

Supply Chain Impact of Internet Bookselling

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I wrote, circulated, and ultimately tore up two earlier versions of this speech. The topic of the future of Internet bookselling and its impact on the supply chain creates more opportunities for discussion and digression than a half-hour can handle.

The first “supply chain impact” of Internet bookselling, perhaps the only channel for most publishers’ sales that is growing at the moment, is that it has its own supply chain components that we didn’t really have to think about before there was an Internet.

Amazon, by far the market leader in Internet bookselling all over the world, and very much so in both the US and UK, has demonstrated that the key to long-term success is “owning the transaction.” Through affiliate programs, Amazon, and its only true remaining competitor in the US and perhaps anywhere in the world, Barnesandnoble.com, have empowered many, perhaps even millions, of websites to become Internet booksellers to vertical and niche markets. Sometimes the referral fees are very generous, as much as 15 percent of the purchase price for doing nothing but sending it to the customer. But, in the end, these become legacy customers to the site that books the transaction, not the one that initiates it.

From the very beginning, Amazon also demonstrated what was another key component of the online supply chain: the title-offering database. Some observers scratched their heads in 1995 when Amazon went onto the Internet using a historical database that had been compiled by Ingram, Bowker, and then later Baker & Taylor, over the preceding decade or more. Because of its origins, it contained many titles that were out-of-print and, by the capabilities Amazon then had in place, impossible to fulfil. But the database itself was a tool for Amazon’s visitors from the very beginning; the consumer recognised immediate value in being told that a book was out-of-print, even at a time when the online bookseller couldn’t do much more to help the customer locate the book.

Online bookstores, like terrestrial ones, are judged by their customers on their ability to fulfil. The thing Jeff Bezos realised enabled Amazon to exist in the first place, was that the broad stock positions of American wholesalers, particularly Ingram, enabled any Internet

bookseller to satisfy the preponderant majority of customer demand within days, without holding any inventory at all. The key, which Amazon also recognised from the beginning, was the management of “promise dates.” Tell the customer in advance, before the order is placed, which books will take three days to arrive and which will take three weeks or longer, and business runs smoothly with a minimum of customer service required, even for books that take a while to deliver.

It is worth noting that Amazon seemed to be embarking on a strategy of substituting their own book supply chain for the wholesalers a few years ago, but have apparently backed off trying to stock sufficiently to supply all their own needs. Instead, Amazon in the US now uses a mixed strategy that includes stocking some of the books, presumably those that sell in the largest and most predictable quantities, and dividing the rest of their business between Ingram and Baker & Taylor. And Ingram and Baker & Taylor have developed the capability to ship directly to the consumer, which means that any Internet bookstore can fill most customer demand without ever touching the book themselves. Each year, more and more books are shipped to online purchasers that way. We are aware that wholesalers in Britain provide a similar service.

Barnes & Noble (B&N), of course, has its own distribution centres stocking more titles than any wholesaler, even Ingram, which in turn stocks far more titles than any other wholesaler in the US or anywhere else in the world. B&N and Ingram, in fact, are probably unique in their desire to order virtually every trade book directly from the publisher. Baker & Taylor (B&T) in the US, and Gardener’s in the UK, stock in the neighbourhood of a quarter million titles, much less than half what Ingram and B&N carry on hand. B&T and Gardener’s, and perhaps others, can offer virtually any title they don’t stock on a slightly longer and less predictable timetable by an “order to order” strategy. That is: when they receive an order for a book they don’t carry, they will place an order for it and fulfil their customer’s demand when the publisher delivers it to them.

In the US, this means that B&N can offer the best promise date more often than anybody else with its own deep warehouse inventory; Amazon is second because they are stocking the fastest movers themselves; and everybody else is tied for third, ordering most from Ingram and sometimes from Baker & Taylor. In turn, this makes an online bookstore

proposition that does not offer just about every title in print competitively inferior and, one would think, short-lived.

