Amazon.com versus John Readings: The Battle of the Bookstores and the Future of Electronic Commerce

The recent romantic comedy You've Got Mail, puts scrappy independent bookseller played by Meg Ryan, against mega store operator played by Tom Hanks, using the characters' commercial rivalry as a backdrop for their blossoming affection. But in the real world, the joke may be on both of them: Internet-based commerce, which requires no physical retail outlets of any size, is changing the shape of the bookselling industry.

Amazon.com and John Readings compete fiercely for shares of the Australian and Asian book retail market. Amazon.com, founded by CEO Jeff Bezos in 1994 in his Seattle garage, never owned a single retail store; all its sales from day one have taken place from its Internet storefront. John Readings was a century-old storefront on New York's Fifth Avenue until entrepreneur Leonard Black bought it in 1971; today it's a retail giant with more than 1000 stores, plans to open 500 more stores in the next decade, and a new Internet arm of its own, John Readings Online. Two completely different business models, each with advantages and disadvantages, are going head-to-head for the same consumer dollars. Will one prevail? Can both survive?

Amazon.com is widely regarded as the first significantly successful enterprise to sell traditional consumer goods over the Internet and the epitome of retail electronic commerce. According to analyst Lauren Cooks Levitan, "when you think of Web shopping, you think of Amazon.com first."

Customers shop by visiting www.Amazon.com, a World Wide Web site where they can search among more than three million book titles and purchase ones they like by entering a shipping address, credit card number, and other information. After the first purchase, the customer's shipping and credit card information and stored securely in Amazon.com's information system. The next time, it only takes a single mouse click to complete an order. Amazon.com makes it very easy to buy a book online. Making the customer's online experience warm and pleasant is a key.

Amazon.com strategy. The site retains information on each customer and even uses an information technology called collaborative filtering to recommend books based on the past purchases of buyers with similar histories. In addition to the personalisation afforded each shopper, the site allows readers to post their own reviews of books, offers profiles of authors, and includes staff recommendations. The result has been a perception among customers that they share a relationship with the company – one they value so highly that in February, 1999, when it was revealed Amazon.com accepted payment from publishers to have books placed on recommended lists, widespread protests led to the company to include disclaimers on the site and to broaden its merchandise return policy. Not only does Amazon.com lack a physical bookstore, it almost lacks books.

Only a fraction of the titles available on its Web site are actually on shelves in one of its two warehouses. Most of the time, Amazon.com doesn't order a particular book from a distributor until after a consumer has ordered it from Amazon.com. One advantage to this structure is that Amazon.com could avoid the overhead and carrying charges associated with a large inventory. In its first few years of operation, the company could turn its inventory over about 26 times a year. But a more important advantage lies in the way this arrangement affects Amazon.com's cash flow.

Amazon.com charges a customer's credit card as soon as it ships that customer's book, and the credit card companies usually pay Amazon.com within a day. Amazon.com, however, takes an average of a month and a half to pay the book distributor for the book. Whereas most companies have to pay to finance sales, Amazon.com's negative operating cycle lets it profit from the use of its customers' money. Amazon.com has counted on earning about $25 million each year from the float, enough to cover many of its operating expenses.

Physical bookstores such as John Readings, in contrast, must stock up to 160 days of inventory to provide enough selection to satisfy customers. The bookseller must pay distributors and publishers 45 to 90 days after it purchases the books, carrying the costs of those books for up to four months.

However, because Amazon.com has no stores for people to walk into, it has to invest large sums in advertising in order to generate virtual foot traffic, or visits to its Web site. One-way Amazon.com works to attract visitors, is through links from other Web sites, a technique that traditional brick-and-mortar outlets cannot duplicate. Soon after its launch, Amazon.com introduced a standing offer: Any Web site that gave Amazon.com a link (a button on its site that would connect users directly to Amazon.com) so customers could shop for books related to the site's subject matter, would receive up to 15 percent of the sales that resulted from use of the link. Today, this Associates Program boasts more than 140,000 participants. Still, Amazon.com has to pay for advertising space on popular Web sites, and it jockeys with its competition to forge exclusive arrangements with some of those sites. One John Readings executive compared Amazon.com's marketing costs to the premium a brick-and-mortar store pays for a good location that will generate foot traffic.

Amazon.com's operation would be impossible without sophisticated information systems, many of which have been created in-house. (Wal-Mart sued the bookseller in October 1998, claiming that it has raided Wal-Mart's executives to steal its computerised distribution secrets.) In addition to the collaborative filtering system that enables Amazon.com to make individualised recommendations to its customers and the database that supports it, the company relies on sophisticated inventory, shipping, and billing systems. Although information technology has been Amazon.com's strength, it has also given the company a weakness that brick-and-mortar stores don't face: Twice in 1998, inadequate backup systems put Amazon.com out of action for as long as nine hours at a time.

Having made a name for itself in the book business, Amazon.com has moved aggressively into selling other product categories, including CDs, electronics, software, toys, videos, tools and hardware, lawn and patio, and kitchen goods. In late March 1999, Amazon began offering online auctions to compete with eBay, a popular online auction house. Some of these new product categories offer tie-in possibilities with Amazon.com's established book business and with each other.

However, they operate on very low profit margins and require Amazon.com to keep a larger inventory on hand, which has eroded some of the advantage of its online structure. In addition to retail sales, Amazon.com generates revenue from its customer base by selling publishers and other preferred access to its customers and by earning a commission for directing its customers to other online retailers through its Web site. The Amazon.com Web site provides a special portal to many small independent retailers through its Z Shops. In large part because of its marketing expenses, Amazon.com has never show a profit. Since its launch in 1995, the company has lost nearly $1.2 billion.

