necessary to revisit the way managers build competitive advantage.

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Table of Contents

Abstract ... ii

Acknowledgments ... iii

Introduction ... 1

Literature review ... 3

1. Dynamic Capabilities: the foundation of the theory ... 3

2. Dynamic Capabilities: the evolutionary path of the theory ... 4

a) The nature of Dynamic Capabilities ... 4

b) The rational of Dynamic Capabilities ... 5

c) Dynamic Capabilities and market environments ... 5

d) Dynamic Capabilities and performance ... 6

3. The gaps in the literature ... 7

Teaching Case ... 8

1. Setting up Amazon.com ... 8

a. Jeff Bezos ... 8

b. The Decision ... 9

c. The Business Model and the first days of Amazon.com ... 10

d. Going Public in 1997 ... 11

e. The evolution of an online bookstore ... 12

2. An e-book reader by Amazon.com ... 14

a. The e-book market ... 14

b. The development of an idea ... 16

c. The launching event ... 20

3. The Kindle ... 22

a. Initial commercial records ... 22

b. The evolution of the Kindle and the digital books market ... 23

Case Exhibits ... 36

Exhibit 1: 1997 Letter to Shareholders ... 36

Exhibit 2: Industry Sales Benchmark 1994-2011 ... 42

Exhibit 3: Industry Net Earnings Benchmark 1994-2011 ... 43

Exhibit 4: Amazon vs. Barnes & Noble vs. Apple Share evolution ... 44

Exhibit 5: The current Kindle family ... 45

Exhibit 6: Kindle books availability 46

Teaching Notes **47**

Teaching Case Synopsis **47**

Teaching Purpose and intended contribution **48**

Instructor preparation **48**

Teaching Plan **51**

Suggested assignment questions **52**

Teaching Notes Exhibits **61**

TN Exhibit1: 61

TN Exhibit 2: 63

Discussion **66**

Conclusion **70**

References **71**

Introduction

In 1997, Teece, Pisano and Shuen suggested the concept of Dynamic Capabilities for the strategic management literature. The purpose of this new concept was to explain why some firms, in highly changing environments are able to create competitive advantage and show superior performance, while others don't. The topic seems quite important as we are living in a turbulent world of constant change in result of successive environmental shocks, where firms' average lifetime have been constantly decreasing and sustainable competitive advantage seems likely to be a myth (Zahra, Sapienza, and Davidsson 2006).

The concept appeared as a major breakthrough in the strategic management field, proposing a different understanding of competitive advantage creation to the dominant approaches to date. Dynamic Capabilities have been first studied as an extension of the Resource Based View model (Barney 1986, 1991) for rapidly changing environments, defined as *«The firm's ability to integrate, build and reconfigure internal and external competences to address rapidly changing environments.»* (Teece et al. 1997). However this definition was judged somehow incomplete, tautological and inadequate for managerial purposes and authors have been trying to achieve a consensual definition of the concept since. To date we have several well-known definitions that one can see as different parts of a global understanding. Currently scholars tend to agree that Dynamic Capabilities are structured and persistent patterns within a firm (Barreto 2010, Zollo and Winter 2002). Implications are that they are costly to create and hold (S. Winter 2003) and, against the first idea held by Teece et al. in 1997, there is no necessary connection between the use of Dynamic Capabilities and superior performance (Zahra et al. 2006). From this point on, the definition is controversial. Teece considers that the concept is related with the scanning of environmental changes and creation of capabilities required to adapt. Other authors such as Eisenhardt and Martin focus on the processes to change the resource base. Zahra et al. add to this latest view the concept of entrepreneurial management. Finally a more recent definition clarifies the concept and overcomes some of the its by defining the concept as an aggregate concept depending on four dimensions: *«the firm's potential to systematically solve problems, formed by its*

propensity to sense opportunities and threats, to make timely and market-oriented decisions, and to change its resource base» (Barreto 2010).

The purpose of the literature in the Dynamic Capabilities field has always been to empower managers with a practical tool to accomplish better profits and performance in their businesses. However the literature to date is still excessively conceptual and theoretical and lacks of empirical evidence and real-life applicability. This absence of actual evidences of the Dynamic Capabilities as a systematic problem-solving process in real-life cases, particularly in prominent firms or sectors, leads to skepticism and suspicion around the validity of the framework as a practical solution for the creation of competitive advantage in shifting business environments.

The aim of this dissertation is to bring evidence that will reinforce the managerial applicability of the Dynamic Capabilities framework as it is defined by Barreto (2010) and illustrate how its four components can be applied to a real-life and notorious case. Throughout our analysis we will find substantiation of systematic propensity to monitor opportunities and threats, the propensities to make timely and market-oriented decisions, and finally propensity of resource base changing in a multinational firm.

the study of the successful case of Amazon.com and the launching of their e-reader device the Kindle was chosen in order to understand the practical implications of the use of Dynamic Capabilities for a firm in a turbulent environment. The particularities of the very complex book sector provides all the conditions to explore how some players have been able to continuously sense, build, and exploit opportunities and creating temporary competitive advantages that translates into superior market performance and profitability in a volatile business ecosystem.

This dissertation will proceed as follows: In a first phase, the studied literature will be presented and examined according to the evolution of the definition of the Dynamic Capabilities concept. Next, the teaching case will be described and its data explored. Afterwards, insights on the case will be discussed in the teaching notes. Then, a link with the studied literature will be made in the discussion. Lastly, the key conclusions will be presented.

Literature review

1. Dynamic Capabilities: the foundation of the theory

Managers facing a globalized business landscape of innovation-based competition, price/performance rivalry and constant “creative destruction” of their current competences and capabilities find the “game” increasingly hard to play. However, in this context, some firms have proved to be able to keep up with the challenge, creating competitive advantage and achieving superior market performance in regimes of rapid change.

In their 1997 landmark paper, Teece et al. presented a new paradigm in the strategic management field, the Dynamic Capabilities framework, which was meant to illuminate the causes of success of firms in highly volatile markets. This framework was intended to give tools and assist business managers in the building of long-run competitive advantage and business flexibility when facing hypercompetitive environments.

This concept appeared as a major breakthrough in the strategic management field, contradicting dominant approaches to competitive advantage creation such as Porter’s five Forces and the strategic conflict approach. Teece and colleagues’ argument was that the current theories were based on strategic moves and Machiavellian tricks that tended to distract managers from seeking real sources of stable competitive advantage such as organizational processes of skills, knowledge and know-how acquisition. They presented the Dynamic Capabilities framework as a gap filling extension of the Resource Based Value model (Barney 1986, 1991), proposing an explanation to competitive advantage creation through bundles of resources and capabilities in rapidly changing environments. They found evidence showing that the most successful firms in those environments have demonstrated timely responsiveness and fast and flexible product innovation, combined with the management ability to effectively coordinate and redeploy internal and external competences. Thus, they defined Dynamic Capabilities as “the firm's ability to integrate, build and reconfigure internal and external competences to address rapidly changing environments. Dynamic capabilities thus reflect an

organization's ability to achieve new and innovative forms of competitive advantage given path dependencies and market positions (Leonard Barton, 1992).”(1997:516)

This first paper about the concept was a turning point in the corporate strategy field, enabling for the first time a different perspective over the creation of competitive advantage.

2. Dynamic Capabilities: the evolutionary path of the theory

Teece and colleagues’ 1997 paper triggered an exponential growth in the investigation around the concept of Dynamic Capabilities. Criticism, however, grew at the same rate. Several authors observed that the definition given was tautological. This problem caused some distrust around the new paradigm’s credibility especially since it turned the framework useless for business managers. Therefore authors have been trying to demystify the framework.

a) The nature of Dynamic Capabilities

The nature of Dynamic Capabilities has been discussed and, yet, authors have still not reached an agreement, triggering a high risk of the concept to become a “big tent” (Barreto 2010).

Teece and colleagues linked Dynamic Capabilities with the strategic management concept, emphasizing the role of being able to create valuable, rare, costly to imitate and non-substitutable business capabilities and resources to correctly adapt to changing environments. Several authors have further developed this view. Zahra et al. (2006) suggested that Dynamic Capabilities are the abilities to reconfigure firm's resources and routines in the manner envisioned and deemed appropriate by its principal decision-makers and Winter defined Dynamic Capabilities as those that extend, modify or create ordinary capabilities that permit a firm to "make a living" in the short term.

Other authors suggested Dynamic Capabilities as business processes. Zollo and Winter (2002) started by defining them as the processes through which organizations systematically generate and modify operating routines in pursuit of improved effectiveness. Eisenhardt and Martin (2000), in an effort to be more specific, defined

Dynamic Capabilities as product development, strategic decision-making and alliancing processes because they are organizational routines by which firms achieve new resource configurations as markets evolve.

Barreto (2010) proposes a different view that does not identify Dynamic Capabilities neither as capabilities nor as business processes but as a firm's potential to systematically solve problems. Beyond the idea of potential to solve problems the author's objective was to stress the adverb "systematically" to underpin the importance of viewing Dynamic Capability as something structured and persistent – not an *ad hoc* feature, nor luck.

b) The rational of Dynamic Capabilities

Teece suggested that the ultimate purpose of Dynamic Capabilities is to create competitive leverage and superior market performance in environments where the traditional sources of success: ownership of difficult to replicate assets, are not sufficient any longer (Teece et al.1997).

In a less general approach, Winter (2003) suggests that the objective of Dynamic Capabilities is to operate changes on "ordinary" business processes. Eisenhardt and Martin (2000) go a step further proposing that the objective of using Dynamic Capabilities is to match or even to create market change. Zahra et al. (2006) propose that Dynamic Capabilities aim is to reconfigure the firm's resources and routines as top management desire and Zollo and Winter (2002) state that the goal is to improve effectiveness. Even though the body of research is disconnected and points in different directions, authors have tended to add such objectives and purposes in their definitions of the concept which seems problematic due to the tautology criticism on one hand and to the consequent difficulties of empirical testing and operationalization on the other hand (Barreto 2010).

c) Dynamic Capabilities and market environments

Along with the effort to understand the nature of Dynamic Capabilities, authors have attempted to understand in which business context these capabilities were created and were more useful. Teece's first idea restricted the concept to fast-moving markets,

though other authors tend to disagree. Eisenhardt and Martin (2000) sustained that Dynamic Capabilities also exist in more static environments. In moderately dynamic markets, Dynamic Capabilities rely on existing knowledge and consequently are very well-defined and complicated processes whereas, in high velocity markets, where industry structure is blurred, Dynamic Capabilities are simple, experimental, unstable processes because they rely on hastily created new knowledge and iterative execution.

More recent studies show that even though Dynamic Capabilities seem to potentially create more value in volatile environments (Zahra et al. 2006), the business environment may not even be relevant to define the concept (Barreto 2010).

d) Dynamic Capabilities and performance

Against Teece's (1997, 2007) first suggestions of a direct link between the use of Dynamic Capabilities and firm's success, a different body of research developed the idea that Dynamic Capabilities *per se* do not lead to superior business performance.

Eisenhardt and Martin (2000) suggested that the intrinsic value for competitive advantage creation might not lie in the capabilities themselves but is embedded in their deployment and ability to reconfigure resources into value-creating strategies. They proposed a series of "best practices" that should leverage the long-term value creation potential depending upon using Dynamic Capabilities sooner, more astutely, or more fortuitously than the competition. The problem of relating competitive advantage creation and "best practices" is that the concepts are contradictory. The concept of "best practices" implies replication while competitive advantage implies uniqueness.

Winter (2003) introduced a new element into the Dynamic Capabilities concept by stating that their development involves long-term commitments to specialized resources and, as such, it involves costs. The argument is that Dynamic Capabilities are an investment, and not a necessarily profitable one because having the capabilities and not finding a circumstance to use them means carrying a cost burden.

Zahra et al. (2006) suggested that the link between the use of Dynamic Capabilities and the potential value creation relies mainly on an entrepreneurial management of the firm. The perception of managers of opportunities and threats of the market, and their ability

and willingness to undertake the change are crucial in order to achieve the strategic goals of change and competitive advantage creation. This implies that the firm's success and deployment of Dynamic Capabilities is not a direct relationship but it is a question of choice, knowledge and assumptions.

Barreto (2010) follows the same line of thought, affirming that to view Dynamic Capabilities as a synonym of success and superior market performance is to incur in the tautology mistake and, as such, concludes that the capabilities are just one way of *"potentially"* achieving success.

3. The gaps in the literature

The vast literature in the Dynamic Capabilities field provided many new, important developments but still presents several gaps and problems. Some have been analyzed and uncovered by the advances in the body of research, others still present major issues to the credibility of the managerial implications of the concept.

Regarding the matters of a non-tautological and clear definition of the concept, Barreto (2010) presented a coherent definition of Dynamic Capabilities that captures the essence of a large body of work, departing from previous one-dimensional proposals in order to suggest an aggregate multidimensional construct formed by four dimensions. According to his definition Dynamic Capabilities are the firm's "potential to systematically solve problems, formed by its propensity to sense opportunities and threats, to make timely and market-oriented decisions and to change its resource base". This definition clarifies the nature of the concept, it is not tautological, it does not imply a direct link to success, and assumes that there can be high and low levels of Dynamic Capabilities.

This definition helps overcoming several essential gaps in the Dynamic Capabilities literature and, it may also allow advances on practical illustration and managerial evidence of this research topic. The definition Barreto, by conceptualizing Dynamic Capabilities as a multidimensional composite, permits, with a case study, to measure and illustrate each one of the four dimensions that enable the potential of systematically solve problems and consequently prove the managerial applicability of Dynamic Capabilities.