In a conversation about publishing's future in London a few years ago, we suggested that the concept of "complete selection" would be redefined, and Amazon is doing the most to redefine it by leveraging their enormous customer base and unmatched technology skills, they have created a peer-to-peer network to sell used books that compares to what eBay, which specialises in peer-to-peer sales, can do. But Amazon does something eBay can't do: it offers the used books customers want to sell on the same screen that describes the book and peddles the publisher's edition. So for many books, a cheaper used copy is available instead of the publisher's fresh new copy. At the same time, many online booksellers are offering used books through other alliances of used book merchants. All of this just makes life more difficult for publishers and is likely, in the future to make it hard to even measure the growth or contraction in the publishers' market for new books on an industry-wide basis.

Indeed, both the US and the UK just experienced a year where brick-and-mortar sales were estimated to have stayed flat or slightly declined, while growth occurred in the online channel. But how much of those online sales were used books and no contributor to growth for the publishers at all? I am not sure we really know.

Amazon is redefining "complete" in another way: with their eDocuments offering. EDocuments are high-priced reports from companies like Accenture, who are more likely using Amazon as a channel of convenience to reach existing customers than as a way to create additional sales. But, either way, there is a wide range of useful offerings available through Amazon that are not in any other bookstore, giving them a unique selling proposition that any competitor will be hard-pressed to match in the future.

B&N and Borders have also made attempts to redefine "complete" by producing proprietary books available only in their own stores. Although this is not, strictly speaking, a supply chain impact of online bookselling, it is a point that raises some interesting supply chain questions that are of interest on both sides of the Atlantic.

The development of proprietary books, usually by purchase by one of the chains directly from a packager, has been going on for quite some time. A few years ago, B&N bought the packager Friedman-Fairfax and made it an in-house operation. Then a year or so ago, B&N

bought Sparknotes, a study guide series that has a large Internet following among students and a unique online proposition. All Sparknotes content – the complete texts - are viewable at their web site for free. Downloadable, printable PDFs are available for the same price as the books. A substantial business in PDFs and books is done online.

When B&N rolled out Sparknotes, they stopped carrying Sparknotes' most successful direct competitor, the long-established Cliff Notes, which are now owned by John Wiley. Now that's a supply chain impact bound to get publishers' attention.

For a few years, B&N had a distribution arrangement for some of the books it generated through Sterling Publishing, which offered books branded as "Friedman-Fairfax", not "Barnes & Noble", to other stores, chains and independents. Some of the titles produced were kept as exclusive by B&N who, like Borders, believed in the advantage of having some attractive merchandise not available anywhere else.

Last spring, B&N decided to press that advantage by not offering the visible and up-and-coming Sparknotes line to other stores. That strategy tacitly expressed the view that the advantage of having unique product for the bookstores, outweighed the additional profit from a wider distribution of the proprietary publishing.

Then, as we all know, B&N acquired Sterling last December. Sterling is such a strong player in certain niche categories like Crafts and Puzzles & Games, that many retailers would see those sections suffer terribly if Sterling books weren't available there. But B&N has apparently reversed course strategically with Sterling, making an even wider array of the proprietary books available through Sterling than they did before. Even Sparknotes will soon be offered to the general trade.

Of course, some of B&N's competitors, most loudly and publicly the Borders chain and the mass merchant, Costco, have decided that buying from Sterling supports their top competitor at retail, so they've announced that they won't buy from Sterling. The question of whom this will hurt, or whether the boycott threat will even be executed for very long, is still open. But it is an interesting paradox that at one time B&N thought they gained an advantage having these titles to themselves and now their biggest competitor is saying: "have these titles to yourself!"

These questions are neither new, nor unique to Barnes & Noble. Of course, Hodder Headline in the UK was acquired by WH Smith a few years ago and I remember concern expressed at the time that the publisher would gain an unfair advantage at the country's most ubiquitous book retailer. Advanced Marketing Services, AMS, is known in the US as the wholesaler that enables mass merchants to be in the book business, which would otherwise be too complex for them to manage and AMS recently bought PGW, the largest distributor in the US of independent presses. And as far back as the 1950s and 1960s, US publisher Doubleday owned a chain of bookstores and US publisher Macmillan owned the Brentano's bookstore chain.

