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Competitive Strategies in the Bookstore Industry:
An Empirical Study of Borders and Barnes & Noble



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by

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I hereby recognize and pledge to fulfill my responsibilities as defined in the Honor Code and to maintain the integrity of both myself and the College as a whole.

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Abstract

This study examines competitive strategies in the bookstore industry. It primarily covers the years 1995 through 2011, which encompass two fundamental shifts in the industry: e-commerce and e-readers. Industry leaders, Borders and Barnes & Noble, are juxtaposed in order to explore competitive strategies within the bookstore industry and identify practices contributing to Borders' liquidation and Barnes & Noble's success. The sources used to analyze each firm's strategies include their annual reports, financial data, and consumer reports. Once analyzed, financial performance indicators are utilized as a means of assessing the firms' strategic success. Financial performance indicators for this study include earnings per share, goodwill, return on assets, sales, and debt ratio.

Analysis indicates that Barnes & Noble's supremacy is largely connected with its ability to integrate emerging industry trends into its core competencies and further enhance its brand within the ultra-competitive market. The instability that the bookstore industry is experiencing, however, implies that Barnes & Noble must diligently work to remain competitive amid rivalry at both the digital and in-store levels.

CHAPTER 1: INTRODUCTION

The goal of this project is to understand the nature of competition in the United States bookstore industry, which has faced several challenges within its existence. There has been intense rivalry between independent and chain bookstores in the 1980s and 1990s. In the new millennium, the primary focus of competition shifted to inter-chain competition amongst bookstore retailers. Throughout, bookstores have had to be careful not to ignore the sweeping force that the Internet began to hold over their industry. Between dealing with the struggling economy and the emergence of technology in the form of e-readers, bookstores have had to rely on a competitive strategy that embraces a significant degree of flexibility or accept disadvantage(s).

To comprehend the competitive forces in the bookstore industry, this study will focus on Barnes & Noble and Borders. These two stores have been identified by the Bowker Library and Book Trade Almanac (2011) as the first- and second-largest book retailers in the United States, respectively. Borders has been through bankruptcy and was ultimately forced to liquidate. However, Barnes & Noble has been able to outlive its primary competitor. Therefore, there is need for a study on what factors led to Borders' failure and Barnes & Noble's success. Frequent speculations on Borders' bankruptcy and liquidation are made in the media, but an empirical study examining each firm's practices has yet to exist.

In an effort to identify determinants of success and competitive advantage in the bookstore industry, factors such as firms' self-identified goals, risks, and reactions to changes in the industry will be analyzed. Upon analyzing these factors, it will become possible to decipher the determinants of competitive success in the bookstore industry. Furthermore, the knowledge gained will yield more accurate information as to whether Barnes & Noble truly has a sustained

competitive strategy or whether it merely demonstrated operational effectiveness in outperforming Borders. Is Barnes & Noble also headed down the path of bankruptcy and liquidation, or is the company flexible and creative enough in its strategy to compete with rivals at both bookstore and online levels?

This study will continue with a review of existing literature, which can be found in the second chapter and specifically focuses on components of a sustainable competitive strategy and the impact innovation(s) has in an industry. A brief but comprehensive history on competition within the United States bookstore industry will then follow in the third chapter. Once existing literature and relevant backgrounds have been provided, the fourth chapter will offer a theoretical framework for its empirical analysis. The theoretical section will center on the characteristics and behavioral patterns within an oligopolistic market. Chapter Five, the empirical chapter, includes both qualitative and quantitative analyses on determinants of success in the bookstore industry and will offer insight into Borders' failure and Barnes & Noble's success. Lastly, the sixth and final chapter will utilize its empirical findings in order to identify successful competitive strategy in the turbulent bookstore industry and to make well-informed conclusions.

CHAPTER 2: LITERATURE REVIEW

Changes in consumer tastes and preferences are occurring and, consequently, causing firms to re-examine their strategies and operational practices. Likewise, rapid strides in technological advancements are offering new opportunities for firms and consumers. The American bookstore industry is no different in that it, too, is experiencing a shift in the competitive landscape of its industry. As a result, firms wishing to maintain or expand market share in the bookstore industry must re-familiarize themselves with the core components of a successful competitive strategy and how to accept and/or embrace innovation. This literature review will discuss strategic tools for success with an emphasis on innovation. The topics that will be explored include the components of strategy, how innovations affect consumers' shopping habits and firms' ensuing decisions, and determinants of innovation based on firms' existing positions.

Porter (1996) discusses the importance of competitive strategy to a firm's success. According to Porter, operational effectiveness, in which a firm is superior to its competitor(s) at a particular activity, is necessary but insufficient for sustainability in its industry (1996). In addition to operational effectiveness, Porter emphasizes three primary aspects of creating a solid, sustainable strategy: positioning, trade-offs, and fit. Strategic positioning involves targeting a specific customer group and fervently trying to meet its needs. The position a firm chooses, however, can center on "customers' needs, customers' accessibility, or the variety of a company's products or services" (Porter, 1996, p.66).

The second component to Porter's framework for an effective strategy is making the appropriate trade-offs. A firm cannot serve all needs to every potential customer group, and an effort to do so would confuse both employees and customers (Porter, 1996). A store that offered

both higher-end and lower-end products, for example, would most likely confuse both high- and low-income customer groups. This could potentially deter both groups from visiting the store. Therefore, a competitive firm carefully makes trade-offs on the image it wants to portray, the activities it wants to perform, and the organizational priorities it will have (Porter, 1996).

The specific industry position and necessary trade-offs come together through the creation of a well-fitting web that reinforces activities and optimizes productivity. Porter (1996) argues that "strategic fit among many activities is fundamental not only to competitive advantage but also to the sustainability of that advantage. It is harder for a rival to match an array of interlocked activities than it is merely to imitate…individual activities" (1996, p.73). So by creating a synergistic web, a firm helps itself to operate more efficiently and prevent competitors from easily imitating its strategy. An additional aspect of strategic fit is its ability to offer a long-term advantage rather than a few financial quarters' worth of profitability. The protection that the firm receives from the strength of its intricate web can afford it the opportunity to expend efforts fine-tuning its activities and enhancing its image, for example. Due to the frequent changes that seem to impact many industries, however, strategies must be flexible. Porter advocates for "the leader [of a company] to provide the discipline to decide which industry changes and customer needs the company will respond to, while…maintaining the company's distinctiveness" (1996, p.77).

The belief that executive leadership holds an influential role in a firm's competitive position is supported by Bernard M. Bass (2007). Bass discusses a 1988 Columbia University study in which 75% of surveyed CEOs ranked strategy formulation first in critical determinants of competence (2007, p.38). The utilization of this statistic effectively conveys how long-term competence is derived from top management's "commitment to strategy" (Bass, 2007, p.38).

Leaders' commitment to strategy must carry over when they are required to address the simultaneous "need for continuity and the need for change" (Bass, 2007, p.33). Bass pushes executive leaders to anticipate customers' future desires in addition to rivals' future competitive moves (2007). A firm that is currently successful is not guaranteed that same success if it becomes complacent. Thus, it must pay close attention to market trends, such as changes in sales or industry regulations.

Not all firms, however, suitably deal with their environment. Bass (2007) discusses four types of firms and their strategic reactions to their environment: prospectors, defenders, analyzers, and reactors. Flexibility is one beneficial quality of prospectors, which "look to discover and work with innovative products even though risks are high" (Bass, 2007, p.36). Defenders, in contrast, maintain their current practices and neglect the pursuit of innovation for their industry. Similar to defenders, analyzers also avoid innovation. Whereas defenders maintain the status quo, analyzers avoid innovation because of their unwillingness to take risks for fear of declining profits. Yet without risk, a firm is unable to reap the rewards of successful innovations. Lastly, reactors are classified as "inconsistent" in their decision-making; they will respond to their changing environment in a multitude of ways (Bass, 2007, p.36).

The behavioral practices of defenders, analyzers, and reactors, however, deviate from what Porter (1996) and Bass (2007) advocate as necessary for a successful competitive strategy. A defender is "inflexible and maladaptive," and thus will surely not maintain profits in virtually all industries (Bass, 2007, p.41). Somewhat parallel to defenders, analyzers are inflexible; analyzers' inflexibility is associated with their low risk tolerance. The ultra-narrow focus on profits prevents any moderate or substantial degree of risk-taking and ultimately deters growth. Unique to the three non-innovative firm classifications is the reactor firm. It may be compared to

a company that fails to make the necessary trade-offs that Porter (1996) encourages. For a reactor firm may impulsively expand its product scope in response to changes in the market but not justify its decision or successfully implement the product into its existing strategic web (Porter, 1996).

The emergence of e-readers offers an example of how each type of firm would react to the new technology. E-readers allow consumers to carry numerous electronic versions of books in one compact device. A bookstore that is a prospector would view the invention of e-readers as an opportunity for its store to advance and increase profitability. Thus, it would pursue the addition of e-readers to its product scope. Conversely, a defender would view the product as a threat to the status quo and neglect any attempt to incorporate the product into its store. The risk associated with such an innovative product would deter any interest on the part of analyzers, and reactors may or may not attempt to incorporate the product into its store.

Like Porter (1996), Peteraf (1993) discusses the components of a competitive advantage. While Porter argues that a firm's positioning, trade-offs, and fit determine its ability to obtain a sustainable competitive advantage, Peteraf argues that heterogeneity, ex post limits to competition, imperfect mobility, and ex ante limits to competition generate a competitive advantage. Naturally, Peteraf's (1993) assumption that firms' resources and capabilities are heterogeneous is credible. It is not the heterogeneity, however, that creates a competitive advantage; rather, it is the Ricardian rents associated with heterogeneity that produces the competitive advantage. Peteraf (1993) argues that resources determine a firm's production capabilities and thus impose a limit on supply. Analogous to how purposeful supply shortages create monopoly profits, "inherent scarcity of resources" create Ricardian rents (i.e. abnormal returns) (p.182).

Ex ante and ex post limits to competition are other competitive cornerstones that Peteraf (1993) discusses. There is a strong recommendation by Peteraf to ensure "limited competition" before a firm works diligently to manage its resources (1993, p.185). Otherwise, a firm will enter and find its expected profits to be eroded by intense competition. Additionally, Peterof (1993) identifies ex post limits to competition as pivotal for competitive advantages. She argues that "if the heterogeneity is a short-lived phenomenon, the [Ricardian] rents will likewise be fleeting" (Peteraf, 1993, p.182). Thus, ex post limits to competition are necessary for a sustainable competitive position in the market. Two sources of ex post limits to competition identified by Peteraf (1993) are imperfect imitability and imperfect substitutability. Imperfect imitability is emphasized based on its intangible values to a firm. The imperfect imitability means that asymmetric information exists between a firm and its competitors, and "causal ambiguity prevents would-be imitators from knowing exactly what to imitate or how to go about it" (Peteraf, 1993, p.182-3).