Teaching Case

Jeff Bezos, a former investment banker, founded Amazon.com, an *online* bookstore, in 1995 when the Internet was still in its infancy. In 1997, when the firm went public, its founder wrote a letter to the shareholders entitled "It's all about the long term" (Exhibit 1) where he explained that the fundamental measure of success would always be the value created on the long term. Following this investment strategy made Amazon one of the few winners of the Dot-com crash[1]. When, in 2004, Amazon decided to invest in the development of a device and an associated business model to enter and mainstream the e-book market, the long-term rational was still the same. And, in 2007, Amazon launched the Kindle that by 2012 had reached an estimate 60% market share of a $1.7 billion market with competition struggling to keep up with challenge.

How has Jeff Bezos been able to disrupt his own market and still survive? What makes Amazon able to build completely new businesses while keep extracting value from old ones? How has Jeff Bezos been able to operationalize his beliefs and not succumb under shareholders short-term pressures and criticism? What strategic decisions were crucial to Amazon.com success?

1. Setting up Amazon.com

a. Jeff Bezos

Jeffrey Preston Bezos was born on January 12th 1962 in Albuquerque New Mexico. From an early age he had showed an outstanding mechanical aptitude, and grew to become a young garage inventor. In high school he was an exceptional student and developed a passion for computers. After graduating he was accepted into Princeton where he studied computer science and electrical engineering. Afterwards he found employment in Wall Street[2].

In 1994, at age 32, he became the youngest-ever senior vice president at D. E. Shawn investment banking, making an estimated six-figure salary[3]. However, Bezos' inventing temperament and passion for the newly-born business of electronic retailing in the World Wide Web[4] didn't let him settle with the challenge and, by the end of that same

year, Jeff Bezos took the decision that would turn his life around, made him part of Forbes World's richest People ranking[5] and to be considered "Men of the Year" by Times Magazine in 1999[6].

b. The Decision

In 1994, while searching in the infant Internet for possible ventures for D. E. Shawn to invest in, Jeff Bezos found that the World Wide Web usage was increasing 2,300 percent per month[7]. This discovery was the evidence Jeff needed. As he retained his childhood passion for invention, he immediately realized the possibilities opened by online selling. He listed the twenty potential products that he thought would better sell online. This list included software, CDs and books[8]. After some analysis Jeff Bezos understood that books were the evident choice due to the extremely high number of existing titles. A virtual bookstore could offer all the titles that existed in the world while even the largest book superstore could only offer a minimal fraction due to space restrictions.[9] It was a window of opportunity as no one was in this distribution channel yet, and Jeff Bezos knew he could have the competitive advantage, though he had to work fast.

Despite its spectacular growth in 1994 the World Wide Web was still doing its first steps, with only 13.5 million users worldwide, or only 0,24% of the total population[10], so, starting an online only business meant betting on its growth; it was a very risky bet that involved being able to think very long term and probably having the nerve to maintain an unprofitable firm for some years. At that moment, Jeff Bezos applied what he calls the "regret minimization framework": he pictured himself as an eighty-year old and tried to imagine if he would regret the decision to not bet on his idea. He understood that he would very much regret it[11].

In the summer of 1994, he passed up on a big bonus and started his entrepreneurship journey. With the support of his wife, Mackenzie, he packed everything he had and headed for Seattle where he believed was the right place to start. It was close to a pool of high-tech talent and to Ingram Book Group's Oregon warehouse[12]. During the car trip, while his wife was driving he typed the business plan on his laptop and called prospective investors for his Internet firm idea: Cadabra[13].

c. The Business Model and the first days of Amazon.com

Jeff Bezos and Mackenzie arrived into their new rented house in Seattle with a $1 million[14] raised from a group of fifteen business angel investors mostly friends of his parents, friends from Princeton, and a reduced group of local investors. Of that $1 million, $300,000 had to came from Jeff Bezos' parents who invested their retirement savings on their son[15]. The new house was a three-bedroom in the suburb of Bellevue and it had one crucial prerequisite: a garage. Jeff wanted a garage start-up like legends such as Hewlett-Packard[16].

Very quickly Jeff changed his name idea when his attorney misheard "cadaver"[17] and opted for Amazon not just in honor of the second largest river on earth but also because the name began with an "A" and would be first on the alphabetical lists[18] that were used for browsing in the most popular internet hubs at the time, like yahoo.com.

After one year the market research was done and an easy to navigate website was set up. The business model would rely on two major pillars. First, Amazon.com would carry very little stock, only 2,000 titles, unlike its major and large competitors Barnes & Noble and Borders. Most orders would be placed directly through wholesalers and publishers and Amazon.com would simply receive the books and ship them, so no large warehouse would be needed. Second, Amazon.com should be the standard for online shopping experience. The online shop was created to be a "virtual hang-out" place and as user-friendly as possible. It contained several innovative features: topic areas to browse, lists of bestsellers, award winners, titles that were recently featured in the media, a recommendation center where customers could find books based on their mood, reading habits, or preferences (based the clients' purchase history) and, a major breakthrough in the industry, the site enabled the customers to write their comments about the books, to have them published and to read other customers' comments about books they were interested in buying[19].

On July 16th 1995[20], Jeff Bezos and his 5 people crew opened Amazon.com, "Earth's biggest Bookstore" for business[21]. The website was not totally ready, but Jeff Bezos wanted to get to the market quickly to be sure that they would get a jump over the competition. The first customers were attracted by discounts of 10% to 30% on the

regular book price and the first orders came as soon as the online shop opened. On their third day, one of Yahoo founders, Jerry Yang, sent Jeff Bezos an e-mail: “"We think your site is pretty cool; would you like us to put it on the What's Cool page?” It was a bold step; the team wasn’t sure to have the commercial capacity to play in that game field. They risked it though and, after the insertion on the list, the orders grew exponentially and by the end of the first week sales reached $12,000 and $15,000 on the second week. The team had troubles keeping up with the shipping process; books were packed on the floor and people were working on their knees packing until 2-3am every day[22] though, they could only ship $7,000 books worth per week.

Jeff Bezos understood very quickly that they had not enough space in his garage so he moved the company to a 1,000 square feet open space office and a 400 square feet warehouse in an industrial neighborhood. Within a month they had filled orders from 50 states and 45 countries[23]. By October they had their first day with 100 books sold and in less than one year they had their first hour with 100 books sold. The word was spreading despite the fact that the company had made no advertising but few mobile billboards cruising by Barnes & Noble superstores with the message “Can’t find that book you wanted?” and Amazon.com online address[24].

d. Going Public in 1997

On March 31st 1997 Amazon.com reported first quarter sales of $16 million but a $3 million loss (Exhibit 2). The sales were growing at the expenses of margins because of a commercial strategy based on hard discounts. Amazon.com was still the only player in the World Wide Web and was clearly battling for establishing a strong customer base before competition could respond. However, the giants of the traditional bookstore sector were finally showing some signs awakening. On January, Barnes & Noble and America Online signed a deal by which the bookseller would have the exclusivity on the online service’s Marketplace section, it was also announced that the Barnes & Noble online store would open on that spring. The traditional bookstore, which was not very interested about going online because of a cannibalization fear, had an epiphany that one barnesandnoble.com employee describes as: "It's better to cannibalize yourself than to be cannibalized." and understood that it could not survive without an online strategy.

As it was developing the core of the new online strategy, Barnes & Noble's board was sure that by leveraging on the offline brand the firm would easily extinguish Amazon.com[25]. Borders also announced plans to go online very soon. As a response to these news, Amazon.com reinforced its positioning by cutting the prices of its best-selling books up to 40% and doubling its inventory to 2,5 million books[26].

With deep pockets competition getting closer, Barnes & Noble's 4th quarter 1996 sales were up to $883 million and Borders made $342 million[27](Exhibit 2), Amazon.com needed to find funds to continue its long-term strategy of low margins. On March 24th 1997, the firm announced that it would proceed with an initial public offering with the objective of raising $33.9 million to cover $6 million of accumulated operating losses, anticipated operating losses, capital expenditures and other general corporate uses[28].

Despite analysts doubts about the viability of Amazon.com business in light of their poor results, strong competition and being on what was viewed as a niche market[29], on May 15th 1997 the firm went public and ended up $54 million richer. The initial public offering closed at 23-1/2, more than 30% above the target price of $18. Amazon.com, a company that had always been in the red and was not expected to be in the black before 1999, was valued at $438 million by the market[30].

e. The evolution of an online bookstore

Even though traditional bookstores were late to respond with an online strategy, the problems with those players began as soon as the Amazon.com website was launched. In 1996[31], Barnes & Noble, which called itself "World's largest bookseller", sued Amazon.com because the online player was calling itself "Earth's biggest bookstore". Even though Amazon.com countersued and the case eventually was settled in 1997 with both slogans intact[32], it was the incentive Jeff Bezos needed to capitalize on complementarities and start a diversification strategy by adding DVDs and CDs[33] (the other items of his original list) to the online store product portfolio. Amazon.com consequently became "Earth's biggest selection"[34].

By the end of 1998, Barnes & Noble's founder had already spent $100 million online[35] however their efforts were being completely disastrous. First, the potential value of their

AOL deal was dissolved when AOL and signed an exclusivity deal with Amazon by which the online retailer would become the only bookseller on AOL.com. And second, they were having problems with their proprietary website, barnesandnoble.com, that was judged the opposite of customer friendly [36]. Borders website was launched only in 1998, three years after Amazon's and one year after barnesandnoble.com. It was a mistake from day one and the firm lost tens of millions of dollars with it.

While its bricks-and-mortar competition was struggling to enter the online bookselling business, Amazon.com was already taking steps in another direction. The online bookstore was turning into an online retailer. In 1999[37], Amazon.com entered a new white space in World Wide Web commerce with commission based brokerage service to sellers and buyers of second hand books. Meanwhile, Barnes & Noble was operating under the assumption that Internet was the only driver of their business and that Amazon.com was the target to take down at any cost. Whereas they were finding it hard to fund their online strategy without putting at stake their physical business, money was pouring out but not coming in at the same rate. The solution they found was to spin off barnesandnoble.com and raise capital by taking it public. In a strike of luck, Barnes & Noble found a partner that wanted to do an equal part joint venture: Bertelsmann AG, a German corporation that had grown into the world's third-largest media company through acquisitions (Doubleday, Dell, Bantam and Random House) and had already an online retailing site, bol.com[38]. On May 25th 1999, barnesandnoble.com went public under the symbol "BNBN" and raised $450 million with 25 million shares[39]. At that time Amazon.com was worth almost $20 billion[40].

In 2001[41], Amazon.com took another innovative step and started offering third-party sellers the opportunity of having their products on sale on Amazon.com online store. Companies such as Target, Toys R Us, Old Navy[42] and Borders were now paying the online retailer a commission for each sale they made on the web store. The investment Borders made in its online store went so wrong that the only reasonable move was to outsource the online sales to Amazon.com through a partnership deal and to concentrate efforts on the physical stores[43]. Finally, by 2002, Amazon found again a new customer. The online retailer developed a web services platform for the IT community[44].

In a period of six years Jeff Bezos had proved to Wall Street that his company and his vision, that were different from "normal" firms, could be successful. In his first letter to shareholders, he wrote that the pillars of Amazon's strategy were the long-term focus and their obsession with their customers. And those principles proved to be true. In good and bad times, during the effervescence of the Dot-com bubble and its collapse, Jeff Bezos had always maintained its focus on the long term and never stopped investing in innovation and customer satisfaction. For the founder "there's no bad time to innovate. You should be doing it when times are good and when times are tough—and you want to be doing it around things that your customers care about. For us, it is such a deep-seated belief, I'm not sure we have a choice."[45] With this strategy, Jeff Bezos survived the Dot-com bubble popping. It took years six years for the company to make profits, in 2000 after the bubble popped they reported $1.4 billion losses, had to lay off over 1,200 workers[46] and the AMZN stock hit a low $10, but in the fourth quarter of 2002 the company finally reported net profits[47].

2. An e-book reader by Amazon.com

a. The e-book market

In 1971, when there were only 100 people using internet worldwide, Michael Hart a college student at the University of Illinois created the first digital book by typing the Declaration of Independence into a computer[48]. As a professor of the same University he began "Project Gutenberg" an ongoing project with the objective of creating the first digital public library. That was the starting point for e-books[49]. In 1999, Simon & Schuster became the first publisher to sell e-books [50] . In the same year barnesandnoble.com, which had a fresh start with the IPO, was investing in electronic distribution of books as a differentiation axis from Amazon. The firm invested on Rocket eBook, the first e-book reader that could connect to a computer through the Rocket eBook Cradle, a device with two cables, one for power, and one for the computer. The device was developed by NuvoMedia, a Palo Alto company, and was launched in 1998. NuvoMedia motto was to be "the electronic book distribution solution, by providing a networking infrastructure for publishers, retailers and end users to publish, distribute, purchase and read electronic content securely and efficiently on

the internet"[51]. The Rocket eBook sold at $500 and the pricing for the digital version of books that could be purchased at barnesandnoble.com ranged from $5 to $25. After purchasing the book the customer had to wait from five minutes to three hours to be emailed a link to the actual download site. Barnes & Noble also invested $600 million on the acquisition of Ingram Book Group, one of US largest wholesalers, and gained Lightning Print, Ingram's print-on-demand division, that owned agreements with more than 100 publishers for book instant-printing. Steve Riggio, Barnes & Noble founder was confident that a strategy rooted on digital distribution of books and instant printing would drive the company past Amazon.com[52] but because e-book sales never took off, Barnes & Noble abruptly stopped all investments on digital reading in 2003[53]. Meanwhile, in August 2000, Amazon.com and Microsoft joined forces in the e-books battle. Amazon.com made e-books available on its website while Microsoft had just launched the first e-book reader software that could be used on a PC or on a PDA[54]. This meant that by 2004 digital books had been available for customers. Nevertheless, sales had never taken off.