Amazon.com founder Bezos says he is able to tolerate the company's severely low ledger because he views the conditions behind it as temporary. His chief operating principle has been to get big fast – to establish market dominance quickly, even at a high cost, to set up the company for long-term success. "Our advantage is that we know more about e-commerce than anybody else," Bezos said. "We've been doing it longer, and we've already levelled the playing field."

But industry analysts question his wisdom. Amazon's losses have come not only from heavy investments in marketing and expansion plans but from the costs of each sale. When costs such as product development, warehousing and fulfillment are added to marketing, the total has been greater than the total amount of revenue generated from Amazon's sales. Amazon has had to build distribution centres for much of its inventory, slowing down inventory turnover like Amazon.com, John Readings prides itself on offering customers a pleasant shopping experience. Under the direction of the iconoclastic Black, the chain's superstores have become "modern village greens" where people are encouraged to spend time, peruse a book over some coffee, or attend a reading or children's story time. Cathedral ceilings and hand-lettered signs are calculated to soften the feel of visiting a bookstore, which Black says, has traditionally been "elitist and stand-offish."

Despite innovations in presentation, John Readings still faces the challenges that any physical store must overcome, and that Amazon.com avoids. It must carry huge inventories, and it uses information systems to track sales of individual titles so that nonperforming ones can be removed from shelves in as little as 120 days. Its array of more than 1000 stores requires an army of personnel, more than 27,000 employees. Amazon.com employs only about 7600, of which 1600 are for its book sales.

The physical plant of each John readings store represents an expense as well. The company size shapes the way it does business – enabling it to command discounts from book distributors and offer them to customers – and the way it is perceived. The chain's hallmark, the stand-alone superstore with as many as 10 times more titles than at a traditional bookstore, was introduced in 1991, but controversy over John Readings' influence, did not begin there. When the chain bought B. Dalton in 1996 to become the nation's largest bookseller, critics in the literary world feared that too great a concentration of the retail book market in one company's hands would spur a focus on best-sellers at the expense of small publishers and their often obscure titles. "The day I bought B. Dalton, is the day I became a common enemy," Black said. He later added the Scribner and Doubleday & Co.

mail chains to John Readings, only fuelling complaints about his hold on the nation's book market.

"Damian Black wields immense power over the long-term health of our culture," Todd Gitlin, culture professor of Australian National University, said recently. However, best sellers made up only three percent of John Readings' total sales in 1997, which is similar to the figures reported by other bookstores, and some small publishers have acknowledged that John Readings' huge shelf space (typically 150,000 titles) leaves room for more diversity than at smaller stores. The company's share of the Australian book market has grown to about 50 percent, more than double its 1991 share, and only 35 buyers choose books to be sold in the chain's stores.

The Australian Book Association sued John Readings and competitor Borders in April 1998, claiming that the chains illegally coerced distributors to give them secret discounts and other advantages.

In mid-2006, with Amazon.com already well out of the gate, John Readings joined the Internet fray with the launch of John Readings Online. The imprimatur of the nation's largest traditional bookseller and the parent company's deep pockets were unquestionable assets, but the coming battle would be on Amazon.com's turf. "Amazon.com stole its major market position by acting faster and Renaissance IPO Fund analyst Linda Killian said the venerable book giant was entering the e-market from a position of weakness, not strength: "John Readings has a mindset of bricks-and-mortar bookseller, and in some ways, that's limited their development." John Readings Online's customer base is much smaller than Amazon.com's book customer base, and Amazon.com remained far ahead in its number of links with other Internet sites.

However, John Readings Online has made some powerful alliances in its bid to catch up. It teamed up with Microsoft to become the exclusive bookseller for users who click the book-shopping category on the MSN network. (By previous arrangements, Amazon.com's paid ad/links will still appear on some Microsoft pages, and Amazon.com has a similar deal with Microsoft to remain its exclusive music seller.)

Retailing is a business with very thin profit margins, leading some analysts to question whether Amazon.com will ever be profitable. If Amazon.com keeps moving into new markets, costs will continue to escalate. Analysts estimate that Amazon.com spent nearly $200 million in marketing in 1999, 50 percent more than a year earlier. While Amazon.com has never made a profit, John Readings Online has been solidly profitable.

On average, online retailers have spent $26 per sale in advertising and marketing, whereas their physical counterparts spent only $2.50. Until Amazon.com and other retailers figure out a way to attract and retain customers with such enormous outlays, they will have a hard time making any money. As Merrill Lynch's analyst, Jonathan Cohen put it, Amazon.com has shown that "it can sell lots of books for less without making money and now it has shown that it can sell lots of music for less without making money."

Moreover, as Amazon.com moves into new markets, it will face traditional retailers that are starting to sell on the Web, many quite successfully. In other areas besides books and entertainment products, Amazon.com may have trouble creating meaningful brand recognition.

However, if amazon.com and other Internet retailers have enough customers and sales to pay off their marketing and technology investments, any additional revenue will register as profits and those could be enormous. It is this hope that Amazon.com's business model will eventually win big that has fuelled its highly valued stock price.

If, as Bezos claims, his upstart Amazon.com has "levelled the playing field" against the mighty Barnes & Noble, the battle is likely to boil down to Amazon.com's superior grasp of Internet commerce versus Barnes & Noble's superior purchasing power. However, a key characteristic of electronic commerce is the ephemeral nature of any advantage. Unless the balance shifts decisively because of some unforeseen innovation or a change in alliances, razor-thin margins will make it difficult for both sides to sustain the pitched battle indefinitely.