The final aspect of Peteraf's (1993) model for competitive advantage is imperfect mobility, where firms' resources have low levels of liquidity. Firms' assets are specialized to better meet their operational needs. A high level of specialization creates a large differential between the firm's valuation and a competitor's valuation of the asset and, as a result, is a disincentive to sell said asset. Hence, the specialized creates imperfect mobility.

Each of the components of success that Peteraf (1993) explores is represented in the following graphic.

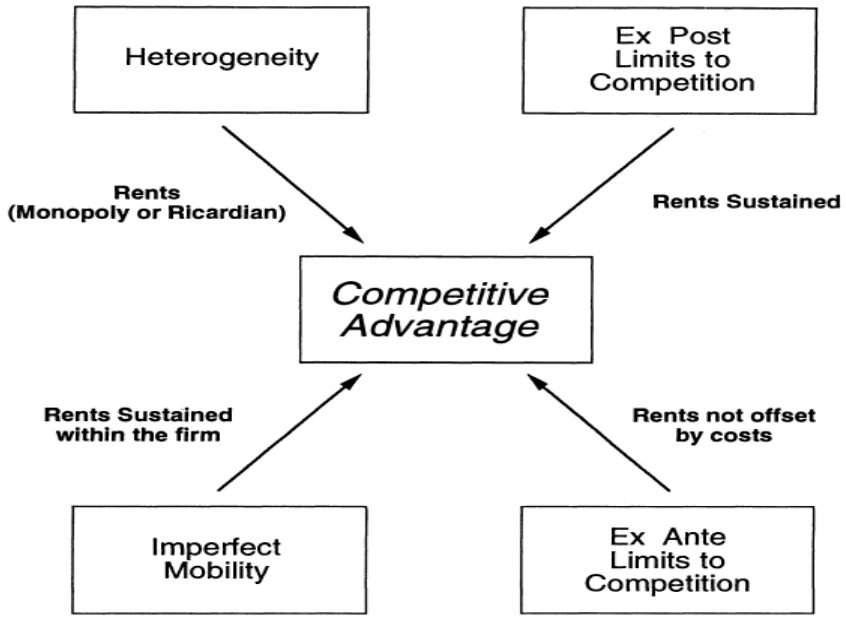


Figure 2.1: Peteraf's Model for Competitive Advantage

Further exploration on innovation and strategy can be seen from the concept of creative destruction. This concept, coined by Joseph A. Schumpeter, is "the process by which emerging technologies, industries, and ideas in capitalist economies continuously supplant existing ones" (Oxford English Dictionary). The supplementary—or substitute nature of the technologies and products created often make existing ones obsolete. Thus, creativity and innovation lead to destruction for contemporary products and technologies. John M. De Figueiredo and Margaret K. Kyle (2006) studied creative destruction in terms of product turnover. Much of their analysis relies on a product's hazard rate, which they classify as the likelihood of a product experiencing economic risk in the form of lost market share and falling profits (2006). The authors theorize three primary reasons products exit the market:

> There are three main determinants of product exit. The first, external competitive pressure, drives uncompetitive products out of markets. Products exit due to very low sales. The second, lack of internal competitive advantage (capabilities, technology), results in relatively high costs of production or an inability to capture the value created by the firm…Finally, managers may choose to withdraw products as part of a portfolio strategy based on market conditions and the firm's innovative capabilities. (2004, p.5)

De Figueiredo and Kyle's (2006) results are summarized in the table below and are based on the level of a firm's innovation and brand strength. Overall, a product proliferator firm—highly innovative and one that has strong brand recognition—will be quick to introduce new products and slow to remove them from the market.

Innovative Firm?	Firm Strong Brand? No	Firm Strong Brand? Yes
No	Entry: Average Exit: Average Stagnator	Entry: Low Exit: Slow Marketer
Yes	Entry: High Exit: Average Innovator	Entry: High Exit: Slow Product Proliferator

Figure 2.2: Determinants of Product Turnover

Tanpong and Kim (2001) also analyze creative destruction but do so in terms of e-commerce, or online sales. In the 1990s, as personal computers (PCs) started becoming as prevalent in the home as a television, the landscape of the bookstore industry was dramatically changed. The Internet extended bookstore competition to online sales. Change invariably impacts various industries, but firms within each industry determine whether change will result in new niche formation or creative destruction. Tanpong and Kim (2001) explore the effects e-commerce has in the book retail industry and conclude that new niche formation has occurred.

Tanpong and Kim emphasize how essential it is for firms to recognize whether their specific industry falls under new niche formation or creative destruction prior to adjusting their

competitive strategy. Prior to the discussion on the empirical model and results, thorough and helpful backgrounds and working definitions were provided for clarity. Three main operational definitions were proposed for their study: new niche formation, creative destruction, and e-commerce. The first, new niche formation, is described by the authors as environmental changes that create new potential in a specified market and grant entrance opportunities for new competition (2001). With the possibility of new competition entering the market, incumbent firms must decide whether they will make strategic decisions to accommodate the shift in their industry. Often these changes come from either changes in technology or "consumers' socioculture" (Tanpong & Kim, 2001, p.664). When incumbent firms either a) neglect to respond to the aforementioned changes, or b) fail to adequately adjust their product or services, creative destruction occurs (Tanpong & Kim, 2001). Competition is increased from the new firms, incumbents' market share suffers, and the "new demand…creates threats rather than new opportunities" for experienced firms (Tanpong & Kim, 2001, p.664). In looking at e-commerce in the retail book industry, the authors attempt to test whether using the Internet as a primary way of generating business will result in the formation of a new niche or erode the segment of the market associated with traditional bookstore sales.

The authors must acknowledge their assumption that Borders, Amazon, and Barnes & Noble are the firms with the most retail book sales, but their results are interesting nonetheless. In essence, their findings characterize online sales opportunities in the retail book industry as a new niche formation. Figure 2 from their study supports this notion, as online sales growth rates taper off after a few years and become consistent with traditional store sales growth rates (2001). A possible explanation for the decline in online sales can be attributed to the excitement consumers experience from the release of a new product. In this case, the online sales option is the new product. The start of online sales in the late 1990s sparked great interest, but the growth

tapered off as time passed and eventually reached steady growth in 2000. At that point, both online and physical store sales reached consistent steady growth. This is unsurprising, as the mania surrounding new products—here, online sales—tends to decline and stabilize over time.

Additional analysis is now needed since the emergence of e-readers has offered an additional area of opportunity for competitors. While online sales may have been classified as a new niche, e-readers hold the possibility for creative destruction and bring an area that requires further exploration. This topic will be investigated in the historical and empirical chapters.

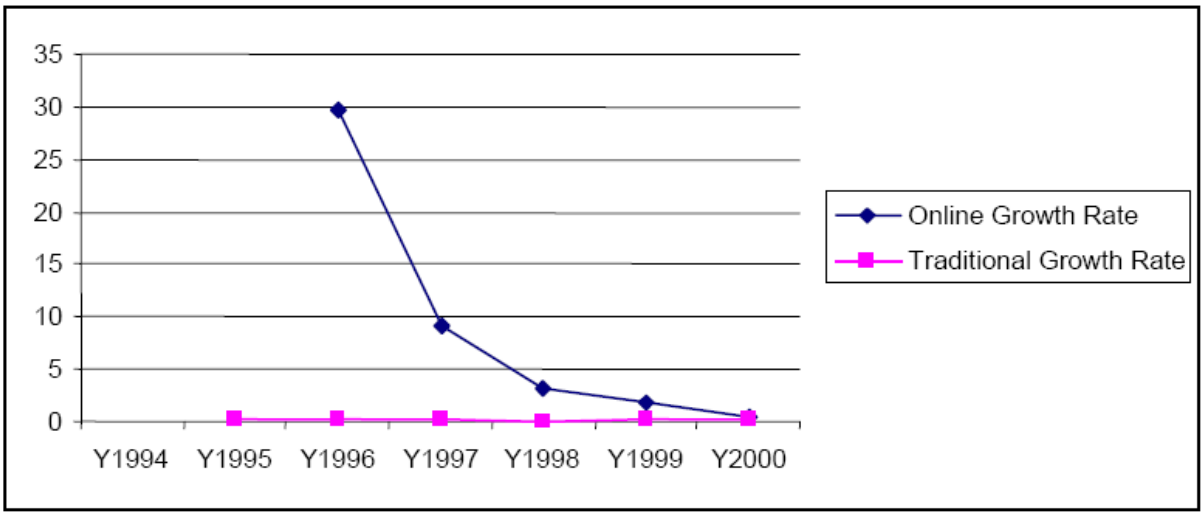


Figure 2.3: Online and Traditional Industry Growth Rates in Sales (in percent)

Similar to Tanpong and Kim's (2001) focus on e-commerce in the retail book industry, Hsiao's (2008) discussion on physical store shopping versus e-shopping examines the factors that influence consumers' decision on where to shop. Hsiao narrows economic factors to travel time, travel cost, delivery time, and purchase price (2008). The indirect utility function created accounts for each of these four factors. Results indicate that consumers value their travel time (associated with physical shopping) moreso than they value delivery time (associated with e-

shopping) and that online firms must offer customers a certain price advantage to attract them away from store shopping (Hsiao, 2008). This finding seems plausible since, as the author points out, consumers can be productive while waiting for a book to arrive in the mail. However, there is little productivity that can occur when one is driving in a car to shop in a physical store. Hsiao's (2008) data offer useful information for book retailers who have online competition and wish to develop a strategy to combat any fallen profits.

Hsiao's study is interesting and informative, yet lacks certain credibility in its methodology. The primary issue came in that all consumers surveyed were at a physical store, naturally biasing results. Furthermore, only 32% of those were experienced with online shopping and therefore added additional bias (Hsiao, 2008, p.92). As with new niche formation versus creative destruction, the emergence of e-readers brings the opportunity for further exploration. It must be considered that the ability to purchase electronic books via an e-reader eliminates—or at least reduces to a couple minutes—the delivery time for consumers. Since the delivery time associated with e-shopping was often the main impediment in online sales, it becomes reasonable to wonder how significantly e-readers will sway consumers away from physical shopping and towards the purchase of electronic books via e-readers. Moreover, it is relevant to question how significantly e-readers will sway bookstores' strategies away from physical store shopping and more towards either online or e-reader shopping. Again, a more in-depth look at e-readers' effect on the bookstore industry will occur in the following chapters.