At the same time that digital books were being developed, music, video and short-form reading were also being digitized and by 2004 consumers had embraced the change on those markets. The event that triggered the change occurred on September 23rd 2001 on Apple's campus in Cupertino with the unveiling of the iPod. The mp3 players existed since the mid 1990s however, by the end of the century Steve Jobs believed that just one word could describe the devices on the market: "crap"[55]. If they were small flash memory-based players they could only hold a CD's worth of songs, and, if they were hard drive players they could hold thousand of songs, but they were big, heavy and had a difficult-to navigate interface. Adding to the hardware problems was the time length the users had to wait to transfer songs: because of the pokey USB 1.1 standard, transferring one CD could last up to five minutes. Despite all those problems with hardware internet-downloaded mp3 was becoming extremely popular. So, Apple solved the problem: it used a FireWire interface for fast transfers, and a 1.8-inch 5GB very small hard drive from Toshiba to build an mp3 device, the iPod. Apple fans and the press were not impressed; the general opinion was that this was the decision that would lead Apple to bankruptcy[56]. However, by December 2004 Apple had sold 10 million iPods[57].

People were now used to downloads and to syncing their devices with their computers. They carried around their entire music library in their iPods, read the news on their favorite newspapers' website and downloaded shows and movies to their computers. However, consumers weren't long-reading digital books and the sales of commercialized e-readers that were the size of a large book, with a black and white LCD screen, and a storage capacity of approximately ten e-books like the Rocket eBook never took off[58]. Amazon.com CEO, a book lover, was struck by this reality. On an interview he shared the idea that "it doesn't make any sense to me that printing our books on dead trees is the final step on the evolution of books."[59]. For him the million dollars question was why books were "the last bastion of analog"[60]? Why customers were not adhering to the digitized books? Carolyn Reidy, the president of Simon & Schuster publishing believed that the reason was that "the hardware was not consumer-friendly and it was difficult to find, buy and read e-books".[61]

b. The development of an idea

i. The technology

For Jeff Bezos it didn't make any sense that people didn't want to read digital books. For him it was a two-axis problem: having the right hardware but also the right content. The market was not offering anything that covered these two core pillars and he had been thinking about the disruptive idea for the online retailer to start manufacturing and selling its own digital reading hardware[62]. Moreover, he thought it could be a good business "there are a lot of people who read. Is there the potential to make that a meaningful business? I believe there is. The onus is on us to continue to execute well."[63]

Jeff Bezos was determined to have the best resources working on that project so he and his vice-president, Steven Kessel, met with Jareen Parekh, a systems engineer who had worked for Philips research and Replay-TV, a digital video recorder first mover. Jareen Parekh was lured by the project and in September 2004 he joined Amazon.com as the first employee affected to the Lab126, the newly founded Amazon subsidiary specialized in R&D based in Cupertino[64], to work on the hardware project. The team was completed with some industrial designers and engineers, among which was Gregg

Zehr, the former vice-president of hardware engineering at Palm Computing, who became president of this new Amazon subsidiary[65].

The first task of the team was to research about current e-readers on the market. Apart from some e-readers that were born in Silicon Valley that were not commercially relevant, like Rocket eBook or the SoftBook Reader[66], the team studied the Sony Librie, a device that worked on AAA batteries, was a market disappointment and never sold out of Japan. The team concluded that there were no great examples; Jareen Parekh noted that “it was the one thing that wasn’t being done well by anyone else out there” and so they had the opportunity to be pioneers and try to set the market standard[67].

The team began working on the creation of the Amazon e-reader, which was meant to become the iPod[68] for books. The Lab126 was an independent startup even though was financed by the search division of Amazon.com. However Amazon’s founder loved the project so much that he decided to integrate the team. And as this device became the result of the CEO’s imagination, eventually he gave the team nearly unlimited resources for its development[69].

The team worked on the technological development of the device for about three years. The e-reader had to be as perfectly suited for the reading activity as printed books and for Jeff Bezos printed books were perfect because they were a highly evolved technology, elegantly suited for their purpose, very personal and emotional for readers, but the most important was their ability to “disappear” on consumers’ hands. Accordingly the technology and the design of the e-reader had to replicate those features. At that time Jeff Bezos believed that few technologies were converging and, even though not totally developed yet, with the right mix and the right bets, it would be technologically possible to build such a device.[70]

The result was a “drop-dead easy to use” e-reader device that could hold up to 200 books in a Mobipocket format, which was invented by a French company with the same name acquired by Amazon Mobipocket in 2005[71], and could be rendered in a large number of devices. It was a device build to disappear in readers’ hands so that they could enjoy their reading as they would with a printed book. After long lasting studies on “how people hold books”[72], Amazon.com designed a device weighting 10.3 ounces,

lighter and thinner than the average paperback edition of a printed book, and that could be held like a book, fitting in one hand and with vertical page-turning buttons on both right and left sides of it. It also had a keyboard that enabled the readers to make annotations while reading, customize bookmarks and search for content. The white and black display read like paper; the screen displays the ink particles electronically using E-ink, a newly developed technology in the Massachusetts Institute of Technology Media Lab. The other important feature of the display was that it had no backlight, which enables it to reflect light like ordinary paper eliminating the eyestrain and glare characteristic to computer monitors and to consume very little power, the device had a life battery of one week. Finally, the feature most appreciated by Jeff Bezos was that the device worked as a self-contained unit, thanks to Amazon *Whispernet*, a wireless delivery system that used the same nationwide speed data network (EVDO) as the most advanced cellphones to date so readers could download content wirelessly without the need of syncing it to a PC or a Wi-Fi hot spot.[73]

With this technological mix and after multiple customers' testing[74], the team was convinced they had designed an easy-to-use e-book reader that would meet customers' expectations in terms of hardware because it met and exceeded all the requirements an special features readers wanted in the "book" object.

ii. The business Model

Having an excellent hardware was a crucial point; the e-reader should be flawless and appealing to customers. However, the team knew it was not a stand-alone point considering the current environment. Of what use would be an iPod if the only mp3 files existing would be classical music? It was clear that there was not enough content to be stored and enjoyed on the Amazon's e-reader. The team needed to determine what kind of content they wanted to provide to their customers and to find a way to make that content digital. For Jeff Bezos it was not something Amazon could do by itself, at least at that moment. The firm was already doing one challenging strategic shift of going from a retailer to become also an original equipment manufacturer (OEM)[75], so it would be too hard to also become a content creator.

The team decided that they would want their device to give access not only to book content, but also to newspapers, magazines and blogs contents[76]. It should be a reading device as good for digital long-reading as for digital short-reading. For Jeff Bezos the motto was very clear: "If you're going to do something like this, you have to be as good as the book in a lot of respects. But we also have to look for things that ordinary books can't do."[77]

The objective was to build deals with publishing houses in order for them to be onboard to start digitizing their content. It was a hard job. In a recent interview, Jeff Bezos made a comment about the difficulty of that particular challenge “As a company, we are culturally pioneers, and we like to disrupt even our own business. Other companies have different cultures and sometimes don’t like to do that. Our job is to bring those industries along. The music industry should be a great cautionary tale: Don’t let that happen to you. Get ahead of it. I think with books, we have gotten ahead of it, as have some very forward-leaning publishers. But some of them are really leaning backward, and that’s going to hurt their business. They’ll find that other publishers are going to do very well in that vacuum.”[78] One “real chokepoint” for publishing houses, said David Shanks, Penguin CEO, was the initial investment of converting the books. Each book costed approximately $200[79]. Jeff Bezos argument was that the digital was very interesting for publishers for three reasons: first, it meant that books never go out of print, second, that they never go out of stock, and third, digital meant that publishers wouldn’t have to ever guess the initial printing stock again[80]. However to help publishers solving this initial investment problem, Amazon started scanning books it had in its “Search inside the book” program[81] and it found innovative forms of partnerships with content producer. As an example, it created a platform called the Kindle digital text platform that allowed independent publishers to generate new content and directly publish it on the Kindle format[82]. For newspapers the problem was of another nature, publishers were worried because when a customer would go from a paper subscription to the e-reader subscription, the billing stream would automatically go from the customers to Amazon[83].

Finally, the last point, and the one that would prove to be the most controversial for publishers on this new business model, was the pricing. Jeff Bezos was very clear,

customer had been complaining for years that books were too expensive and levels of reading in US population had been decreasing for years too, so the prices had to go down to push digital reading content sales. In his mind, the price of the digital format of New York Times bestsellers should be exactly $9,99, and this would be the price cap for all typical consumer books[84]. For the founder it was the fair price to charge, not only because digital books do not have marginal costs but also because of DRM policy[85] that decreased the value offered by digital books compared to printed books because they can't be offered as gifts, lent or resold[86].

c. The launching event

The development of the e-reader device and the complementary business model took three years. Its launch was delayed several times because of technological improvements but also because of negotiations with publishers[87]. However, when asked if he was not afraid that someone would get ahead of him, Jeff Bezos was very clear "No, because when you put all these pieces together (…) we knew that nobody was working on it or thinking on it the same way we were."[88]

Finally, on November 19th 2007, Amazon.com held a small press event for only a hundred fifty invitees at the New York's W Hotel in Union Square[89] to unveil its first e-reader device: The Kindle, a venture Amazon executives thought could possibly be a $1billion business[90].

The device was on sale on Amazon's website for $399[91] and was bound with a digital media platform, the Kindle store, where transaction and subscription-based content delivery coexisted, the first for books and the second for newspapers, magazines and blogs[92]. The Kindle store was built to offer the same shopping experience as the Amazon.com website. Kindle owners had access to 90,000 e-books[93], on Amazon's proprietary format, including 101 out of 112 of the New York Times bestsellers[94], or in Jeff Bezos' words "the books that people want to read"[95]. The prices for new releases and best sellers were $9.99 and books were delivered wirelessly in less than one minute. Most of Kindle books offered one sample chapter for free. On the Kindle store, customers could also subscribe to their favorite newspapers or magazines - the Times, The Wall Street Journal, The Washington Post, Le Monde or Time, Fortune[96], and

Newsweek[97], for example. When the issues went to press, the digital publications were automatically and wirelessly downloaded into the e-reader. The subscription fee asked for the digital publication was less than the one for printed edition because it had no advertising in it[98]. Monthly newspaper subscriptions ranged from $5.99 to $14.99 per month, and magazines monthly fees from $1.25 to $3.49. In addition, all magazines and newspapers included a free two-week trial. And, lastly, readers could also buy unlimited access to more than 300 blogs[99] that were automatically wirelessly updated, for a monthly fee of $0,99[100]. The most interesting feature was that the Kindle worked with the same EV-DO technology as a cellphone, enabling it to be connected all the time with no data-plan or 3G monthly bills. Amazon *Whispernet,* the 3G cellular data service provided with the Kindle that enabled free, automatic and fast downloads of content, was built on top of Sprint's EV-DO network and Amazon was covering the charges of the service to give customers what they wanted: to just read[101].

The device had also some additional features that completed the Kindle experience. The Kindle was a storing and reading device also for personal files, as it supported Microsoft(R) Word, HTML, TXT, JPEG, GIF, PNG, and BMP files. These files could be wirelessly delivered through a Kindle e-mail address, unique to each device, for $0,10 per e-mail received. The Kindle had also a built-in dictionary that could be easily used while reading . Finally, it enabled free access to all Wikipedia contents[102].

This combination of ergonomic hardware, free wireless connectivity, varied contents and complementary features was what Jeff Bezos and Lab126 team believed would make the Kindle a commercial winner. The Kindle was not a digital substitute for the printed book. The Kindle was a real innovation; it was a new and extremely complete business model thought as a long-term project and not just one more device to be sold on the Amazon.com store. For the CEO, this device did not aim at “out-book the book” but to do things that the reader could never do with a printed book[103].

3. The Kindle

a. Initial commercial records

Some critics questioned the wisdom of launching an e-book reader at that time[104]. Their first argument was related to the concept of digital books that they believed was far less suited concept for reading than printed books. Those were "doing their job" perfectly, they were cheap, they never run out of battery, they survived almost all kind of accidents and their file format would always be readable[105]. Their second argument, on the other hand, was related to market evidence. While Amazon was developing its Kindle, the market had observed several e-book readers flopping: the Rocket eBook Reader, the Gemstar, the Everybook, the SoftBook, the Librius Millennium Reader and the Sony Reader Device version 2.0, launched in October 2006, priced at $350 with a capacity of 160 books[106] and making poor sales records[107].

The following events proved the Kindle critics to be wrong very quickly. Kindle sold out in only 5.5 hours and continued out of stock for the next five months as the retailer caught up with backorders. Even though Amazon never communicated their real stock, estimates were made and the industry believed the online retailer sold approximately 500,000 devices in its first year[108].

The Kindle commercial success, comparing to other e-readers, was remarkable and there were several theories created to try to explain it. Some believed that the critical factor was the 3G cellular Internet connection that Amazon offered its Kindle customers. That same service had a commercial monthly cost of $60 [109]. Others considered that pricing was the reason. Kindle books were less than half the price of Sony's e-books and printed books, as were all subscription fees to newspapers and magazines[110]. Lastly, some assumed Amazon.com marketing efforts to position the Kindle as a conservative and convenient device were the root of success. The targeted publics were the "road warriors" and the business travelers – not young generations of savvy techies early adopters[111] – but the heavy readers[112] that wanted simple gadgets[113].

b. The evolution of the Kindle and the digital books market

i. Technological evolutions of the Kindle device

Since its first version, the Kindle device has been upgraded several times. These evolutions accompanied not only the technological advances but also customers' preferences. By February 9th 2009, Amazon.com released the Kindle 2, a slimmer version of the original Kindle, with longer battery life, seven times more storage space and a new experimental "read-to-me feature". "Kindle 2 is everything customers tell us they love about the original Kindle, only thinner, faster, crisper, with longer battery life, and capable of holding hundreds more books. If you want, Kindle 2 will even read to you — something new we added that a book could never do." said Jeff Bezos[114]. Three months later, Amazon announced a new member to the Kindle family: the Kindle DX, an e-reader with a display size 2,5 times the regular size. This Kindle was built for customer who wanted to use the device not only to read books but also to store and read personal and professional documents in a built-in PDF reader.