The prevailing wisdom about retailing brands, always subject to change, is that they will have to serve customers both on and off the net to keep their customers. Most of us who buy online don't buy everything we buy online. Generalising from one's own experience is a dangerous practice, but I find myself in synch with most people I know in that I buy some books online and some in stores. And while the online market is still taking new customers from brick-and-mortar every day, and will for quite some time, most customers will split their purchases for the foreseeable future.

To the extent that having a presence both online and in cyberspace helps hold customers in both places, B&N has the clear edge in the US market. B&N competes with Borders on land and with Amazon online, but nobody competes with B&N nationally as a total solution for the book consumer. How important this will be as a success factor remains to be seen and depends somewhat on how well B&N can exploit their presence in both places.

B&N does have an offer of same-day delivery within Manhattan of books ordered through Barnesandnoble.com, a capability afforded by the large number of superstores they have in New York City and the presence of an enormous distribution centre in nearby New Jersey. How scalable that particular offer would be is difficult to guess, but an integrated offering that allowed shopping from the store or from home or office, to result in books available at the store or delivered to home or office, would definitely build customer loyalty among the biggest book consumers. How quickly B&N can build such a capability and how effective it will be as an affinity tool, remain to be seen.

Some other components of online bookselling in the US should not go unremarked upon, even though it is likely that Amazon and B&N comprise as much as 90 percent of the online

book sales. Independent booksellers almost all have online presences now, many through the American Booksellers Association's Book Sense offering. As a unified site that competes with national online brands from Amazon and the two large national chains, or even smaller regional ones like Books-A-Million, Book Sense is apparently not cutting it. But the turnkey and inexpensive capability for stores to have their own sites, dressed up with their own reviews and recommendations, and enabled to sell a broad catalogue with shipment direct by Ingram or Baker & Taylor, has at least permitted independents to offer their customers an online choice other than simply abandoning their local merchant.

Powells.com is worth a mention as well. Powell's, in Portland, Oregon, is the biggest single-store vendor of used books in the US. For many years, they have sold new books and used books side-by-side in their store. Now they offer a database combining the two online that is even more integrated than Amazon's. In fact, the noted observer of the American book scene, Michael Cader of Publishers Lunch, suggested to me that a merger between Powells and Book Sense would be a very logical one. From the consumer standpoint, he's right, but the business issues of engineering that combination would be very daunting.

This all suggests that the day of the new-book only bookstore may be waning. I think it is.

There is another important way that online sales are changing the supply chain: online supply is not an equal-opportunity channel. Experience is showing that some books sell much better online than others and, more importantly, that for some books, the sales are migrating from brick-and-mortar to online. That is: for some books, the customers' ability to buy online is destroying the market at traditional retail.

This effect seems to be noticeable first to university presses in the US, who are seeing huge growth in online sales while they are experiencing what feels like a meltdown in some of their brick-and-mortar channels. Our company has been analysing sales for many publishers at B&N for the past year; one thing we look at is the relative sales levels, by title and category, through BN.com versus what the superstores sell. On titles that are readily seen to be books that would be discovered by academics and professionals through what would now largely be online information sources, sales online have mushroomed and brick-and-mortar sales have often collapsed. Until the publishers and booksellers get a handle on these changes, they result in large returns that are costly to both sides.

Certain other categories, like business books, are also seeing sales migrate to online.

There is another development at retail, which we also see in the UK and to which we alluded earlier: the entry of mass merchandisers into the business of selling the top titles at deep discounts. If online bookselling is the only channel that is growing for most publishers, sales through mass merchants still represent a growth channel for the much smaller number of publishers who carry one of the small minority of titles these outlets sell in prodigious quantities.

There would appear to be a real danger that the combination of online bookselling bleeding away the sales of the hardest-to-find books and the mass merchants taking an increasing chunk of the bestseller business, could cripple the general bookstore business as we have known it. Half of the sales of major bestsellers, or even more, can elude the book trade through these channels. What we know for sure is that forces are at work which are making new demands on all the players: publishers, chain and independent booksellers, wholesalers, and online booksellers as well.