Tanpong and Kim (2001) and Hsiao (2008) focus on consumer preferences and how they impact firms' innovative strategies. Firms' views of new products, on the other hand, are discussed by Uri Ben-Zion and Dennis J. Fixler (1981). Zion and Fixler explore incentives to produce new goods and how strategy and new products impact firms' decisions. Specifically,

they focus on strategic incentives behind the production of complement and substitute goods and how those incentives differ based on the firm's current market position. The two market positions are termed "outsider" and "insider" (Ben-Zion & Fixler, 1981, p.437). An outsider is "a firm for which the new product [Y] has no effect on the demand for its current product," while an "insider is defined as a firm whose demand is affected by the new product" (Ben-Zion & Fixler, 1981, p.437).

In the study, the producer of the new good has a patent, granting it monopoly power over the product. Ben-Zion and Fixler's (1981) results indicate that the insider (or monopoly producer) would have a competitive advantage if the new good [Y] was a complement to the existing good [X]. However, a new substitute would compete with the existing good and disincentivizes the insider. Arguably, the authors' most interesting results are associated with that of the outside firm. It is unsurprising that the outsider will charge consumers a relatively high price if it sells a good complementary to what the insider offers. Moreover, this implies that the marginal revenue of producing a substitute is less than the marginal revenue of producing a complement. The authors "conclude that the output level of Y [the new good] and the corresponding profit are greater for the outsider when Y is a complement to X [the existing good] than when Y is a substitute for X" (Ben-Zion & Fixler, 1981, p.446). Overall, both the insider and outsider firms will benefit more from a complement than a substitute because both firms can exploit monopoly power in different ways.

While there are not any firms that currently possess a monopoly over e-readers, it is interesting to place them in Ben-Zion and Fixler's simulation. The electronic nature of the e-readers classify it as a substitute to physical books. Yet, for those consumers who do not regularly purchase physical books and are more excited over technology, the e-reader would not

necessarily affect sales the same way a substitute would. Different customer groups (experienced readers versus new readers) might be an unanticipated result of the substitute good.

Commitment to new goods in the market is further investigated by Kopel and Loffler (2008). They explore firm strategy in relation to first-mover- and second-mover-advantages. There is much economic debate on whether a first-mover-advantage truly exists, and Kopel and Loffler immediately address this question. Much of the basis for their work stems from the Stackelberg Model, "which demonstrates that the leading firm can obtain higher profits than the follower by committing to a high production quantity" (Kopel & Loffler, 2008, p.145). In Kopel and Loffler's model, the leading firm decides on a production quantity, and the follower's quantity is set in response. Within the model, there are multiple subgames with two main influencers. The first area concerns either the existence or absence of research and development (R&D). The second concerns the level of production, which is either decided by the firm owner or delegated to a manager. There are sixteen possible outcomes based on these options. (See following table, where F= follower, L= leader, O = owner decides quantity, D = quantity decision delegated to manager, I = investment in R&D, N = no investment in R&D)

		F			
		ON	DN	OI	DI
L	ON	$\pi_L^{ONON}, \pi_F^{ONON}$	$\pi_L^{ONDN}, \pi_F^{ONDN}$	$\pi_L^{ONOI}, \pi_F^{ONOI}$	$\pi_L^{ONDI}, \pi_F^{ONDI}$
	DN	$\pi_L^{DNON}, \pi_F^{DNON}$	$\pi_L^{DNDN}, \pi_F^{DNDN}$	$\pi_L^{DNOI}, \pi_F^{DNOI}$	$\pi_L^{DNDI}, \pi_F^{DNDI}$
	OI	$\pi_L^{OION}, \pi_F^{OION}$	$\pi_L^{OIDN}, \pi_F^{OIDN}$	$\pi_L^{OIOI}, \pi_F^{OIOI}$	$\pi_L^{OIDI}, \pi_F^{OIDI}$
	DI	$\pi_L^{DION}, \pi_F^{DION}$	$\pi_L^{DIDN}, \pi_F^{DIDN}$	$\pi_L^{DIOI}, \pi_F^{DIOI}$	$\pi_L^{DIDI}, \pi_F^{DIDI}$

Figure 2.4: Kopel and Loffler's Subgame Outcomes for Production

Kopel and Loffler's (2008) results indicate that the overall equilibrium of the first-mover-advantage game results in the subgame of OIDI (i.e. the leader invests in R&D [I] but does not delegate production decisions to a manger [O], and the follower invests in R&D [I] *and* delegates its production decision [D]) (Kopel & Loffler, 2008). Regardless of the follower's decision, the leader's dominant strategy is to innovate and decide the production quantity without delegating the decision to a manager. Yet, the follower will always benefit from both delegation and innovation and can steal the supposed advantage that comes in being a first mover. This only somewhat supports the Stackelberg Model since the combination of R&D and the delegation of production quantity can allow the follower to "leapfrog" over the leader (Kopel & Loffler, 2008, p. 150).

In the context of the bookstore industry, Kopel and Loffler's (2008) findings indicate that incumbent retail bookstores should have invested in R&D or had a joint venture with another firm in order to avoid losing valuable market share. Furthermore, production decisions—again, according to Kopel and Loffler (2008)—should have been made close to the top of the executive hierarchy as opposed to being delegated to a manager. This investment in R&D could have been for e-readers or book-related products. A more proactive approach to technological integration in the bookstore industry could have prevented substantial losses for Borders. Discussion of R&D and joint ventures for Borders and Barnes & Noble will occur in the empirical chapter.

Further analysis on first-mover-advantage is carried out by Henkel (2002). Similar to Kopel and Loffler (2008), Henkel (2002) acknowledges the uncertainty surrounding first-mover advantages. The model Henkel uses on offers "partial commitment" on the part of the first-mover, in which "deviating later is possible, but costly" (Henkel, 2008, p.157). Essentially, the 1.5^{th} mover advantage offers enough flexibility to withdrawl from a commitment due to the

partial nature of the commitment. Much of Henkel's theory looks at pricing competition between two competitors. In which case, the leader (being the first-mover) would set the intial price of the new product, and the follower would respond. However, the leader makes it evident that, if the follower's response is too aggressive, a pricing war will ensue. This would benefit neither the leader or follower, who can both profit from higher prices. Just as Ben-Zion & Fixler (1981) point out how the new invention and monopoly over a complementary good—not a substitute—will benefit either the insider or outsider firm that produces it, the consistent higher prices will benefit both leader and follower firms.

The concept of the 1.5th mover advantage can also be applied to other areas besides pricing. Perhaps a firm is looking to implement a change in its stores. Chain bookstores' decision to implement cafés in its stores can serve as an example. Following Henkel's (1981) work, the firms may have first partially committed to coffee and pastries. This might have occurred through smaller coffee stands or by testing the cafés out in select stores as a trial-run. After waiting to see customers' response to the stands or test cafés, the firm could then either increase or decrease its current commitment levels, thereby maximizing profitability. It is the partial commitment aspect of the 1.5th mover advantage that allots flexibility in a firm's innovation strategy.

Gayle (2001) provides another look at the strategies behind firms' innovation decisions and relates the topic to the Schumpeterian hypothesis. The Schumpeterian hypothesis argues that firms in more heavily saturated markets will be more inclined to adopt innovative strategies (Gayle, 2001). In order to reassess Schumpeter's hypothesis, Gayle looks at how "firm and industry characteristics, especially industry concentration, affect firms' innovation" (Gayle, 2001, p.16) In his study, Gayle measures innovation by simple patent count and by citation-

weighted patent count. This offers two opportunities for interpretation and addresses one of the common problems when a simple patent count is used as a proxy for innovation. While applying for a patent, one has to list relevant existing patents. The citation-weighted patent count accounts for every time a patent is cited, whereas the simple patent count does not. In assigning more weight to the more stimulating patents, Gayle improves—yet does not perfect—the use of patents as a proxy for innovation.

As expected, resulting "coefficients on innovation and advertising are both positive across both [simple patent count and citation-weighted patent count] tables" and indicate that firms that incorporate innovation and advertise can strategically increase market share (Gayle, 2001, p.24). Yet, Gayle notes that the adjusted coefficients favor "successful innovation" over "advertising" as a more effective strategy in increasing market share (2001, p.25). Additionally, there is a statistically significant relationship between market concentration and innovation, supporting the Schumpeterian hypothesis.

The strategy surrounding innovation has a heavy focus on first-mover advantages and the environment of firms and markets. A particularly relevant determinant of firms' innovation strategies, however, are their existing resources. Piscitello (2004) discusses the resource-based theory of the firm and how diversification can either strengthen or weaken a company's corporate coherence. Piscitello (2004) defines corporate diversification as firms making the choice to expand their existing services or product scope. The way(s) in which firms diversify, however, varies greatly. They can choose to diversify in areas that are closely aligned with their current products and venues, which would be categorized as related diversification. A relevant example might be a bookstore deciding to add a section of the store for magazines and newspapers that it can now sell alongside books. Conversely, a company may decide to delve

into a completely dissimilar field or industry. The managerial decision to do so falls under the concept of unrelated diversification. A bookstore that decides to sell toys and games would be diversifying in an unrelated manner. Thus, when firms are creating their diversification strategies, they must choose where on the diversification continuum they want to land, which ranges from related to unrelated lines of business. Similar to Porter's (1996) emphasis on trade-offs in competitive strategy, Piscitello emphasizes how firms must carefully choose their diversification paths.

Much of the diversification decisions, according to Piscitello (2004), come from the resource-based view of the firm. The resource-based view of the firm "acknowledges the importance of the resources of the firm in shaping their diversification patterns" (Piscitello, 2004, p.759). Otherwise stated, firms' future paths and areas of diversification are contingent upon their current resources and capabilities. Over time, firms develop "'portfolios…of technological competencies to cope with what they make and sell in the future'" (Piscitello, 2004, p.761). The capabilities companies have in creating interconnectedness between the "inputs" and "outputs" of the business determine its level of corporate coherence (p.757). As firms work to create more links between, and amongst, the products and technologies that are a part of their business, they enhance their corporate coherence (p.758).

The concept of corporate coherence is parallel to the strategic fit that Porter (1996) mandates as necessary for an effective competitive strategy. Both Piscitello (2004) and Porter (1996) believe that a company will operate more efficiently if its activities are well-connected with each other. Webs of interconnectedness strengthen firms' productivity, enhance their protection from competitors wishing to emulate their strategies, and direct focus to key aspects of the business.