On July 28th 2010, more than three years after the first Kindle was introduced to the world, Amazon.com announced a new generation Kindle. Steven Kessel, the senior vice president of Amazon Kindle described this new e-reader as "50 percent better contrast, 20 percent faster page turns, 15 percent lighter, up to one month of battery life--and a new price of only $139." In that Christmas, the new devices became the fastest-selling items ever on the website[115]. Moreover, to achieve the cheapest price possible, Amazon developed a way to partly subsidize the devices' price. On April 11th 2011, the Kindle with special offers was announced and Amazon started shipping the WI-FI Kindle supported with ads that showed up as full-screen screensavers and as banner at the bottom of the Kindle home screen, never interfering with the reading. This Kindle was priced $25 cheaper, selling at $114[116].

On September 28th 2011, Amazon announced another generation of Kindles, the Kindle Touch family: three smaller, lighter, and cheaper e-readers. The first price for these new Kindle was only $79 and the old generation Kindle price was down to $99. It was the first time a Kindle reached "the magical two-digit price", announced Jeff Bezos[117].

ii. Evolution of the Kindle value chain

While the firm improved the hardware, they also worked on the Kindle vision. The Kindle is a new way of thinking the complete book value chain. With the launch of the Kindle Digital Text platform, Amazon shook the entire publishing industry. This platform, launched at the same time as the first Kindle, consisted of an online set of tools for preparing, formatting, publishing, and merchandising books as well as for sales management[118]. It was designed to help writers and independent publishers to easily and quickly publish books in Kindle format. Authors decided on the price of their books and they received a 35% royalty[119]. By January 2010[120], the firm developed its digital platform, opening it to non-US authors and introducing a new 70% royalty option for authors that agreed with some conditions that included making the book available in all Kindle stores worldwide and setting a price between $2.99 and $9.99[121]. By 2011, this strategy was already showing great results: the #1, Darcie Chan's 'The Mill River Recluse,' and #4, Chris Culver's 'The Abbey,' best-selling Kindle books released in 2011 were both published independently using Kindle Direct Publishing[122].

Amazon was surely making things right. The first proof was the exponential growth on book availability; when the Kindle was first introduced in 2007, there were only 200,000 e-books available; only four years after, when the last generation of Kindles was announced there was already over 1 million kindle books available[123]. (Exhibit 6) The second evidence was announced on May 19th 2011, when Amazon reported that customers were purchasing more Kindle books than paperback and hardcover books combined. "Customers are now choosing Kindle books more often than print books. We had high hopes that this would happen eventually, but we never imagined it would happen this quickly - we've been selling print books for 15 years and Kindle books for less than four years," said Jeff Bezos[124].

While working to find new ways of developing the Kindle books availability upstream, Amazon.com was also developing creative ideas to increase the availability of Kindle books in customers' everyday life. In March 2009, they set the first stone of their "Buy once, read everywhere" strategy launching the first Kindle app. It was an application available for free on the Apple App store that enabled customers to *whispersync* Kindle books they bought at Amazon.com into their iPhone or iPod Touch and read[125]. Then

came the apps for PC[126], for BlackBerry[127], for Mac[128], for iPad[129], for Android devices[130] and finally for web browsers[131]. Once a customer bought a Kindle book, he could "catch up on their current book wherever they are, like in line at the grocery store or between meetings" said Ian Freed, vice president of Amazon Kindle[132]. This was the vision for the Kindle, it was not meant to *outbook* the book, but to enable customers to do things with it that they could never do with traditional printed books.

iii. Evolution of the Kindle commercial records

The Kindle has been an absolute success. Even though Amazon never released the real number of units sold, over the years they always announced the most relevant Kindle's commercial achievements. It became the most wished for, the most gifted, and the #1 bestselling product across all product categories on Amazon best selling item[133] as of its first edition. On December 2009, Amazon announced that the Kindle became the most gifted item in Amazon's history and that on Christmas day there were more Kindle books sold than printed books for the first time ever[134]. And by the Christmas of 2011, customers purchased over one million Kindles per week[135], this accomplishment was probably due, in part, to Amazon's new selling strategy. On the beginning of November they announced that the Kindle family was available for sale in a new distribution channel: traditional retailers. Customers had the possibility of experiencing and buy the Kindle device in over 16,000 stores across the U.S. such as Best Buy, Target, Walmart, Staples, Sam's Club, RadioShack, and Office Depot[136].

iv. Evolution of the Kindle competition

Barnes & Noble the bookseller that had first invested in digital books in 1998, but was never able to turn them commercially viable and eventually quit the investment in 2003, was very late to introduce to the market a potential substitute to the Kindle. The company secret plan to build an e-book began only in March 2009 when William Lynch, a businessmen with a background in e-commerce and technology, arrived as head of barnesandnoble.com[137]. The small team of engineers that had the responsibility to build the future of books for Barnes & Noble worked behind an unmarked door in a former bread bakery and had a six months deadline[138]. In October 2009, when Amazon had already introduced the second generation of Kindles, Barnes & Noble introduced their e-reader device: the Nook, a black and white Android based device priced at $259.

The Nook strategy was "an every-device strategy" said William Lynch, the more than 1 million digital books available were published in an ePub downloadable format[139] that would be readable on the iPhone and BlackBerry smart-phones, and most Apple and Windows-based computers[140]. The e-readers were on sale at barnesandnoble.com, on the traditional Barnes & Noble stores in a special "boutique" space and on all major US retailers[141].

On January 2012, while working on the fifth Nook version[142], the company announced that they were considering the option of spinning of the Nook business. The rational behind the operation would be the different maturity points of the two businesses, the brick-and-mortar shops being a mature business, evolving smoothly and without investment needs, while the e-reader business needed deep pocket investments. In just two years on the market, the Nook was able to capture an estimated 30% market share whereas Amazon is believed to have 60% of the market. Yet the Nook business wasn't profitable, estimates were that the bookseller spent an average $250 million for revenues of only $200 million yearly. Despite the good indicators of the commercial potential of the Nook, investors are not showing great trust in the bookseller strategy and the Barnes & Noble stock fell more than 30% in 2011[143].

While Barnes and Noble was able to bounce back and keep up with the digital challenger, Borders, the other traditional bookseller giant was not that lucky. Even though it invested on an 11% stake in the e-reader manufacturer Kobo, its efforts to enter the e-books market were in vain[144]. Since 1999 until 2011 the company saw six CEOs pass, and none of them was capable of turning the firm's faith even after job cuts, point-of-sale closures and debt restructuration. On February 16th 2011, the company filled for bankruptcy and closed its doors. Barnes and Noble acquired some of the company's assets.

Sony, one of the first technology brands to launch an e-reader, worked mostly on improving its Sony Librie device. It was the first device to introduce real "touch" technology and even though it relied on tethering for a long time, eventually Sony e-readers adhere to WI-FI connectivity and to instant book downloading[145]. Sony entered the digital book content business with the launch of the Sony Reader Store in 2006[146].

However, Sony readers, which start at $129 [147] price point, have not conquered customers, and Sony market share was estimated to be less than 10%[148].

From almost nonexistent in 2007 to a $1.7 billion market in 2011 the e-book market showed an exponential growth in the US, with 20% of the adult American population reading an e-book that year[149]. Albert Greco a book industry expert at Fordham University expects that by the end of 2012 the market will be worth $3.55 billion in sales, an increase of over 100%[150]. E-books have become a mass market and the role played by Amazon's Kindle was crucial. Jeff Bezos' e-reader project was a success case of creating an innovative business model and building sustainable competitive advantages in a white space. However, not all stakeholders involved were content with Amazon's remodeling of the industry. Publishers, in specific the big five, Macmillan, Penguin, Harper Collins, Hachette and Simon & Schuster, which were used to set book prices, were shaken not only by Amazon decision of setting the price cap for bestsellers at $9.99, but also because the retailer was taking away their business by undermining their agency role between writers and bookstores. Amazon was turning publishers' role obsolete. Those players found an allied on Apple. The technological giant wanted to enter the e-book market with its iPad device and iBooks app with an agency model: "we told the publishers, We'll go to the agency model, where you set the price, and we get our 30%, and yes, the customer pays a little more, but that's what you want anyway." said Apple's founder Steve Jobs on an interview for his biography[151]. This "deal" obliged Amazon to break its $9.99 price cap. But on April 11th 2012 the US government sued Apple and the five publishers for conspiracy to limit competition on the e-book market. None of the publishers admitted the charges, though on April 12th Hachette, Harper Collins and Simon & Schuster had already settled[152]. This was a victory for Amazon and its Kindle device. However, this event is an evidence of how inevitable and hard are the consequences of unbalancing the *Status Quo*. In the years to come Amazon should expect to see more events of this kind happen. Some of them may even be triggered by Amazon's most recent investment the in Kindle Fire, a $199 tablet built to compete head-to-head against Apple' iPad. Jeff Bezos needs to get ready.

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Case Exhibits

Exhibit 1: 1997 Letter to Shareholders

To our shareholders:

Amazon.com passed many milestones in 1997: by year-end, we had served more than 1.5 million customers, yielding 838% revenue growth to $147.8 million, and extended our market leadership despite aggressive competitive entry.

But this is Day 1 for the Internet and, if we execute well, for Amazon.com. Today, online commerce saves customers money and precious time. Tomorrow, through personalization, online commerce will accelerate the very process of discovery. Amazon.com uses the Internet to create real value for its customers and, by doing so, hopes to create an enduring franchise, even in established and large markets.

We have a window of opportunity as larger players marshal the resources to pursue the online opportunity and as customers, new to purchasing online, are receptive to forming new relationships. The competitive landscape has continued to evolve at a fast pace. Many large players have moved online with credible offerings and have devoted substantial energy and resources to building awareness, traffic, and sales. Our goal is to move quickly to solidify and extend our current position while we begin to pursue the online commerce opportunities in other areas. We see substantial opportunity in the large markets we are targeting. This strategy is not without risk: it requires serious investment and crisp execution against established franchise leaders.

It's All About the Long Term

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 solidify our current market leadership position. The stronger our market leadership, the more powerful our economic model. Market leadership can translate directly to higher revenue, higher profitability, greater capital velocity, and correspondingly stronger returns on invested capital.

Our decisions have consistently reflected this focus. We first measure ourselves in terms of the metrics most indicative of our market leadership: customer and revenue growth, the degree to which our customers continue to purchase from us on a repeat basis, and the strength of our brand. We have invested and will continue to invest aggressively to expand and leverage our customer base, brand, and infrastructure as we move to establish an enduring franchise.

Because of our emphasis on the long term, we may make decisions and weigh tradeoffs differently than some companies. Accordingly, we want to share with you our fundamental management and decision-making approach so that you, our shareholders, may confirm that it is consistent with your investment philosophy:

We will continue to focus relentlessly on our customers.

- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.
- We will continue to measure our programs and the effectiveness of our investments analytically, to jettison those that do not provide acceptable returns, and to step up our investment in those that work best. We will continue to learn from both our successes and our failures.
- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.
- When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows.
- We will share our strategic thought processes with you when we make bold choices (to the extent competitive pressures allow), so that you may evaluate for yourselves whether we are making rational long-term leadership investments.

- We will work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture, particularly in a business incurring net losses.
- We will balance our focus on growth with emphasis on long-term profitability and capital management. At this stage, we choose to prioritize growth because we believe that scale is central to achieving the potential of our business model.
- We will continue to focus on hiring and retaining versatile and talented employees, and continue to weight their compensation to stock options rather than cash. We know our success will be largely affected by our ability to attract and retain a motivated employee base, each of whom must think like, and therefore must actually be, an owner.

We aren't so bold as to claim that the above is the "right" investment philosophy, but it's ours, and we would be remiss if we weren't clear in the approach we have taken and will continue to take.

With this foundation, we would like to turn to a review of our business focus, our progress in 1997, and our outlook for the future.

Obsess Over Customers

From the beginning, our focus has been on offering our customers compelling value. We realized that the Web was, and still is, the World Wide Wait. Therefore, we set out to offer customers something they simply could not get any other way, and began serving them with books. We brought them much more selection than was possible in a physical store (our store would now occupy 6 football fields), and presented it in a useful, easy-to- search, and easy-to-browse format in a store open 365 days a year, 24 hours a day. We maintained a dogged focus on improving the shopping experience, and in 1997 substantially enhanced our store. We now offer customers gift certificates, 1-Click(SM) shopping, and vastly more reviews, content, browsing options, and recommendation features. We dramatically lowered prices, further increasing customer value. Word of mouth remains the most powerful customer acquisition tool we have, and we are grateful for the trust our customers have placed in us. Repeat purchases and

word of mouth have combined to make Amazon.com the market leader in online bookselling.

By many measures, Amazon.com came a long way in 1997:

- Sales grew from $15.7 million in 1996 to $147.8 million -- an 838% increase.
- Cumulative customer accounts grew from 180,000 to 1,510,000 -- a 738% increase.
- The percentage of orders from repeat customers grew from over 46% in the fourth quarter of 1996 to over 58% in the same period in 1997.
- In terms of audience reach, per Media Metrix, our Web site went from a rank of 90th to within the top 20.
- We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

Infrastructure

During 1997, we worked hard to expand our business infrastructure to support these greatly increased traffic, sales, and service levels:

- Amazon.com's employee base grew from 158 to 614, and we significantly strengthened our management team.
- Distribution center capacity grew from 50,000 to 285,000 square feet, including a 70% expansion of our Seattle facilities and the launch of our second distribution center in Delaware in November.
- Inventories rose to over 200,000 titles at year-end, enabling us to improve availability for our customers.
- Our cash and investment balances at year-end were $125 million, thanks to our initial public offering in May 1997 and our $75 million loan, affording us

> substantial strategic flexibility. Our Employees The past year's success is the product of a talented, smart, hard-working group, and I take great pride in being a part of this team. Setting the bar high in our approach to hiring has been, and will continue to be, the single most important element of Amazon.com's success. It's not easy to work here (when I interview people I tell them, "You can work long, hard, or smart, but at Amazon.com you can't choose two out of three"), but we are working to build something important, something that matters to our customers, something that we can all tell our grandchildren about. Such things aren't meant to be easy. We are incredibly fortunate to have this group of dedicated employees whose sacrifices and passion build Amazon.com. Goals for 1998 We are still in the early stages of learning how to bring new value to our customers through Internet commerce and merchandising. Our goal remains to continue to solidify and extend our brand and customer base. This requires sustained investment in systems and infrastructure to support outstanding customer convenience, selection, and service while we grow. We are planning to add music to our product offering, and over time we believe that other products may be prudent investments. We also believe there are significant opportunities to better serve our customers overseas, such as reducing delivery times and better tailoring the customer experience. To be certain, a big part of the challenge for us will lie not in finding new ways to expand our business, but in prioritizing our investments.

We now know vastly more about online commerce than when Amazon.com was founded, but we still have so much to learn. Though we are optimistic, we must remain vigilant and maintain a sense of urgency. The challenges and hurdles we will face to make our long-term vision for Amazon.com a reality are several: aggressive, capable, well-funded competition; considerable growth challenges and execution risk; the risks of product and geographic expansion; and the need for large continuing investments to meet an expanding market opportunity. However, as we've long said, online bookselling, and online commerce in general, should prove to be a very large market, and it's likely that a number of companies will see significant benefit. We feel good about what we've done, and even more excited about what we want to do.

1997 was indeed an incredible year. We at Amazon.com are grateful to our customers for their business and trust, to each other for our hard work, and to our shareholders for their support and encouragement.

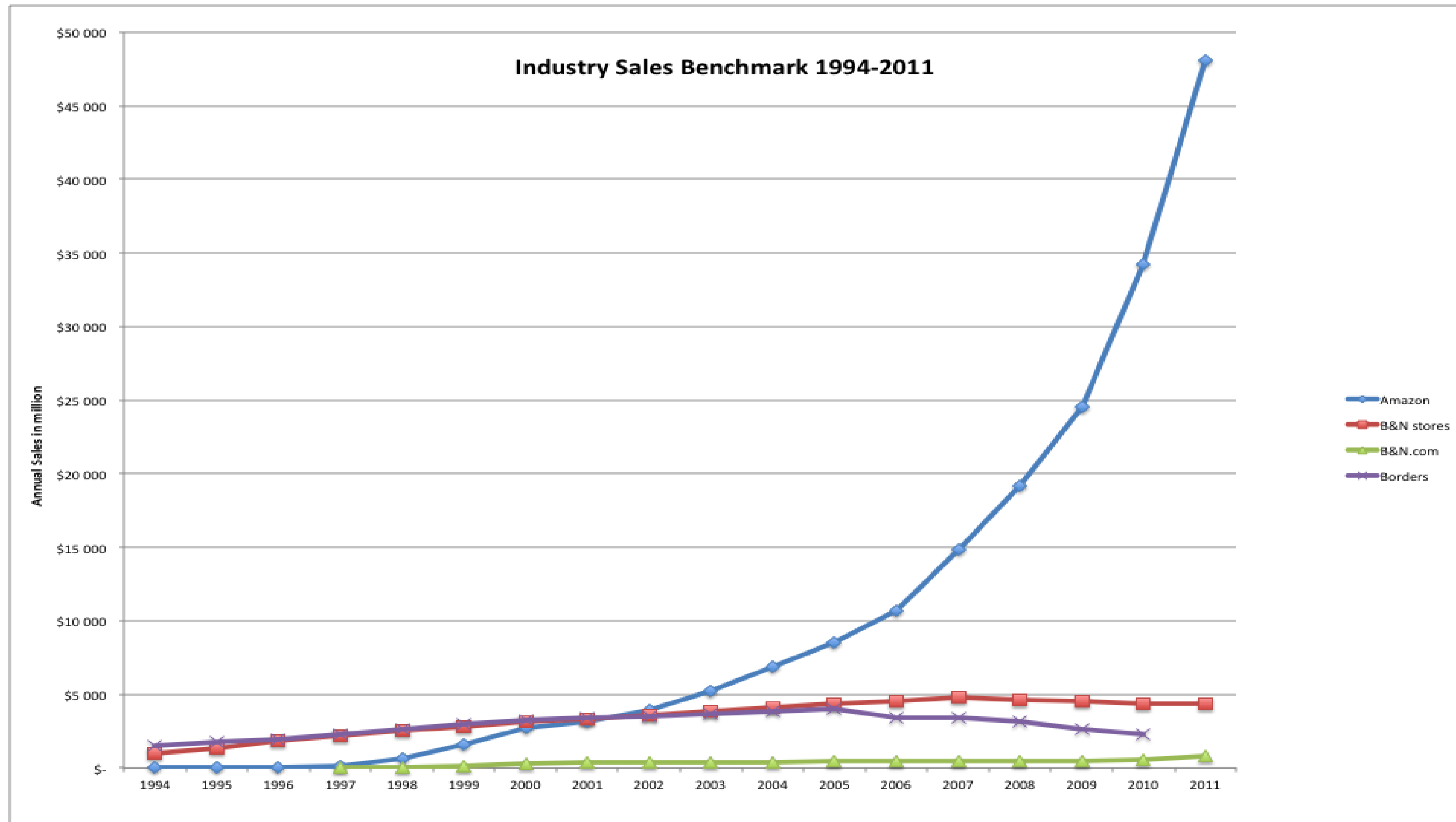
/s/ JEFFREY P. BEZOS

Jeffrey P. Bezos

Founder and Chief Executive Officer

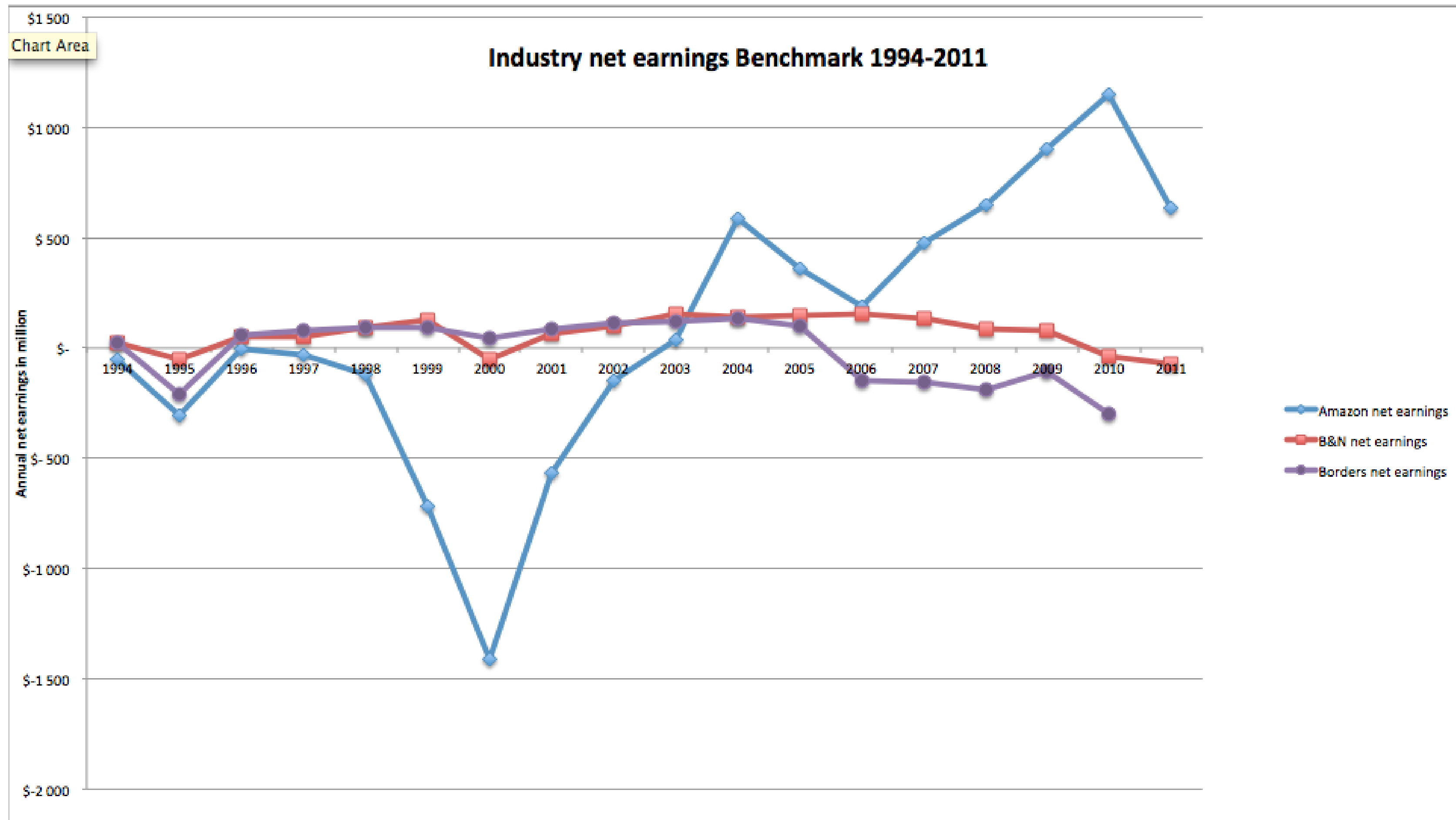
Amazon.com, Inc.