When firms diversify in an unrelated manner, however, Hoskisson (1987) advocates that they organize themselves in a multidivisional form, or M-form. A multidivisional firm is structured in a way that a parent firm and its subsidiaries are organized in a separate manner, and each division manages its own operations separately. Conversely, a centralized functional structure (U-form) is organized by functions (i.e. finance, human resources, and so forth). A significant advantage to adopting a multidivisional form, as argued by Hoskisson (1987), is that "the separation of overall strategic control…reduces strategic control problems. The role of a CEO becomes scanning and forecasting opportunities and threats to the whole firm and allocating resources accordingly. Strategic affairs at the product-market level are delegated to division managers who have the information pertinent to those strategic decisions" (626).

If the multidivisional form concept is applied to the bookstore industry, the physical bookstores might be seen as one division and the online and e-book sales as another. Hoskisson (1987) might argue that, although both physical and electronic sales center on books, the daily operations and business needs differ. Thus, it may be beneficial to view the venues as separate entities and treat the electronic business as a form of unrelated diversification.

Like Piscitello (2004) and Hoskisson (1987), Chaneta (2008) addresses the issue of corporate diversification. A unique aspect of Chaneta's work is that he offers insight into diversification for firms in struggling industries. His recommendations are targeted towards financially secure firms: "Companies that are strongly positioned in a slow-growth industry should consider using their excess cash to begin diversifying. Diversification into business where a firm can leverage its core is usually the best strategy…A strong company in a slow-growth industry usually needs to curtail new investment in its present facilities to free cash for new endeavors" (Chaneta, p.32).

Also discussed are three tests designed to help companies decide what diversification path to explore. Ideally, firms would seek out—as Piscitello (2004), Porter (1996), and Chaneta (2008) would recommend—areas of related diversification. However, the attractiveness-, cost-of-entry-, and better-off-tests would invariably provide additional guidance. The attractiveness test evaluates whether there is long-term growth potential via "a market environment conducive to long-term profitability" (Chaneta, 2008, p.32). A firm would want to avoid leaving a mature and declining industry only to diversify into another. There is also the cost-of-entry test, which essentially cautions firms from investing too much money in its diversification. Thirdly, the better-off test assesses whether the investment can "bring potential for competitive advantage to the company" (Chaneta, 2008, p.32). The theme of Chaneta's work is that firms must be careful when diversifying and/or adjusting their competitive strategies. Yet they must also realize that a strategy is only as effective as the surrounding environment permits it to be. New challenges are inevitable, particularly when considering the rapid technological growth of the past.

The empirical chapter takes into account the previous literature on competitive strategy and innovation. It will explore determinants of success and competitive advantages in the bookstore industry, as well as analyze strategic failures. The central focus throughout this study is two-fold. Initially, competitive strategies and determinants of success in the bookstore industry will be explored. Additionally, this study will question whether Barnes & Noble's ability to outlast Borders comes from operationally effective practices or a sustainable strategy that will transcend the new challenges of the bookstore industry.

CHAPTER 3:
HISTORICAL BACKGROUND ON THE BOOKSTORE INDUSTRY

The bookstore industry has faced several challenges since its inception. There has been competition between independent and chain bookstores in the latter half of the 20th century. In the new millennium, the primary focus of competition fell amongst the chain bookstore retailers. Throughout, bookstores have had to be careful not to ignore the sweeping force that the Internet began to exert over their industry. Between dealing with the struggling economy and the emergence of technology in the form of the Internet and e-readers, bookstores have had to rely on a competitive strategy that embraces an appropriate degree of flexibility or accept disadvantage(s).

The historical background of the bookstore industry can be subdivided into two primary areas: 1) competition amongst small and independent bookstores, chain bookstores, and chain superstores—a larger version of chain stores, offering a wider selection and more amenities for its customers—and 2) the prevalence of new technology and its impact on the bookstore industry. Each subgroup significantly contributes to understanding the past nature of the bookstore industry. In order to understand competition in the bookstore industry, it is important to study how the market has influenced bookstores in the past, as well as understand various competitors' approaches to gaining profits and market share.

I. Competition Amongst Bookstores in American Culture

A. Competition Between Chain Bookstores and Local, Independent Bookstores

Prior to the emergence of chain bookstores in the United States, independent bookstores—along with department and discount stores—were the primary places for purchasing books. The atmosphere within each independently-owned bookstore was unique and reflected its local environment. Horvath (1996) shares how an independent bookstore "…excite[d] the book lover's soul" (p. 1). He discusses the powerful relationship between locally-owned bookstores and those with a passion for literature. The relationship between independent bookstores and its customers was due to a variety of factors. Proximity surely played a substantial role in where book lovers would shop. In addition, "diversity, customer service, and literary knowledge" were some of the key characteristics that distinguished independent bookstores as a whole (Gatewood, 2007, p.505). Diversity was an intrinsic aspect of the independent bookstore, for each store manifested the preferences and values of the town in which it was located. An independent bookstore in a New York area would be invariably different from an independent in, for example, Virginia. Book displays, among other features, would have been different in size, content, and—to some degree—price. The diverse aspects of each independent bookstore were dependent on the characteristics of the town. As Miller (2006) states, "independent bookstores hold themselves up as guardians of local solidarity, local character, and local interests" (p.13).

Customer service and literary knowledge also went hand-in-hand in creating value for independent bookstores. Horvath (1996) supports Gatewood's (2007) emphasis on the importance of independent stores' employees, who would be able to make knowledgeable book selections and suggestions to better service its local customers (Horvath, 1996). Collectively, independent bookstores' high degree of diversity and knowledgeable customer support brought it the goodwill that chain bookstores would not be able to mimic. Independent stores communicated to the public that "they [independent stores] were designed with the serious

booklover in mind" (Miller, 2006, p.3). A sense of pride was integral to the independent bookstore atmosphere. Those that frequently shopped at independent stores valued literature and enjoyed immersing themselves in intellectually stimulating topics.

While independents succeeded in offering their customers local value and creating a sense of intellectual superiority, Gatewood (2007), Miller (2006), and Horvath (1996) emphasize the threat chain bookstores brought to independents in the later part of the 20th century and attribute economic advantages as a driving force in chains' growth. Waldenbooks and B. Dalton—which would later be acquired by Borders and Barnes & Noble, respectively—were two chain stores that emerged in the 1960s (Miller, 2006). Roughly 20 years later, in 1982, Waldenbooks and B. Dalton captured "approximately 24% of all bookstore sales" (Miller, 2006, p.45).

One key aspect of chain stores' dominance over bookselling is attributed to strategic store placement. Miller (2006) points out that Waldenbooks made the important decision of opening stores in suburban, as opposed to urban, areas based on new population patterns. Chain stores' decision to open in shopping malls also provided the chance to reach a different customer group. These suburban and mall locations had a well-established tactic by the end of the 1980s: "small stores in shopping centers or malls that emphasized popular titles, minimal service, and heavily advertised discounts" (Miller, 2006, p.49). Chains were finding ways to reach out to new customers, but independents still led in market share in the 1980s. And as mall traffic began to decline, independents could boast of higher-quality customer service and an either wider or more diverse selection of book titles. It seemed that these characteristics attributed to independent stores were inimitable and offered a competitive advantage.

B. The Introduction of Chain Superstores to the Bookstore Industry

The 1990s, however, brought another sweeping change to the bookstore industry: chain superstores. Much of superstores' dominance can be attributed to the economic efficiencies associated with large-scale operations. In his discussion of how chain bookstores reduced inefficiencies in book sale management, Gatewood (2007) explores how superstores "pioneered the use of computer technology to track sales, place orders, and monitor book-buying trends" (p.504). The technological tracking, combined with superstores' larger size, brought stores "popularity and profitability by pursuing economies of scale" when purchasing from publishers and also contributed to their success (Miller, 2006, p.5).

Economies of scale are often associated with large-scale productions and occur when an increase in inputs leads to a relatively larger increase in productivity. In the context of chain superstores, additional inputs come in the form of, for example, the inventory-tracking technology. Investing in this specific input helped stores to generate more accurate data on sales trends and replenish books in high demand, which led to increased sales and profitability. With an entire chain of superstores utilizing this advanced technology, time was saved and sales climbed, ultimately leading to a competitive advantage.

Book superstores' economies of scale and incorporation of technology enabled them to gain a competitive advantage over smaller, less advanced independent stores, which in turn factored into the increase in both sales and the number of chain stores in the 1990s. From 1993 to 1994, for instance, Borders superstores' sales increased from $225 to $425 million, as its number of stores went from 44 to 85 (Horvath, 1996, p.3). Similar exponential growth was also experienced by other chains, such as Barnes & Noble and B. Dalton. By 1997—much to the dismay of independent stores—Borders and Barnes & Noble collectively held 43.3% of bookstore sales (Miller, 2006, p.52).

As chain stores began to permeate America's bookstore industry, a loss for consumers emerged. Consumers were faced with a "depersonalization of the retail experience and the homogenization of bookselling" (Gatewood, 2007, p.505). Surely, advantages (a larger selection of books, longer store hours, economies of scale from stores' size, etcetera) provided chains with a competitive edge over independent booksellers. Yet, these advantages brought definite change to the bookstore atmosphere. Customers could no longer enter a bookstore and know its entire staff. Simultaneously, the diversity unique to independent stores was not a characteristic that was carried to chain stores.

This culminated in a divide within consumers. Miller (2006) categorizes customers into four categories, but they can be further truncated into two broad customer groups: the personal customers and the economic customers. Those true book lovers who coveted a personal experience would frequently visit local bookstore establishments, and those less concerned with diversity and a connection between themselves and the bookstore could now have the opportunity to shop at chain stores. Horvath (1996), whose thoughts on the customer divide resemble Miller's (2006), argues that the line between customer groups came down to price sensitivity. As mentioned, the larger chain stores' cost structure granted them the chance to pass savings from economies of scale down to their customers. The lower relative prices attracted those with greater price elasticity away from independents and created a new set of standards that customers would come to expect in the future when shopping for and purchasing books. When offered a discount, a utility-maximizing consumer will choose the option that grants him the product for a lower cost. Unfortunately for independents, their inability to offer a price discount similar to chain stores culminates in a loss of business unless the independent retailer-customer relationship is shaped by non-economic factors.

II. Technology's Effects on the Bookstore Industry

A. The Pervasiveness of the Internet

The impact of chain superstores on the bookstore industry was not the only substantial force in the latter part of the 20th century. With the pervasiveness of the Internet in the mid-to-late 1990s, the bookstore industry faced unfamiliar territory once again. The incredibly wide scope of the Internet meant increased access to educational and business information, as well as better, faster communication via electronic mail. As consumers' familiarity and satisfaction for the Internet improved, e-commerce earned a spot in retail sales.

Looking at trends in Internet popularity during the mid-to-late 1990s, it is evident that growth was rapid and sustained. In 1995, 9.39% of the United States population used the Internet (World Bank, 2012). Each successive year from 1996 through 1998 brought the percentage of users to 16.7%, 22.01%, and 30.66% of the U.S. population, respectively (World Bank, 2012). This substantial growth was an indicator that the Internet's prevalence in American society was not temporary. Thus, the technological innovation left firms with the need to make some strategic decisions pertaining to the future of their businesses. At 78.14%, the 2009 statistic is evident of the Internet's staying power.

There were arguably two main strategic paths bookstores could choose from when responding to the Internet. One option was to continue with business as usual and ignore the Internet's increasingly overwhelming role in consumers' and firms' lives. Bookstores reluctant to adopt Internet practices saw the Internet as a means of eroding physical bookstore sales. The impersonal nature of shopping for books online could lessen consumers' attachment to literature and bookstores and therefore result in declining revenues and profits.

Alternatively, bookstores could acknowledge that, like chain superstores, the Internet had a grasp on the bookstore industry and could attempt to target the untapped market for online book sales. Whether bookstores were quick to create Internet sites or not, it was the only sensible business decision. For failure to adapt would have left many bookstores without the ability to reach out to new consumers through online purchasing channels. Referring once more to Figure 2.3 shows that e-commerce for books erupted in the mid-1990s. Although the rate for online book sales did decline, it is important to note that it tapered off at a growth rate comparable to physical bookstore sales. Thus, neglecting e-commerce would have been detrimental for many book retailers' profits.

Creating a website was more critical for larger chain stores than independents based on the different customers that the stores attracted. Chains could lose a significant volume of sales if competitors offered customers online purchasing options while they did not. As stated in the historical section on chains and independents, chain bookstore customers were more sensitive to variables such as convenience, price, trends in popular culture, and so forth. Therefore, neglecting the Internet revolution lessened chain bookstores' attractiveness. It was less imperative for small, independent stores to develop online store sites, as the core of their business was centered on local value for consumers and the town in which it was located. Customers of local bookstores were attached to the unique qualities of the store. They specifically visited and shopped at independent bookstores to gain a sense of community, to support small-businesses, to enjoy browsing bookshelves, and so forth. Thus, a majority of independent bookstore customers would not find substantial value in a website since it failed to offer the characteristics they valued.

The Internet offered a wide range of unexplored territory for consumers and firms alike, and bookstores came to recognize the potential increases in brand recognition and sales that could come from organizing an online webpage and/or providing customers with the ability to purchase books online. A new pool of customers, who detested crowded stores and shopping malls, were presented with the ability to shop in the comfort of their own homes and have books shipped directly to their houses. Maintenance of an Internet website became a regular task for bookstores and continues to be an integral part of the industry in present day.

B. The Invention and Popularization of E-Readers

Technological advances continued to occur after the popularization of the Internet, and the emergence of the e-reader is arguably the next—and most recent—example. Analogous to the iPod's ability to hold large quantities of music in a small, portable device, e-readers presented consumers with the ability to purchase, store, and read hundreds (as of 2012, storage capacity is in the thousands) of books in one handheld device. E-readers can hold leisure books, textbooks, and magazines, making the product convenient for multiple reading environments and various types of users.

E-readers were first introduced to the market in 2007 with Sony's e-reader—the Sony Reader (Perenson, 2007). It was not until late 2007 when Amazon introduced the Kindle e-reader, however, that the invention truly began to grow in popularity (Perenson, 2007). Kindle's technological allure and user-friendly nature played a prominent role in attracting customers, as the device can download books purchased via Amazon's Whispernet, their version of wireless Internet (Perenson, 2007). There are many other e-readers aside from the Amazon Kindle and Sony Reader, such as the Barnes & Noble Nook and the Kobo—formerly associated with, but not produced by, Borders.

Many firms are highly secretive with e-reader sales figures. Amazon, for instance, claims record-high sales with the release of each version of its Kindle but has never provided end-of-year unit sales. The Bowker Annual put total estimates for the leading e-readers at three to five million units as of December 2010 (p.518). With regard to e-book unit sales, MSNBC reported that, in 2010, "114 million e-books were sold — a 1,039 percent increase since 2008, according to the Association of American Publishers and the Book Industry Study Group" (Choney, 2012). These figures are different from "trade hardcover books" sales of 603 million units, but the 5.8% growth rate for the trade hardcover books compared to the 1,039% growth rate for e-books must be considered (Choney, 2012). For comparison's sake, it is important to remember that using the small 2008 e-book unit sales as the initial comparison figure would naturally cause 2010's 114 million e-book sales to generate an exorbitant growth rate. And while that consideration is pertinent in analysis, the substantial growth of e-book sales should not be ignored.

The highly attractive nature of e-readers is due to the product's many benefits. Its large storage capabilities, instantaneous downloads, and alignment with the technology craze make e-readers enticing to many consumers. E-readers have carved space for a new market, one that is arguably most enticing to customers that follow new technology. Those customers that are quick to learn of new technologies are attracted to e-readers. E-readers can instantly download e-books, removing the wait time associated with e-commerce book shopping that Hsiao (2008) discusses. Further, the on-the-go characteristics of e-readers make it convenient for, among others, those commuting to work via public transportation or riding as passengers on long car trips.

The increase in consumer preferences and fascination for trendy electronic devices with instantaneous downloading capabilities cannot be ignored. The last few years have been especially challenging for bookstores of all varieties, as in-store sales have declined as a result of

significant industry changes. Stores have had to reevaluate their core competencies and determine if they can remain a part of the turbulent bookstore industry. Firms that have failed to react to changes in the bookstore industry, or have reacted to changes without incorporating them into their goals and strategies, have risked maintaining (or growing) market share in the bookstore industry. There is a strong need to be cognizant of an industry's competitive environment to maintain success, and competitive factors can include factors such as rival firms and new innovations. A primary goal of this project is to understand two of the main bookstore competitors—Borders and Barnes & Noble—and their pivotal business decisions with the ever-changing bookstore landscape. Through careful analysis of each firm, as well as a statistical analysis on determinants of success, a clearer picture of the bookstore industry will emerge.

CHAPTER 4: THEORETICAL CONSIDERATIONS IN OLIGOPOLY MARKETS

The previous chapter provided historical background on the bookstore industry and how it has evolved over time. It is also beneficial to discuss the theory behind the type of market bookstores operate in, which is that of an oligopoly. Thus, the goal of this chapter is to provide a framework for understanding oligopolies, which will enable a better understanding and analysis of Border's and Barnes & Noble's strategic actions.

I. Characteristics of an Oligopoly

Oligopolies arise when a market is comprised of a few dominant firms and other fringe firms. In the bookstore industry, Barnes & Noble and, prior to its liquidation, Borders are the two most dominant firms. Fringe firms include smaller and less influential firms, such as independently-owned bookstores. As dominant firms, Barnes & Noble and Borders hold considerable market share in their industry and are thus able to influence price. Consequently, the actions of either Borders or Barnes & Noble will impact the rest of the firms within the bookstore industry. Actions may include decisions concerning pricing, strategy, product scope, and so forth (Case & Fair, 2007). An example of a dominant firm's powerful decision is Barnes & Noble's production and sale of e-readers. The choice to expand its product scope invariably impacted Borders' strategy and operational practices and will be further analyzed in the empirical chapter.

Production in an oligopoly is analogous to competition in a perfectly competitive market; firms will produce up until marginal revenue is equal to marginal cost. Yet, unlike a competitive market, oligopoly firms are price makers as opposed to price takers. Prices are set above marginal cost and, therefore, provide firms with abnormal profits. The products within an

oligopoly may be homogeneous or heterogeneous (Case & Fair, 2007). In the case of the bookstore industry, bookstores generally sell the same goods. Therefore, unless a bookstore is a specialty store, its goods are homogeneous.

When oligopoly firms earn a profit, their financial success incentivizes other firms to enter the market. The new entrants attempt to gain market share while simultaneously reducing the shares incumbent firms hold. Nonetheless, there are high barriers to entry that often work in favor of the existing firms and inhibit others from accessing the dominant firms' economic profits. A challenge that new firms experience while attempting to enter an oligopolistic market is the establishment of brand name and recognition. Habitual consumers may not be motivated to stray from their shopping patterns, which would imply that the incumbent firms still retain much of the business within their respective market(s). Additionally, pricing wars also present a challenge to new firms. Financially healthy incumbent firms would be able to resort to a pricing war in order to drive business away from a new entrant. The new entrant, on the other hand, would not be able to outlast the incumbents' pricing strategies. Within the bookstore industry, Barnes & Noble, for example, can rely on its size, brand name, and finances to outlast a new firm's attempt to capture market share. Unable to compete, a new book retailer would most likely withdrawal from the market. As stated, oligopoly firms are well-aware that price wars do not offer a sustainable advantage over their competition. Accordingly, these practices would only last long enough to eliminate potential new competition from the market.

II. The Kinked Demand Model

One of the most common models utilized to explain pricing and production theory in oligopolistic markets, such as the bookstore industry, is the kinked demand model. Case & Fair (2007) explain the kinked demand model such that firms competing within an oligopoly follow

rivals' price cuts but not price increases. Relating their explanation to the bookstore industry, it is anticipated that Barnes & Noble, for example, would respond to a Borders' price cut by matching its rival's lower sale price. In this situation, Borders—one of the dominant firms—influences other firms within the bookstore industry via pressuring rivals to reduce prices.

The figure below shows that the equilibrium is set at point "E," an ideal balance between elastic and inelastic demand. The elastic sector of the demand curve occurs above point "E," and the inelastic sector occurs below point "E." The kinked demand model is logical because higher price elasticity—or more sensitivity to pricing—would show a flatter demand curve. Conversely, less sensitivity to price—or price inelasticity—would be represented by a steeper demand curve. The quantity demanded would change less when consumers are not as sensitive to firms' price adjustments. Oligopoly firms, such as book retailers, are able to utilize the kinked demand curve model when making pricing and production decisions.