Exhibit 2: Industry Sales Benchmark 1994-2011



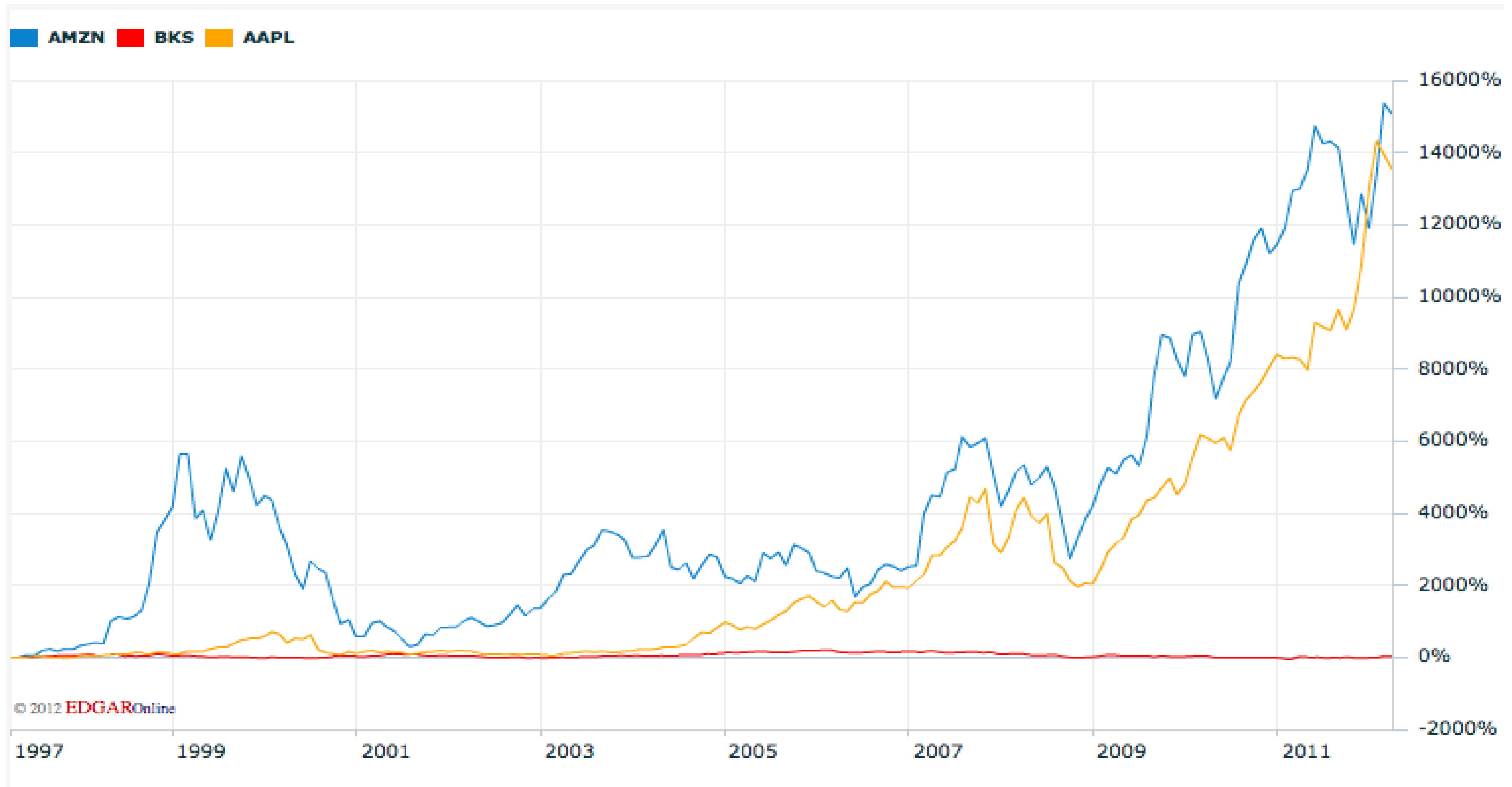
Source: Firms' Annual Reports

Exhibit 3: Industry Net Earnings Benchmark 1994-2011



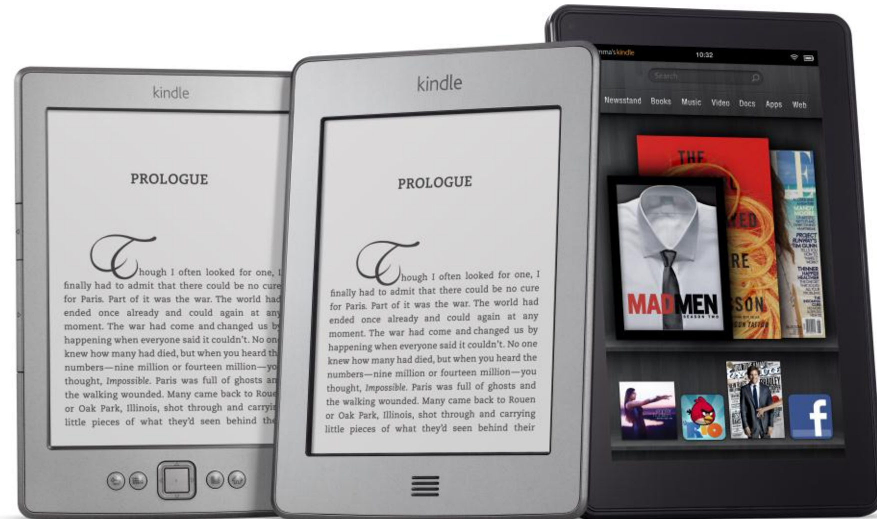
Source: Firms' Annual Reports

Exhibit 4: Amazon vs. Barnes & Noble vs. Apple Share evolution



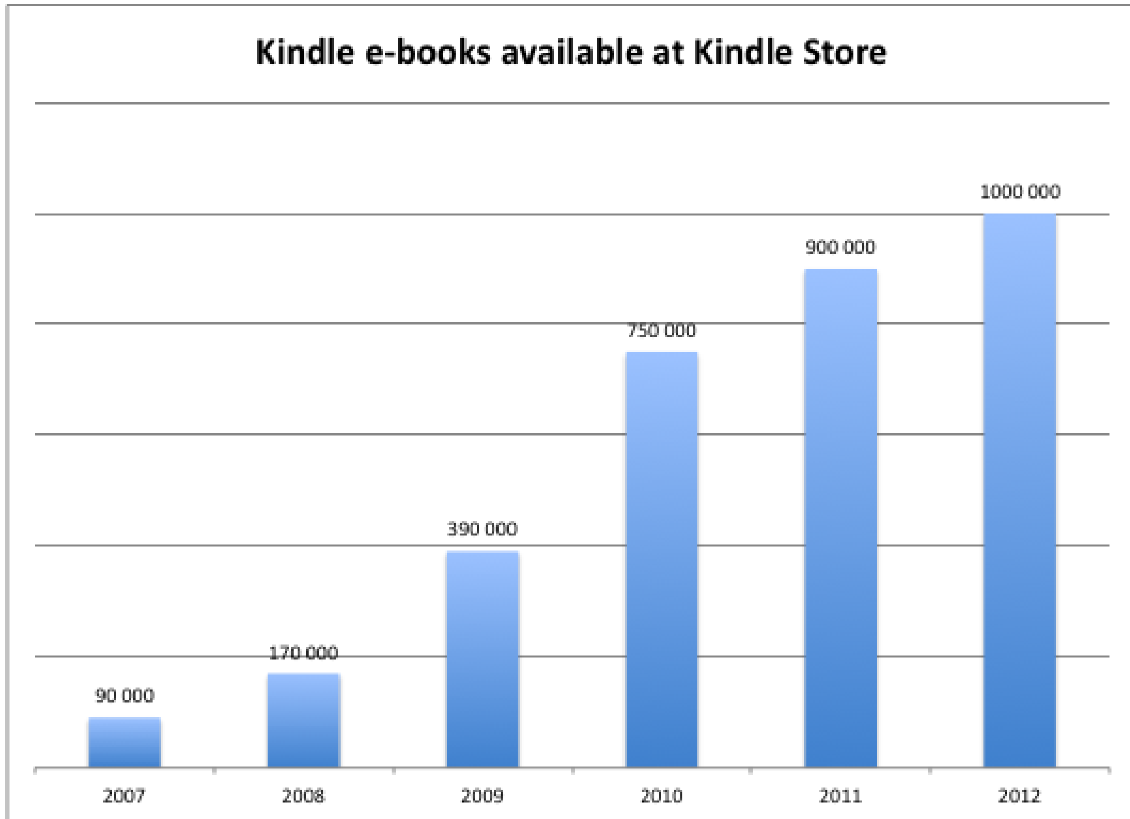
Source: Nasdaq.com

Exhibit 5: The current Kindle family



Source: Amazon.com

Exhibit 6: Kindle books availability



Teaching Notes

Teaching Case Synopsis

This teaching case is the story of Amazon.com and how it evolved to adapt to the digital world. The story begins with Jeff Bezos, how he sensed the market opportunity for an online bookstore when the Internet had only few millions of users annually and formed the idea of Amazon. We then enter the business creation process, how the entrepreneur operationalized his vision until 1995 when Amazon.com opened its virtual doors. Furthermore, the case oversees some events of Amazon's historic evolution that aim at preparing the student to analyze the case problem by giving insights about the firm culture and Jeff Bezos leadership style.

The major event the teaching case focus on is the development and launching of the Kindle, the e-reader, sold and manufactured by Amazon. By 1971, the first book was digitized. In 1998, was launched the first device aimed at reading e-books. In 2001, the iPod was commercialized triggering a revolution in consumer behavior. By 2004, people had massively adopted music and video downloads. Nevertheless e-books were still waiting for general acceptance by the public. Again the case follows the events that led Jeff Bezos to sensing a market opportunity, but this time the case explores the strategic and operational decisions implied by the transformation of his company to form the opportunity. The teaching case tracks the steps taken by Amazon to develop a customer friendly device and a business model that would enable the *"massification"* of digitized reading material and the public launch, in 2007, of the Kindle and the Kindle store.

The Kindle and its complementary business model were a commercial success. With the corporate decision of becoming an original equipment manufacturer and a new kind of publisher, not only did Amazon disrupt its own business but also an entire industry. The case analyzes the reactions of the stakeholders directly impacted by Amazon's decision.

The Kindle triggered the development of the digital book market. By 2011 this industry sales overcame $1 billion. While customers were massively adopting e-books, traditional bookstores, Amazon's competitors, were finding it hard to keep up with the

challenge. By 2012 some appear to be succeeding, others, failed completely. Finally, publishers, which benefited for cost reasons with the digitalization, were threatened by Amazon's increased power position, when they began noticing their own position becoming obsolete. The objective of the final part of the case is to assess how all these players involved evolved and responded to the market success of the first Kindle.

Teaching Purpose and intended contribution

By addressing all these points, the teaching case aims at understanding how Amazon.com was able to succeed in disrupting its own business.

This case is intended for Business Administration Master students that have a solid background in corporate strategy and want to develop their understanding of value creation in unknown and unknowable contexts. This is not a best practice case; it is a case about a unique strategy created for a specific company in a special context. For this reason, this case requires that students focus on contextual factors, the consequent business challenges, the strategic responses and, finally, their operational implementation. It is an exercise that will force students to focus on the details that enabled the constitution of a competitive edge.

The general questions that students need to ask themselves while studying this case are: Why can some firms anticipate and sense market evolutions while others don't? And what enables companies to reach out and shape those anticipated market evolutions into real market opportunities?

Instructor preparation

To help the preparation of Amazon.com case, I would advise the Instructor to use the following sources of information, additionally to the references of the teaching case, in order to enable a deeper understanding of the firm, the business context and the most recent challenges.

About Amazon.com:

After reading the teaching case the instructor may notice that Amazon.com is a very

complex company with a very large product portfolio. I recommend to assess the retailer US website and explore it. In my opinion, the most useful approach is to explore the Kindle store, the different Kindle devices available for sale, the accessories, and the content offer: the books, the newspapers, and the magazines. When exploring the website the instructor will observe that there has been an evolution in Amazon's offer: the Kindle owner's library. This library is available for Kindle users that have an Amazon Prime subscription allowing them to choose one out of a 100,000 Kindle e-books library per month with no due date[1]. It can also be interesting to explore the website of Kindle Direct Publishing: the platform that transformed Amazon in a publisher. It will enlighten the instructor about the easiness of becoming a Kindle author and about the revolutionary revenue model created by Amazon.

In my opinion, instructors may also gain by watching an interview with Jeff Bezos. As the founder leadership plays a central role in the development of the case, comprehending his fascinating personality might be easier by watching him in action. Instructors can watch the Charlie Rose interview, referenced in the teaching case, where Jeff Bezos talks about the first Kindle or for a less targeted content instructors can watch the graduation speech the founder gave at Princeton in 2010 about the difference between choices and gifts.

Finally, it might be also insightful to assess the Bloomberg.com website. On Amazon.com page the instructor can find the share fluctuation, the most significant financial indicators and the latest news about the company and the industry. As the market is very competitive and volatile, this latest feature offered by Bloomberg might be noteworthy for instructors and students that want to make a deeper analysis of the case.

About the e-book market:

Most of the published reports about the e-book market and its forecasted development are paid content. However, the instructor can find some interesting reports about the e-

[1] http://www.amazon.com/gp/feature.html/?docId=1000739811

book market from consulting companies for free. AT Kearney released two studies in 2010: “The E-Reader (R)Evolution” and “Do readers dream of electronic books”, while PwC released “Turning the page, the future of ebooks”. These three studies have the advantage of being complementary and consequently giving an extensive overview of the market. We should expect these companies to release updated versions of these reports in the short term.

About the most recent developments and challenges of industry:

As mentioned in the concluding paragraph of the teaching case, in the beginning of April 2012 several publishers and Apple have been accused by the US Justice Department to conspire to fix prices above the competitive level. I would advise instructors to follow the news on Bloomberg, Reuters and the Financial Times; it can also be interesting to follow the evolution of the share prices of the firms involved.

On April 26th 2012, Amazon reported its first quarter results. It announced that quarter sales increased 34% to $13.8 billion and about the latest Kindle developments Jeff Bezos stated “I’m excited to announce that we now have more than 130,000 new, in-copyright books that are exclusive to the Kindle Store – you won’t find them anywhere else. They include many of our top bestsellers – in fact, 16 of our top 100 bestselling titles are exclusive to our store. If you’re an Amazon Prime member, you don’t even need to buy these titles – you can borrow them for free – with no due dates – from our revolutionary Kindle Owners’ Lending Library. The Kindle Owners’ Lending Library is heavily used by Kindle owners, and it has extremely unusual features that both authors and customers love. Every time you borrow a book, the author gets paid – and we have an inexhaustible supply of each title so you never have to wait in a queue for the book you want. Kindle is the bestselling e-reader in the world by far, and I assure you we’ll keep working hard so that the Kindle Store remains yet another reason to buy a Kindle!” In TN Exhibit 1 the instructors can read excerpts of the Press Release.

And finally, on April 30th 2012, Barnes & Noble and Microsoft announced a joint venture to compete in the e-book market. Microsoft invested $300 million for a 17.6% stake in the un-named Barnes & Noble subsidiary that will house the recently span-off Nook and it will also pay the subsidiary $180 million related to revenue sharing on the

"to-be-created" by Barnes & Noble Nook app for the Windows 8 platform. In TN Exhibit 2 the instructors can read the article released by the technology blog TechCrunch.com.

Teaching Plan

The Amazon teaching case is designed for a 90 minutes class, where the instructor should dedicate 45 minutes to the analysis of the case and 45 minutes to the answers of the suggested questions referred in the next chapter. It is suggested that the students should read the case and prepare the questions previously to the class.

The table below gives a possible division of the teaching case in five main parts. This is a suggested structure that the instructor can follow to prepare the case analysis for class. Each suggested main part has a teaching purpose and should allow the students to a certain number of lessons learned.

Main Part	Dedicated Time	Teaching Purpose
I. The creation of Amazon	5'	• Contextualize the students – Get to know the business, the firm, and the main character of the teaching case. • Understand that there has been a pattern of evolution of the business into new sectors and new customers.
II. The e-book market and the idea of an Amazon's e-reader	10'	• Recognize that there has been several exogenous shocks. • Determine the factors that lead to the opportunity formation.
III. The development of the e-reader business model	15'	• Apprehend the various steps of the development of the device and the necessity of developing a business model in order to prepare the market. • Understand the disruptiveness of the concept to the industry players.
IV. The market development of the	10'	• Determine the level of success of Amazon's decision. • Understand that the Kindle and its complementary business model weren't a

Main Part	Dedicated Time	Teaching Purpose
Kindle		just "luck" or "one-shot" decision - it was about the future sustainability of the company.
V. The competition	15'	• Compare Amazon's market performance with competitors'. • Demonstrate that the Kindle was not an obvious decision. • Understand the reach of Amazon's success.

Suggested assignment questions

1. **In your opinion what were the main factors that influenced Amazon in its decision to develop an e-reader? Were they mainly exogenous factors, market factors or internal factors?**

The main factors influencing the creation of Lab126 and the consequent Kindle development were exogenous to Amazon. By 2004 there were confluences of several exogenous shocks that had happened and were changing the marketplace where Amazon operated.