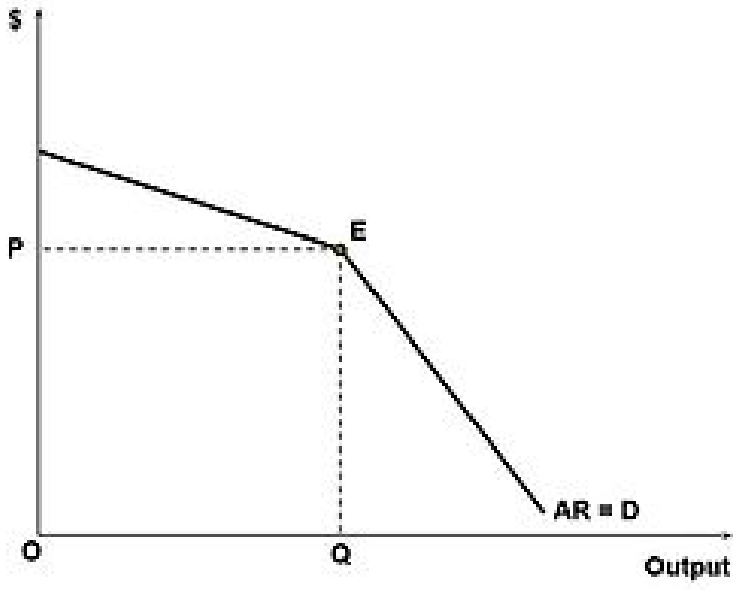


Figure 4.1: Kinked Demand Curve Model

III. The Bertrand Model

The Bertrand Model offers an alternative explanation for behavior within an oligopoly; it includes *n* number of firms that produce a homogeneous good. Since the good produced by *n* firms is homogeneous, price becomes a pivotal factor in obtaining customers' business. As previously stated, bookstores generally carry the same goods as their competitors, and, thus, the goods can be characterized as homogeneous. If there are two dominant firms within the oligopoly, suppose p_1 and p_2 represent firm #1's and #2's prices, respectively. D(p_i) represents the quantity demanded at a firm's given price, and C_i represents the cost a firm absorbs in producing said good. With the knowledge that consumers' business is drawn to the lowest price in the market, it is possible to identify a profit function. Cramton (2012) provides insight into what firm #1's profits would be based on its price relative to firm #2:

$$\pi_1(p_1, p_2) = \begin{cases} p_1 D(p_1) - C_1(D(p_1)) & \text{if } p_1 < p_2 \\ \frac{1}{2} p_1 D(p_1) - C_1(\frac{1}{2} D(p_1)) & \text{if } p_1 = p_2 \\ 0 & \text{if } p_1 > p_2 \end{cases} \quad (1.0)$$

The results of the expected profit function indicate that the two dominant firms' profits are largely based upon the expected prices its main source of competition offers in the market. Looking at the Bertrand Model in the context of the bookstore industry, Borders and Barnes & Noble would want to carefully forecast the other's prices as to avoid potential declines in sales. This intensifies rivalry and can cause firms to seek additional methods of attracting customers. Surely, fringe firms' prices and actions also influence consumers' spending patterns, but the insignificant market share individual fringe firms hold indicate that competitive decisions primarily lay with the top firms.

IV. Oligopoly in the Bookstore Industry

As mentioned, Barnes & Noble and Borders—up until its liquidation—were the first-and second-largest book retailers in the United States book industry, respectively. The third leading competitor is Books-a-Million (Bowker Annual Almanac, 2011). Undoubtedly, Amazon also holds significant influence over the book industry. While Books-a-Million nor Amazon are focal points of this study, they certainly have influence over Borders' and Barnes & Noble's past actions. Every shift in strategy Borders and Barnes & Noble made has indubitably been done with the other firms' potential responses in mind. Decisions are not made within a vacuum, but rather in the context of a firm's position within an oligopolistic market. Having now established a framework for understanding the type of market bookstores operate in, we can apply the knowledge gained to the empirical chapter.

CHAPTER 5: EMPIRICAL ANALYSIS

Previous literature argues that a successful firm's strategy will enable it to be focused, adaptable, and, at times, diversified in order to obtain and sustain a competitive advantage. To quantitatively measure the extent of a strategy's success, it is valuable to rely on performance indicators. The goal of this chapter is to use various performance indicators and apply them to an analysis of competitive practices of the two most dominant firms in the bookstore industry: Borders Group, Inc. (Borders) and Barnes & Noble.

This chapter begins with a concise overview of each of the selected performance indicators (sales, earnings per share, return on assets, goodwill, and debt ratio). Brief backgrounds on Borders and Barnes & Noble are then provided. A thorough analysis of each firm's strategic responses to two noteworthy changes in the bookstore industry (e-commerce and e-readers) will then follow. Throughout the strategic analysis, performance indicators will be utilized to assess the success of Borders' and Barnes & Noble's strategies.

Data supporting the empirical analysis comes from Mergent Online, the United States Census Bureau's Monthly Retail and Food Service Trade Survey, *The Bowker Annual Library and Book Trade Almanac*, and Borders' and Barnes & Noble's annual reports for fiscal years 1996 through 2011. The annual reports provide a foundation to characterize each firm's behavioral practices. Analyzing each firm's strategic actions, consistency in those actions, ability to identify risks, and so forth can help to recognize elements of success for bookstores. Various consumer reports and reviews will also be incorporated to capture preferences and opinions on Borders and Barnes & Noble, such as consumer preferences for e-readers. As stated, an analysis of performance indicators and firm behavior will better enable us to measure the success of each firm's strategy.

I. Performance Indicators

Sales: Sales figures indicate how well a firm's goods are selling in the market. Sales data can be interpreted by units sold or revenue generated. Due to firms' privatization of unit sales, this chapter examines revenue.

Earnings per Share (EPS): EPS is a measure of profitability that represents a firm's net income divided amongst its outstanding shares of capital stock. Trends in EPS are often used as an indicator of future performance and are highly influential in determining the stock price of that firm's shares (Williams, Haka, Bettner, & Carcello, 2010).

Return on Assets (ROA): ROA is a financial ratio used to assess management's ability to generate income based on a firm's available assets. It is calculated by taking operating income and dividing it by the firm's average total assets.

Goodwill: Goodwill is an asset that "represents an amount that a company has paid to acquire certain favorable intangible attributes as part of an acquisition of another company" (Williams, et. al., 2010, p.408). When perceptions of firms' acquisition are positive, its goodwill increases and raises the value of the business. Goodwill measures the overall value of the firm as opposed to limiting the valuation to tangible assets.

Debt Ratio: Borrowing funds is a common way for firms to finance their operations. A debt ratio measures how much of a firm's assets are funded from creditors and is calculated by taking total liabilities over total assets. A high debt ratio indicates a high credit risk and that the firm may have difficulty paying back its liabilities in the future.

II. Brief Firm Backgrounds

Barnes & Noble is the largest book retailer in the United States and is centrally managed from New York City, New York. Until the mid-2000s, Barnes & Noble operated a smaller store format, B. Dalton, but made the executive decision to phase out B. Dalton stores based on decreased market demand. Its superstore format is still in operation.

Borders Group, Inc. (Borders) was, until its bankruptcy and liquidation in 2011, the second largest bookstore retailer in the United States. Its headquarters were located in Ann Arbor, Michigan. There were two primary stores within the Borders brand, which were Borders and Borders Express (formerly known as Waldenbooks). The former aligned with the superstore format discussed in previous chapters, while the latter was designed for smaller formats, such as shopping malls.

III. Analysis of Strategic Focus

Inquiry into the contents of Borders' and Barnes & Noble's strategies will occur in latter parts of this chapter; the goal of this subsection is to comment on the firms' strategic focus. Were there any notable changes in either firm's goals or initiatives? How often were modifications made? Can we speculate that the firm(s) changed too quickly (or too slowly) in adapting to the market?

Looking through each Borders' and Barnes & Nobles' annual reports, it is evident that both firms crafted goals and initiatives for the future. The representation of these strategic business plans, however, varied greatly between the bookstore rivals. It may be surprising to discover that the now liquidated firm, Borders, distinctly identified its strategy, while Barnes & Noble did so in a less apparent manner. Each of Borders' annual reports from 1996 through 2010 included a four-to-five factor list of what the firm would use as a guide when making critical business decisions. The annual report from 2001, for example, includes 1) Expand and refine

core superstore business 2) Drive international growth by leveraging infrastructure investments and expanding established markets 3) Leverage strategic alliances and in-store based web-commerce technology to enhance customer experience 4) Maximize cash flow at Waldenbooks by containing costs (p.12).

Unlike Borders, Barnes & Noble identified the components of its strategy in a less distinct manner. Whereas Borders chose to craft its strategy for the firm as a whole, Barnes & Noble arguably chose to focus more on various elements of its business and develop strategies to best suit those needs. One particular instance of this practice comes with Barnes & Noble's "market clustering" strategy, which it discussed in the late-1990s annual reports. The market clustering strategy was utilized with the expansion of Barnes & Noble superstores. It motivated the firm to identify areas of dominant influence (ADI) when making decisions on where new stores would be located or which existing stores might receive funding for expansion. The ADIs enabled Barnes & Noble to focus on largely populated areas that would respond well to a new book superstore and aid the firm in taking advantage of the "superstore business and [its] significant growth opportunity" (*Barnes & Noble Annual Report*, 1996, p.4). At first glance, it may appear that Barnes & Noble's relatively vague strategy signifies a firm that lacks a clear focus. Strategies that are somewhat general, however, provide management with the ability to utilize judgment and flexibility. With each change that affects the bookstore industry, Barnes & Noble's relatively general strategy functions as a guide; management can then be better adept at responding to market demands and maintaining the firm's profits. The latter parts of this chapter offer evidence of Barnes & Noble's dexterity in the marketplace.

Regarding notable shifts in strategy, both Borders and Barnes & Noble were generally consistent with their initiatives. Much of Borders' strategic focus fell on its international store

investments, and it believed its international operations offered a competitive advantage. A notable variation in strategy came in 2006 with Borders' "concept store" plan, which was designed to divide superstores into popular destinations (i.e. Young Adult Fiction), as well as offer Seattle's Best Coffee and Paperchase stationary sections. At this point, the beginnings of Borders' financial struggles were causing the firm to reevaluate its core strengths. Thus, the concept store initiative began, and it coincided with Borders' withdrawal from international endeavors. The last significant shift in strategy came in 2009, as Borders began its attempts to intertwine the e-book market with its stores via the creation of "Area E." The area was a device-neutral station in superstores where customers could come to discover and purchase a variety of e-readers while receiving the assistance of a Borders sales associate.

Similar to Borders, Barnes & Noble's strategy remained relatively consistent over the last fifteen years. The latter had a "community store concept" that resembles Borders' concept store. Implementation of the community store, however, occurred back in the late 1990s and roughly ten years prior to Borders' concept store. Barnes & Noble also consistently implemented a market clustering strategy and strategic partnership alliances, focusing on store placement and e-commerce, respectively. Both topics will be discussed in the next subsection. In 2006, poor economic conditions led Barnes & Noble to increase its membership discounts and better-promote popular authors' new releases. Noteworthy changes in strategy for Barnes & Noble occurred in 1996 and 2010 when the firm redirected attention to e-commerce and a digital strategy, respectively.

As a whole, both book retailers committed to their strategies and altered them when substantial market trends impacted their business. The main differences between firms is the variation in timing and approaches taken with issues (i.e. the discouraging economic conditions

of 2006 or the e-reader popularization); Borders lagged in certain areas, such as interpolating customer and community preferences and the e-reader trend, while Barnes & Noble seemed to recognize the pivotal impact proactive approaches to each would offer its firm. Continued examination of Borders' and Barnes & Noble's strategies follows this subsection and provides a more rigorous approach to exploring each firm's strategy.

IV. Responses to Technological Changes in Bookstore Industry

A. E-Commerce

As stated in the historical chapter, the mid-to-late 1990s saw a phenomenal increase in the Internet's popularity for businesses and consumers alike. The pervasiveness of the Internet accordingly brought the pervasiveness of e-commerce, which essentially mandated that Barnes & Noble and Borders, as the top two booksellers, establish online retail channels if they wished to hold their positions in the market.

While both Barnes & Noble and Borders may have recognized the impact e-commerce was to have upon the bookstore industry, Barnes & Noble's entrance into the world of e-commerce began earlier and with much more vigor. In March of 1997, the firm entered into a strategic partnership with America Online (AOL), stating in its 1996 annual report that Barnes & Noble was the "exclusive bookseller in AOL's marketplace and ha[d] plans to launch a World Wide Web site, operating the 'world's largest bookseller online' in 1997" (p. 3). Association with AOL granted Barnes & Noble access to AOL's over 12 million members, a group that grew to over 16 million by the end of the 1998 fiscal year. The strategic decision aimed to strengthen Barnes & Noble's brand recognition and attract online customers.

True to its 1996 declaration, the firm started Barnesandnoble.com in May of 1997. Later in 1997, the company partnered with a plethora of websites, including CNN, The Discovery

Channel, *The New York Times* and *USA Today* Online, and Disney. Barnes & Noble categorized its partnerships as strategic management partnerships; similar to the partnership between itself and AOL, the relationships built with a wide variety of other well-established firms aided Barnes & Noble in gaining a competitive advantage in the e-commerce market. An evaluation of e-commerce published in 1998 by Media Metrix identified Barnes & Noble as the fourth most e-trafficked e-commerce site (*Barnes & Noble Annual Report*, 1998).

Additionally, to increase the robustness of its online business sector, Barnes & Noble entered into an agreement in 1998 with a firm titled Bertelsmann. The agreement granted Bertelsmann 50% interest in Barnesandnoble.com in exchange for $200 million in capital, which the retailer invested into growing and improving its site. Over time, Barnes & Noble would gradually obtain full interest in the website. Barnes & Noble's 1999 annual report supports the firm's actions to invest in the online platform: "Internet technology is not a threat to retailers; rather, it has become the ultimate enabler" (p.6). Further, the firm's online slogan read: "If we don't have your book, nobody does" (*Barnes & Noble Annual Report*, 1998, p.23). It is clear from its statements that Barnes & Noble viewed the Internet as new niche formation and not a technology that would induce creative destruction within the bookstore industry. The graphs below exhibit the exponential sales growth Barnesandnoble.com experienced upon its inception compared to the firm's stable, yet modest, retail growth.

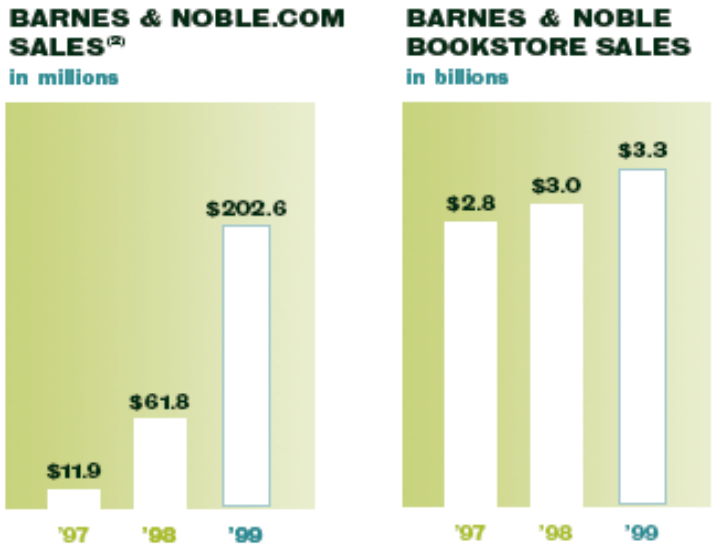


Figure 5.1: Comparison of Barnes & Noble's (Early) Online and Retail Sales
Source: Barnes & Noble 1999 Annual Report

Barnes & Noble's flexibility and open-minded business practices enabled the firm to integrate e-commerce into its operation segments, which in turn brought the firm closer to current and potential customers. As stated in 2003, Barnesandnoble.com acts as a "broadcast channel to our millions of customers and key conversion point for millions of book buyers who are not yet our customers" (*Barnes & Noble Annual Report*, 2003, p.4). Clearly, Barnes & Noble adopted Bass (2007) and Porter's (1996) recommendation to remain flexible and disciplined in identifying what changes are worthy of a shift in strategic focus. The $202.6 million 1999 sales from Barnes & Noble online—an exorbitant leap from the $11.9 million in 1997—validated Barnes & Noble's decision to incorporate e-commerce into its portfolio.

The firm's most recent online sales figures (below) support Barnes & Noble's investment in an e-commerce platform; sales for the 2011 fiscal year were $858 million (*Barnes & Noble Annual Report*, 2011, p.5). From its 1997 fiscal year online sales of $11.9 million to its most recent 2011 fiscal year sales of $858 million, Barnes & Noble has experienced over 7,000% growth and justified its online ventures.

Fiscal Year	B&N Online Sales (in thousands)	Growth from previous FY
2006	$ 436,384	-0.74%
2007	480,324	10.07%
2008	469,138	-2.33%
13 weeks ended May 3, 2008	100,254	----
13 weeks ended May 3, 2009	93,075	-7.16%
2010	572,763	22.09%
2011	858,096	49.82%

Table 5.1: Barnes & Noble's Recent Online Sales Growth

Borders, too, recognized the change the Internet held for retail. Its 1996 annual report communicated that "the company [was] developing its own vehicle for retailing over the Internet which it expect[ed] to be in operation within a year" (p.5). As of 1997, the firm created an online subsidiary, Borders Online, Inc. and introduced Borders.com in 1998. It was not until 1999, however, that Borders integrated the Internet and e-commerce into its defined strategies; the firm listed "development of web-based commerce technologies to enhance customer experience in-store and online" as important for future success (*Borders Annual Report*, 1999, p.12). Plans to expand, however, were relatively weak in comparison to its primary rival, Barnes & Noble, and can be viewed below. Sales figures for the 1999 fiscal year were barely $18 million, while Barnes & Noble's were $202 million.

STATEMENT OF OPERATIONS DATA (Dollars in Millions Except Per Share Data)	Fiscal Year Ended January 23, 2000	January 24, 1999	January 25, 1998	January 26, 1997	January 28, 1996[11]
Borders Sales	$1,823.2	$1,521.0	$1,267.4	$ 979.1	$ 717.5
Waldenbooks Sales	989.9	948.7	970.0	979.7	1,031.5
International Sales	168.2	120.7	28.6	—	—
Total Store Sales	2,981.3	2,590.4	2,266.0	1,958.8	1,749.0
Borders.com Sales	17.9	4.6	—	—	—
Total Sales	$2,999.2	$2,595.0	$2,266.0	$1,958.8	$1,749.0

Figure 5.2: Comparison of Border's (Early) Online and Retail Sales
Source: Border's 1999 Annual Report

It can be inferred from its lackluster online sales figures and above-average return on assets (ROA) that Borders' primary focus in the late 1990s was physical bookstore sales. Borders was achieving an ROA of approximately 5% when the estimated industry average was 0.9% (CNN

Money, 2012). The industry average was calculated by combining the averages for the entertainment and general merchandise industries. While placing heavier strategic focus upon store sales led to ROAs that were superior to Barnes & Noble, the benefit was not ideal for future trends and a long-term focus. The popularity of digitization eventually contributed to poor ROAs for Borders and will be discussed in the following subsection.

Fiscal Year	ROA: Borders	ROA: B&N
1995	-0.201	-0.027
1996	0.048	0.014
1997	0.052	0.013
1998	0.052	0.012
1999	0.047	0.010
2000	0.021	0.008
2001	0.040	0.008
2002	0.049	0.007
2003	0.049	0.006
2004	0.050	0.008
2005	0.039	0.008
2006	-0.058	0.007
2007	-0.068	0.007
2008	-0.116	0.008
Feb through April 2009	----	0.036
2009	-0.077	----
2010	-0.310	0.007

Table 5.2: Return on Assets Comparison

Whereas Barnes & Noble energetically and strategically invested in its online platform, Borders was slower to adapt to the industry change and neglected to successfully form multiple strategic partnerships. Arguably, Borders' most pivotal e-commerce decision was its later ties with Amazon.com in 2001. Much like Barnes & Noble's alliance with AOL, Borders built a relationship with Amazon with the hopes of increasing brand awareness and e-commerce sales. The increases in sales from its alliance are factored into Borders' total sales figures (below). Yet, Borders' failure to break down figures into store sales, international, online, etcetera prevent a clear vision of how successful its alliance proved to be for the firm. Further, it was not until 2008

that Borders' had proprietary ownership over the online site (*Borders Annual Report*, 2008). Overall, evidence suggests Borders accepted e-commerce but failed to adopt it into its core competencies and, consequently, fully capitalize from online sales.

As of Date	01/25/2004	01/26/2003	01/27/2002	01/28/2001
Borders Total Sales	$3.7 billion	$3.5	$3.4	$3.3

Table 5.3: Border's Sales Post Strategic Alliance with Amazon

Returning to Bass' (2007) analysis of the four ways in which firms respond to changes in their industry's environment, it is clear that Barnes & Noble can be labeled as a prospector. As a prospector, Barnes & Noble "work[ed] with innovative products," such as the Internet, and remained flexible (Bass, 2007, p.36). In contrast, Borders exhibited behavior that Bass would classify as defender. Defender firms embody the status quo and do not desire substantial disruption in their industries. Furthermore, the fact that Amazon was responsible for managing Borders' website until 2008 demonstrates a failure to integrate e-commerce book sales into Borders' competencies. Barnes & Noble created alliances with multiple business partners, but it took ownership over its online business segment. And while Borders' decision to form an alliance with Amazon was not a mistake, there could have been significant benefits for Borders if it had managed its e-commerce.