In 1971, Michael Hart, a college student at the University of Illinois, created the first e-book by typing the Declaration of Independence into a computer. However, it was not until the mid-1990s that the book industry began to change with digital content slowly proliferating. In 1998, the first e-book reader, the Rocket Ebook, was launched by a Palo Alto start-up NuvoMedia. And, the first publisher to commercialize digital books was Simon & Schuster in 1999. However the efforts to digitize the industry were not being translated into commercial success mainly because the market was not ready. The devices developed lacked consumer *"friendliness"* and readers had troubles to find and buy content because digitized content and Internet users were still rare.

Moreover, at the same time that the book industry was dealing with slow technological changes, the music industry was observing radical ones. In 1987 The Fraunhofer Institut

in Germany initiated a research code-named EUREKA project EU147 Digital Audio Broadcast with the goal of developing high quality, low bit-rate audio coding. In 1989, from this project, was born a new technology called MP3 that stands for Music Pictures Expert Group Audio Layer III, which enables audio compression with little or no sound quality loss. This patented file format eventually became the standard file for music compression.[2] By the mid-1990s it became clear that digital music downloads, based on MP3 technology, were going to replace CDs. Nevertheless there were not suitable devices to read those MP3 files. The commercialized devices were too big or had not enough memory space and they were very slow transferring files from the computer. So, by 2001 Apple solved this problem with the iPod launch, a small mp3 reader device with a FireWire interface for fast transfers, and a small 1.8-inch 5GB hard drive from Toshiba. It was an amazing commercial success selling 10 million units in just four years. The Apple device, thanks to its technological advances, triggered the general acceptance of music downloads over the World Wide Web and it killed the CDs as well as the Discmans. Therefore, because of the iPod, consumers became much more aware and open to adopt digital content, they were now used to downloads and transfers from the computer to other devices.

The technological and the consumer behavior shocks observed on the music industry had a direct impact on the entire content industry by changing the way people could and wanted to consume content. Moreover, they were driving away Amazon's business. The products Amazon was selling were mainly traditional books, CDs and DVDs and consumers were now downloading movies and songs illegally or, when they were paying, essentially from one online store: the iTunes Apple store.

These were the main reasons that influenced the decision of Amazon to develop a device and a complementary business model for e-books.

2. How important was Jeff Bezos' leadership in the Kindle development?

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[2] http://inventors.about.com/od/mstartinventions/a/MPThree.htm

In every Amazon Annual Report, in the list of the firm risk factors there has always been, since 1997, one item stating that: *"The Loss of Key Senior Management Personnel Could Negatively Affect Our Business: We depend on our senior management and other key personnel, particularly Jeffrey P. Bezos, our President, CEO, and Chairman. We do not have "key person" life insurance policies. The loss of any of our executive officers or other key employees could harm our business."* The company has always admitted Jeff Bezos' key role as an essential resource for the creation of its competitive advantage.

In the case of the first Kindle launch Jeff Bezos was the central character. He did not invent digital books or e-book readers; they already existed for a long time. The first digital book appeared in 1971, with Michael Hart's Gutenberg Project. In 1998, the first e-book reader, the Rocket Ebook, was launched by a Palo Alto start-up NuvoMedia. And, the first publisher to commercialize digital books was Simon & Schuster in 1999. Therefore by 2004, when Amazon decided to begin developing the Kindle the concepts and the products already existed but readers were not adopting them.

So, even though Jeff Bezos did not invent the concepts he was startled by the fact that people did not adhere to digital books. If they massively adopted iPods and Internet news reading, why would they still hang to books printed on "dead trees"? Jeff Bezos played the role of questioning the *status quo* and not just accepting that books would forever be the "last bastion of analog" as most people believed at that time.

Even more important than inventing something is to develop the idea into something that can be commercialized and would be accepted and adopted by consumers. In Thomas Edison words: "Innovation is 1% inspiration and 99% perspiration." Jeff Bezos excelled at the "perspiration" phase. He created the Lab126 and formed a team of the best engineers and industrial designers in the field to work uniquely on creating a reading device. Nevertheless he did not let the team work without guidance. The founder understood the importance of the project for the continuity and sustainability of Amazon and he had in memory the errors made in the music and Media industry and the growing power of Apple. So he got involved, he participated in the team meetings, he obliged the team to do long lasting research and testing and most importantly he

invested heavily by giving Lab126 almost unlimited resources for the development of the project.

Thanks to this cash flows release it was possible to enlarge the project reach. So, the output delivered by the Lab126 was not only a piece of hardware but a complete digital books business model that should enable what couldn't be achieved to date, the general acceptance of digital books and a competitive option against Apple iTunes store.

Therefore, Jeff Bezos leadership was key in the Kindle development, because he was able to look at the macro environment and question a situation that was taken for granted and, moreover, because he took action on it and had the courage to get involved and to invest on a technology everyone in the sector had already abandoned. Therefore, Amazon could, in 2007, reach the market with a well-rounded product and complementary business model. The Kindle can be considered the first real innovation in the digital book market because it became a commercial success.

3. **In light of the definition of Dynamic Capabilities by Barreto (2010), do you believe that there are evidences in the case supporting the existence of the four dimensions of that multidimensional construct?**

D1 – Propensity to sense opportunities:

When Amazon decided to develop the Kindle and by the time they finally launched it, many questioned the wisdom of such decision. First because the printed books were "*doing their job*" quite well and second because others had already tried it and failed. For most people, it was enough evidences to prove that digital books could never become more than a niche market for a micro targeted customer segments. Barnes & Noble, the first bookseller to invest on e-books with the acquisition of Ingram's Group, was forced to discontinue its strategy, due to lack of results, in 2003. However, Jeff Bezos was not convinced that books printed on "dead trees" were the last step on book technological evolution. In 2004, where no one saw hope for a future Jeff Bezos saw a possible, very meaningful, market. In his own words: "there are a lot of people who read. Is there the potential to make that a meaningful business? I believe there is. The onus is on us to continue to execute well." Executing well meant giving customers what

they wanted and needed. And that was something that no other player had been able to achieve.

The opportunity Amazon sensed was that there was a white space in the market. No one was ever able to offer a device that would be as good at performing the book function as a printed book; that was the Lab126's challenge. Amazon, once again in its history, demonstrated the ability to sense an opportunity better than any potential rival; even though this opportunity meant cannibalizing its own current and very profitable business.

D2 - Propensity to make timely decisions:

The timing of Amazon entrance in the e-book market was perfect compared with the others players in the market.

The company made the first steps in the e-book through a joint venture with Microsoft in August 2000. At that time Microsoft had just developed the software for e-book reading in PCs and PDAs and Amazon was the partner that sold the e-books. This means that on late 2000 Amazon was already aware of digital books, but it took seven years to the company to reach the market with a complete offer. First it took the company four years for the company to take the decision of start developing a device. And then it took the firm three additional years to develop it.

Only in September 2004 Amazon decided that there was an opportunity for them to become an Original Equipment Manufacturer. Jeff Bezos had the first hint, observing the market development and the increasing acceptance of the digital by consumers especially in the music industry with the iPod and the Media sector becoming ever more digitized with the growing power of Apple iTunes store. But, only after he decided to create Lab126 did they pursue a market research that lead to the conclusion that the e-readers devices on the market had not the commercial potential of becoming the printed book substitute.

The development of the device was very long because it depended on several new technologies that were not yet completely developed in 2004: the e-ink and the EV-DO that enabled the device to be self-contained. Then what postponed the launching of the

device was also the need to prepare the market to the commercialization of the e-book readers: there was not enough content available to be enjoyed on the Kindle and even the content available was not easy to find and purchase so Amazon had find ways to increase content availability. The Kindle was only launched on November 2007.

Though, Amazon's CEO was not worried about the long time they took to reach the market, he said that he knew that nobody was thinking or working on the issue the way they were. Jeff Bezos was aware that it could be very damaging for the future sustainability of Amazon to reach the market with an incomplete product or before consumers were ready to adopt it. These were the main mistakes Amazon's rivals had done. Perfect timing was one key of Kindle's success.

D3 – Propensity to make market oriented decisions:

This is the propensity that may be seen as one of the highest. For Jeff Bezos Amazon's business has always been about creating the most value for the consumer as possible – he likes to describe Amazon as a consumer-centric company; he stated it in his 1997 letter to the shareholders that he reprints in every Annual Report since.

When developing the Kindle he knew that he could not make the same mistakes Sony and Palo Alto start-ups had made with their e-readers. These players had not been able to develop a product that would deliver more value to the customer than the book itself and as such, not only did their products not sell, but they shaped consumers' preferences to become averse to the idea of digital books. So Jeff Bezos knew that developing an e-reader would be a double challenge; it should not only be as good as a printed book, but also allow readers to do things that they could not do with traditional books.

First, Jeff Bezos concentrated on not doing the same technological mistakes his competitors had done: an e-reader needed to be perfectly suitable for long reading – this meant that it should have an ergonomic design and a special screen that would not hurt the eyes independently of how long the consumer was reading or where he was reading. So Lab126 studied deeply how readers used to hold books in order to design a device that could be held just like a book and that was less heavy than an average paperback edition. They also made a screen using e-ink technology, with no backlight, which made

it as readable as an ordinary paper, with no eyestrain and no glare. The device had a rechargeable battery that lasted one week (unlike Sony's e-reader that worked on AAA batteries) and it could hold up to 200 books (a lot more than the ten e-books Rocket eBook could store). Though the most important technological feature, in Jeff Bezos' opinion, was that the Kindle worked as a self-contained unit, it didn't need cables to tether to computers. Lab126 developed *Amazon Whispernet* a wireless delivery system built on top of Sprint's EV-DO network as the most advanced cellphones to date, so readers could download content wirelessly without the need of syncing it to a PC or a Wi-Fi hot spot. This meant that the device had free 3G incorporated and that an e-book bought would be in the device in less than 60 seconds, a lot less than the 5 minutes to 3 hours Rocket eBook readers had to wait for their books. Finally, the device also allowed storing and reading of personal files in multiple formats that one could send through a Kindle e-mail address. In terms of technical features, these were the ones Jeff Bezos believed were essential for the device to be as customer friendly as a printed book and to "disappear" from the readers' hands.

After overcoming the technological mistakes made by other rivals, the team had to overcome two other mistakes in order to create value for customers: pricing and content. Jeff Bezos believed the e-readers were too expensive; Rocket eBook was sold $500 and e-books for the device ranged from $5 to $25. It was too costly compared to the consumer value it was creating. The Kindle was launched at $399 including a 3G free data plan that was worth $60 monthly and Jeff Bezos did not rest until he was able to reach the "magical two digit price" point for the Kindle device, something that he finally achieved on September 2011 with the Kindle Touch generation. Then he also made a point of selling the Kindle books with a price cap of $9.99 because for him it didn't make sense to charge more due to the inexistence of marginal costs and the DRM policy.

Finally, content was one of the most complex challenges to overcome. There was not enough content digitized and the books everyone was reading, the bestsellers, were not available. That was an issue that could very fast drive the consumers' mental valuation of the Kindle to a very low level. Of what use could be a greatly designed device if there was nothing of readers would want to read on it? So Jeff Bezos developed the

Kindle Store, a Kindle specialized store with multiple types of content for the e-reader with things people wanted to read. At the launching the Kindle store gave access 90,000 e-books, including 101 out of 112 of New York Times bestsellers, to newspapers and magazines (like the Times, The Wall Street Journal, The Washington Post, Le Monde or Time, Fortune and Newsweek). Monthly newspaper subscriptions ranged from $5.99 to $14.99 per month, and magazines monthly fees ranged from $1.25 to $3.49 in addition all magazines and newspapers included a free two-week trial. And last but not least readers could also buy unlimited access to more than 300 blogs for a monthly fee of $0,99.

Investing on these three key pillars: technology, price and content, Amazon showed that it was able to generate a product and a business model entirely consumer focused that could maximize the readers' mental valuation of the Kindle.

D4 – Propensity to change its resources:

With the Kindle business Amazon had to become an original equipment manufacturer. And, it was a substantial challenge. In the quest for the technologies and resources to build the device there were several setbacks. The e-ink technology was so newly developed that there were still flaws and the displays that seemed perfectly good at first would, after just one month of usage, degrade completely. The wireless chips supplier, Qualcomm Inc. was sued by its competitor and was mandated by judicial order to not sell during months. Lastly, Amazon modeled the Kindle demand based on the first-year sales of the iPod and it turned out extremely low compared to real sales. The Kindle sold out in few hours and as Amazon struggled to serve backorders it discovered that one of its Taiwanese providers had discontinued a crucial part of the device and it spent months getting a replacement.[3]

Nonetheless, an even bigger challenge than becoming an original equipment manufacturer and having to find resources to build the actual Kindle device was the

[3] http://www.bloomberg.com/news/print/2011-09-28/bezos-portrays-pocket-sized-fire-as-service-not-tablet-in-ipad-challenge.html

challenge of developing content for it. Jeff Bezos and his team were aware that at the time no one in the industry was offering digital book content that would be enough for the Kindle to become valuable for consumers. So they had no option but to find a way to create a consistent “digital bookstore”. This objective obliged Amazon to enter a completely new world: the online bookstore that was used to have suppliers of printed books had now to find suppliers of digital content knowing that the industry believed the e-readers were dead even before they existed.

Amazon started discussions with publishers and it took a long time before they were able to convince them to get on board. The problem was that embracing digitation required an initial investment of around $200 per book, which was a real “chokepoint” for publishers even though they could expect future returns in terms of manufacturing and holding costs. The second chokepoint was Amazon pricing strategy; for Jeff Bezos digital books were not worth more than $9.99. The issue was that publishers had historically always determined the book prices and retailers had always been price takers. With the Kindle, Amazon was changing the industry rules and publishers were not ready to accept it easily.

After the Kindle release had been postponed several times because of publishers’ issues Jeff Bezos understood that he had to find a solution to source for content without depending on publishers. The first idea was to enable the Kindle to read already digitized content like newspapers, magazines and blogs. The second idea was for Amazon to become a publisher itself. With the Kindle Digital Text Platform, authors could directly publish their texts in Kindle format. This platform was a long-term strategy but enabled Amazon to depend less on the publishers. And, by 2011, this strategy was already giving showing results: the #1 and the #4 best-selling Kindle books were Darcie Chan’s ‘The Mill River Recluse’ and Chris Culver’s ‘The Abbey’ both published independently using Kindle Direct Publishing.

<u>Summary:</u>

Dimension	Level
D1 – Propensity to sense opportunities	High
D2 - Propensity to make timely decisions	High
D3 – Propensity to make market oriented decisions	High
D4 – Propensity to change its resources	High
Overall Level of Dynamic Capabilities	**High**

Teaching Notes Exhibits

TN Exhibit1:

AMAZON.COM ANNOUNCES FIRST QUARTER SALES UP 34% TO $13.18 BILLION; 16 OF THE TOP 100 BESTSELLING TITLES ARE EXCLUSIVE TO THE KINDLE STORE

SEATTLE--(BUSINESS WIRE)--Apr. 26, 2012-- Amazon.com, Inc. (NASDAQ:AMZN) today announced financial results for its first quarter ended March 31, 2012.

Net sales increased 34% to $13.18 billion in the first quarter, compared with $9.86 billion in first quarter 2011. Excluding the $56 million unfavorable impact from year-over-year changes in foreign exchange rates throughout the quarter, net sales would have grown 34% compared with first quarter 2011.

Operating income was $192 million in the first quarter, compared with $322 million in first quarter 2011. The unfavorable impact from year-over-year changes in foreign exchange rates throughout the quarter on operating income was $4 million.

Net income decreased 35% to $130 million in the first quarter, or $0.28 per diluted share, compared with net income of $201 million, or $0.44 per diluted share, in first quarter 2011.

"I'm excited to announce that we now have more than 130,000 new, in-copyright books that are exclusive to the Kindle Store – you won't find them anywhere else. They include many of our top bestsellers – in fact, 16 of our top 100 bestselling titles are exclusive to our store," said Jeff Bezos, founder and CEO of Amazon.com. "If you're an Amazon Prime member, you don't even need to buy these titles – you can borrow them for free – with no due dates – from our revolutionary Kindle Owners' Lending Library. The Kindle Owners' Lending Library is heavily used by Kindle owners, and it has extremely unusual features that both authors and customers love. Every time you borrow a book, the author gets paid – and we have an inexhaustible supply of each title so you never have to wait in a queue for the book you want. Kindle is the bestselling e-reader in the world by far, and I assure you we'll keep working hard so that the Kindle Store remains yet another reason to buy a Kindle!"

Highlights

- Kindle Fire remains the #1 bestselling, most gifted, and most wished for product across the millions of items available on Amazon.com since launch. In the first quarter, 9 out of 10 of the top sellers on Amazon.com were digital products – Kindle, Kindle books, movies, music and apps.

- Amazon launched Kindle Touch Wi-Fi and Kindle Touch 3G on Amazon.co.uk, Amazon.de, Amazon.fr, Amazon.it, and Amazon.es. The full line of Kindle e-ink readers is now available in over 175 countries around the world. Kindle Touch 3G is the most full-featured e-reader with an easy to use touchscreen and the unparalleled convenience of free 3G – no hunting for Wi-Fi spots, simply think of a book and download it. Kindle remains the bestseller on Amazon.co.uk, Amazon.de, Amazon.fr, Amazon.it and Amazon.es since their launches.

Amazon introduced a new version of its popular Kindle for iPad app, which is the #5 free iPad app of all time and the #1 free books app on iPad. Millions of customers are using the new Kindle for iPad app, which is optimized for the high resolution display of the newest iPad.

(Source: Excerpt from Press Release Apr. 26, 2012 - http://phx.corporate-ir.net/phoenix.zhtml?c=176060&p=irol-newsArticle_pf&ID=1688177&highlight=)

TN Exhibit 2:

B&N 8-K: Microsoft Paying $180M Advance On Nook For Windows 8, $125M For Content, Tech Acquisition

Microsoft really wants to make sure it can compete against Amazon and Apple in the e-books space — and it's putting its money where its mouth is. In addition to the $300 million Microsoft is investing for a 17.6 percent stake in Newco, the un-named subsidiary that will now house B&N's Nook and other digital businesses, it looks like it is putting othermoney towards the venture, according to the 8-Kform filed by Barnes & Noble earlier today.

A section called "Commercial Agreement" notes that Microsoft will be paying the Barnes & Noble subsidiary $180 million in connection with revenue sharing on the Nook app that B&N will make for the Windows 8 platform. This is nonrefundable, the filing notes. Microsoft is also paying $125 million (equal to $25 million over five years) "for purposes of assisting NewCo in acquiring local digital reading content and technology development." This, too, looks to be nonrefundable.

The 8-K form appears to note that this is on top of the $300 million investment, and it will only become effective once the investment deal is closed. It also notes that it can only be terminated by Microsoft in case of bankruptcy or insolvency of Newco; a material default at Newco; or by Newco for a similar material default by Microsoft. The exact terms of the revenue share are not included in the filing.

The 8-K form was filed after the two companies came together for a joint call with analysts. That, too, gave a little more insight into what the deal will entail.

Andy Lees, president of Microsoft, is leading on the deal for his team, and he made it clear that while today there was no news on devices or any "product roadmap," this was about more than just a book app for Microsoft's next OS: "The option here is to define the future of reading," he said. "We're more than just the platform provider." His take today was to turn that into a wider conversation about experience and discovery, but what people really want to know was whether that means a Windows Nook.

Today, no direct answer on that but no denial, either. "We've been working with hardware manufacturers to provide [the minimum requirements]" for them to make Windows 8 tablets with the lowest-costing processors and other equipment, he said. He also claimed that Microsoft has "not yet done teardown of the Nook," to determine whether it would run Windows 8 as it is today.

Similar to the lack of specifics on hardware there was also little detail from the B&N end on Windows 8, but again no flat-denial: "We have no plans to sell Windows software right now…but this partnership opens up a whole host of opportunities going forward," noted B&N's CEO William Lynch.

And while B&N has taken only small steps in looking at how it would roll out a Nook in Europe, today B&N's Lynch made a much more forward commitment to the idea: "We think the opportunity is through this partnership internationally," he said in answer to a question of whether it was more of a domestic or international play. This will also throw into question whether B&N is going, after all, to do anything with Waterstones in the UK, as many have thought it would.

Another thing that didn't come up much in today's call: Android. "Microsoft is the ideal partner for the Nook," noted Lynch. "Few companies own more screens than Microsoft." So it's clear that B&N can use Microsoft's platform as an outbound route to getting more traction on its Nook platform. The question is whether Microsoft can use Nook's platform to its own advantage.

That's a question that some have already started to weigh up:

"My 1st reaction: MS just invested $300M in further insuring Android fragmentation. B&N will now have resources to eat with a fork," quipped Charlie Kindel, the ex-Windows Phone boss who is now an angel investor and entrepreneur.

That wasn't his only thought. The other underscores a challenge Microsoft has to try to make this work when its other attempts have gone nowhere: "Today, I feel for the members of the old Microsoft Reader team (and Bill Hill). So typical of MS to ignore its visionaries," he noted, referring to the exec who left Microsoft in 2009 — ironically before Amazon launched its first Kindle e-reader.

(Source: http://techcrunch.com/2012/04/30/bn-8-k-microsoft-paying-180m-advance-on-nook-for-windows-8-125m-for-content-tech-acquisition/)

Discussion

The Amazon teaching case is meant to be illustrative of the Dynamic Capabilities concept.

In the beginning of the 21st century and the beginning of the so-called digital revolution, Amazon.com, that had just proved to Wall Street to be a "survivor" (as one of the few Web companies escaping the Dot-com bubble popping), had in hands a new challenge: to survive in the digital Era.

Amazon's strategic capabilities and resources were designed to create value in the business of selling traditional books, CDs and DVDs online. And they were doing it amazingly well; their sales curve was showing signs of exponential growth while traditional bookstores sales were almost stagnate. Amazon was actually doing everything right. However, with the digital revolution and the emergence of Apple's iTunes Store, Amazon business was doomed to fail. In the digital content world, Amazon's current capabilities and resources were of no use – relationships with book distributors, giant warehouses for product storage, effective and cheap shipping methods, etc. In 2004 Amazon was under pressure with its competitive advantage endangered by "creative destruction" threat.

When in 2004, Amazon.com decided to pursue a digital book strategy with the creation of the Kindle and the associated Kindle store – it was, at the same time, a decision to compete head-to-head with Apple's iTunes store. This strategic choice was the complete opposite of what a traditional "strategized" analysis would advise. At that time, if Amazon had relied on that kind of evaluation of the marketplace, it probably would have done nothing but try to improve efficiency. This kind of "strategizing" would have lead Amazon to underinvest in its core competences and would have most probably harmed its long-term competitiveness (Teece et al., 1997). Even though Amazon had a clearly dominant position in the industry and seemingly nothing to worry; it was growing way ahead of competition, both in sales as in net earnings, there was no threat of new entrants and e-book sales were almost non-existent in 2004 making the perceived threat of substitutes very low. "Strategizing" was not an option for executives at Amazon and they demonstrated that they could go beyond the

traditional elements of business success (Teece, 2007). It was at that point in their history that Amazon showed the ability to use Dynamic Capabilities as described by Barreto (2010).

Amazon demonstrated a high propensity to sense opportunities, being able to sense an opportunity in a white space the other players on the industry had already abandoned. Then it was able to act on the opportunity (Eisenhardt and Martin, 2000), showing a high level of propensity to make timely decisions and an extremely high propensity to make market oriented decisions. Amazon used the cash flow generated by the traditional business to invest in the Kindle, without any kind of restrictions. On the one hand, this substantial investment on the project proved how essential this was for the sustainability of the firm and enabled the development of a really consumer oriented product. On the other hand, it had the twisted consequence of increasing the timings of the decisions and the length of the project development. Yet, in spite of the slow progress, Amazon launched the Kindle device and the Kindle Store before any other player could think or commercialize something similar. Finally, considering the propensity to change its resources, Amazon attested to be extremely resourceful considering rethinking its procurement chain. The Kindle business meant that many of Amazon's current resources were useless and the retailer was able not only to transform itself on a Original Equipment Manufacturer and convince some of its suppliers to disrupt their own businesses in order to provide Amazon with digitized content but it also was able to think outside-the-box for the long term with the creation of the Kindle Digital Text platform, with the expectation of becoming less dependent on the publishers.

By performing well on the four dimensions that compose the aggregate multidimensional construct, Amazon was able to solve the problem it had in hands. The Kindle and the Kindle Store were a commercial success. With the new business Amazon was able to enter the digital content market, to develop consumer acceptance of e-books, and, in consequence, to build one all-new market, and preclude the giant Apple from becoming a larger competitor.

The story of Amazon is an evidence of the real-life applicability of the concept of Dynamic Capabilities. It illustrates how important it is for managers to invest in

developing the four dimensions that constitute the Dynamic Capabilities in order to be able to develop a systematic potential to solve problems. With Amazon we learned that it is important to be sensible to the market but not just the micro market; managers need to understand the macro market in order to survive. Changes and shocks that seem out of the perimeter of the company might impact the business harshly. Managers need to be aware and they need to develop capabilities and processes that will help them scan the market environment using multiple perspectives in order to enable them to sense and foresee probable market evolutions and question the status quo.

With Amazon we also learn a second lesson: it is not enough to sense a market development. What is crucial is to act on those market evolutions, shaping them, trying to transform them on possible opportunities. Amazon case showed us also that, during this process of shaping the market to form an opportunity, being very fast to reach the market is not the most important factor. What is essential is to reach the market with a product or service that is suited to what consumers expect, position it differently from competition and get to the market on the opportunity window. This means that it is not about being the first and deciding fast. The important point is to take action on the right time, not rush into the market with a not that good product or service just to be the first. The development of the value for the customer is at least as important as the time-to-market in a new product development.

Finally, we learned with Amazon how important it is for managers to have the ability of changing resources. To be able to accept that some current resources are, or will be in the near future, irrelevant for the competitive advantage creation is the first step. The second step is to redefine what will be the resources that will create competitive advantage on the new business. Lastly, the third step involves the ability to rethink the supply chain creatively, trying to redefine the power positions among its players. In a changing market the bargaining power between players can also change, depending on how managers will redefine them. Finding solutions where the firm is in a privileged position is possible, although it may involve the ability of investing and thinking in the long-term.

The most relevant lesson we can take away from the Amazon teaching case is that firms should weigh trade-offs on the long-term. Managers need to have the ability to foresee

market changes and act on them according to the four dimensions of the Dynamic Capabilities, even if it means disrupting their own business, because future sustainability depends on it. In a world of constant change, just wait and do "all the (old) right things" is not enough anymore.

Conclusion

In sum, with this thesis I intended to bring evidence of real-life applicability of the novel concept of Dynamic Capabilities. My analysis of Amazon suggests that the firm has showed high levels in every main dimensions of Dynamic Capabilities throughout the development of the Kindle: the online retailer demonstrated the propensity to monitor opportunities and threats in its market environment, the propensity to make timely and market-oriented decisions, and the propensity to rethink and actually change its resource base. Furthermore, the teaching case also evidenced how successful the Kindle has been and how increasingly essential that business segment became to Amazon global competitiveness and performance. Those facts bring substantiation to the belief that Dynamic Capabilities are a practical tool that can empower business managers to systematically solve problems and thus build successive temporary competitive advantages that can be translated into superior market performance and profitability in a volatile business environment.

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