B. E-Readers

1. Reaction to Industry Changes

To assess Borders' and Barnes & Noble's reaction to industry changes linked to e-readers, this study will analyze annual reports and third-party evaluations of each firm's associated e-reader. Towards the turn of the 21st century, it appeared that Barnes & Noble and Borders both recognized the impact e-technology would soon have over their bookstore industry. In 1999 and 2000, Barnes & Noble reported making investments in e-technology, informing

customers and shareholders that "in the not-so-distant future, you may be sipping a cappuccino in our café…while we fill your e-book reader with content" (*Barnes & Noble Annual Report*, 2000, p.23). The firm's statement demonstrates its clear understanding of the forthcoming changes and how it realized investments in the future were necessary. Similarly, Borders' 2000 annual report made mention of e-book sales as an "emerging sales opportunity" (p.10). Both firms' terminology portrays their cognizance of technology's significant role within their industry, as well as the superior efforts they planned to put forth in order to stay competitive in a changing business.

E-books had marginal impact in the book industry within the next few years, but substantial changes occurred with the 2007 releases of the Sony e-reader and Amazon Kindle. As discussed in the historical chapter, Sony was the first-mover in the e-reader revolution, but Amazon's Kindle was the e-reader device that consumers gravitated towards. Not wanting to be left in the pre-digital book world, Borders and Barnes & Noble both adjusted their focus and strategies for the future. Borders, for instance, discussed a change in product format from physical to online and digital, for "consumers have increasingly turned to digital downloads…this trend, which we expect to continue, is also beginning to manifest in book category with the popularization of e-readers" (*Borders Annual Report*, 2009, p.2). Barnes & Noble mentioned the "increase in consumer spending patterns to e-content" (*Barnes & Noble Annual Report*, 2008, p.15).

Each firm's statements are very much similar to the other's. Yet, Barnes & Noble's statement came from its 2008 annual report, while Borders' came one year later in the 2009 fiscal year. Thus, by the time Borders was identifying the monumental pull e-content had over its industry, Barnes & Noble had purchased Fictionwise, a firm adept in the technological aspects of

e-content, which would offer Barnes & Noble a "core component to its digital strategy." Its digital strategy as of 2009 was as follows:

1) Continue to invest in digital business to fuel NOOK and seize market opportunity
2) Use infrastructure to deliver digital content to customers wirelessly and online
3) Utilize strong Barnes & Noble brand and retail footprint to attract customers to its multi-channel platform
4) Develop innovative technology
5) Expand distribution channels through strategic partnerships with world-class hardware and software companies and retail partners

The strategic decision to purchase Fictionwise—aligning with its digital strategy—gave Barnes & Noble the capabilities it required to expand its brand into the e-reader market. Four months after the Fictionwise acquisition, Barnes & Noble launched its e-bookstore. Its e-reader, the NOOK, was introduced in October of 2009. The firm diligently worked to produce a viable e-reader in time for the 2009 holiday season. Although demand exceeded supply and potential revenue was lost, Barnes & Noble keenly entered the e-reader market in a critical time for bookstores (Gross, 2011).

Significant changes in a firm's operations are often followed by changes to its goodwill. As stated, goodwill indicates an overall valuation of a firm and is not limited to assessing the value of tangible assets. When a firm makes a decision that is viewed positively by the public and business professionals, its goodwill can reflect an improvement in the firm's reputation. Mergers and acquisitions are two primary influencing factors in a firm's goodwill. Thus, it is beneficial to evaluate Barnes & Noble's strategic decision to acquire Fictionwise in 2009 with any changes in goodwill. Doing so, it is evident that the acquisition of Fictionwise and

substantial increase in goodwill correspond with each other. From 2003 to 2008, goodwill declined from $509 thousand to $240 thousand. Yet, 2009 and 2010's goodwill figures rose to $255 thousand and $529 thousand, respectively. Looking to Barnes & Noble's goodwill trends, there is a distinct increase in goodwill that coincides with the Fictionwise acquisition and development of e-reader competencies. The graph below captures the sharp increase in goodwill.

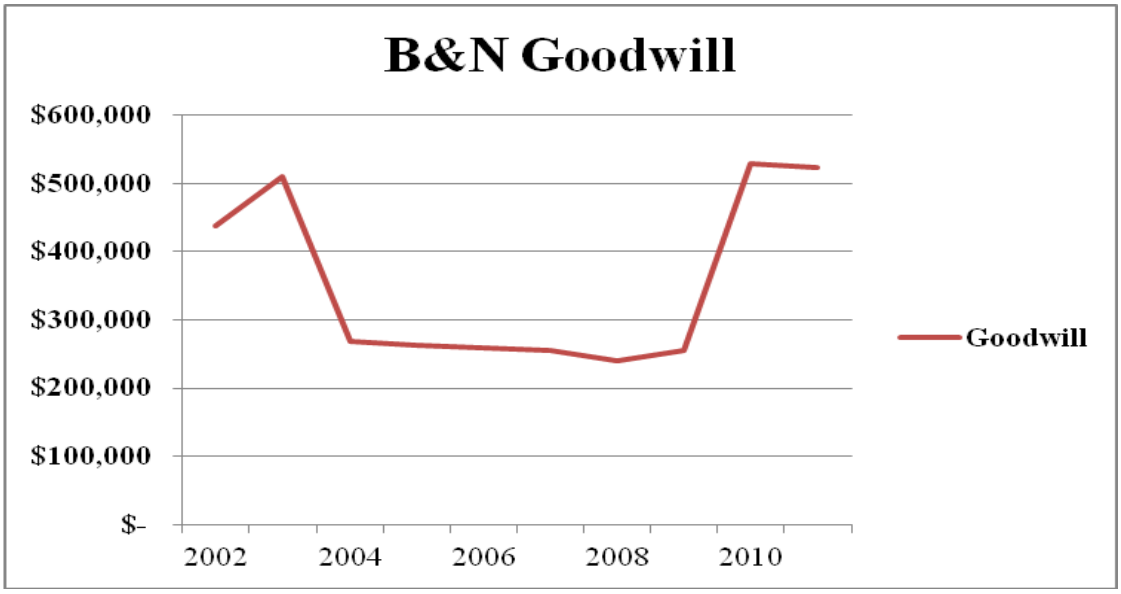


Figure 5.3: Barnes & Noble Goodwill

A notable effort to make e-technology a core competency enhanced Barnes & Noble's strategy by way of Porter (1996) and Piscitello (2004). The NOOK Boutiques in Barnes & Noble superstores is one example of the firm connecting its multi-channel business and aligns with Porter's (1996) guidelines for a sustainable competitive advantage. The firm presented current and potential customers with physical and electronic shopping options as it accustomed all customers to the various retail channels the book retailer embraced.

As Barnes & Noble was establishing itself as a credible name in the e-reader market, Borders late-moving practices left it scrambling to combat a potential loss in market share. Unlike its competitor, Borders' initial e-reader strategy centered on developing a new concept

titled “area E,” a “device neutral” section of its bookstores. Area E would offer a variety of e-reader options with knowledgeable sales staff available to answer questions and aid Borders customers in selecting the device that best suited them. Arguably, Borders realized the significant variation between its competitor’s and its own digital strategy because contracting between Kobo and Borders occurred in December of 2009. Kobo is an e-bookstore—similar to Fictionwise—that provided Borders with e-content. The nine month lag between Barnes & Noble’s acquisition of Fictionwise and Borders’ partnership with Kobo provides a clear distinction in the efforts each book retailer took. Additionally, Borders’ decision to implement e-readers into its product scope demonstrates the influence dominant firms have over one another in oligopolies. As Borders’ prime competition, Barnes & Noble’s development of the NOOK essentially mandated the former firm’s diversification into e-technologies.

On the surface, Borders’ strategy may have seemed like an original way to enter the e-reader market, retain current customers, and attract new ones. Yet, Borders neglected the importance associated with brand name and recognition. The idea of taking the device neutral strategic path may have led to increased customer satisfaction, but it failed to take the Borders name from solely a retail bookseller to a simultaneous retailer in the e-reader revolution. And with the momentum e-books began to hold in the bookstore industry, Borders’ decision was highly risky. In July of 2010, Chief Operations Officer Mike Edwards addressed claims of Borders reacting slowly to e-reader market trends; Edwards claimed that the e-reader boom just began and assured the public that Borders was not going to be left behind (Wahba, 2010).

Eventually, Borders was left behind, and top management realized it too late. Borders’ low brand recognition and low innovation would classify the firm as a stagnator a la De Figueiredo and Kyle (2006), while Barnes & Noble’s high brand recognition and high innovation

characterizes the firm as a product proliferator. The former experiences average entry and exit speeds with new products, and the latter experiences early entry and slower exit than its competition. The precarious nature of Borders' past behavior was indirectly recognized in 2011 when the firm declared that it "must execute a transformation of the Borders brand" (p.9). Borders' most recent sales figures (below) exhibit its lackluster performance compared to rival Barnes & Noble amidst a changing industry landscape. At the end of the 2009 fiscal year, Borders' sales were $3 million less than its rival. Even when accounting for the number of stores, Barnes & Noble's per store sales have been consistently higher than Border's.

As of Date	1/29/2011	1/30/2010	N/A*	1/31/2009	2/02/2008
Borders Sales	$2.3 billion	$2.8	----	$3.2	$3.8
Number of stores	642	686	----	904	1031
Sales per store	$3.6 million	$4.1	----	$3.5	$3.7
	4/30/2011	**5/1/2010**	**5/2/2009**	**1/31/2009**	**2/2/2008**
B&N Sales	$6.7 billion	$5.8	$1.1	$5.1	$5.4
Number of stores	1341	1357	1357	778	713
Sales per store	$5 million	$4.3	----	$6.6	$7.6

***B&N's acquisition of B&N College altered its fiscal year and affected number of stores.**

Table 5.4: Border's and Barnes & Noble's Sales Figures for Most Recent Fiscal Years

This undesirable performance is also evident in Borders' negative ROA (see Table 5.2) beginning with the 2006 fiscal year. From 2006 to 2010, Borders' ROA worsened from a loss of 5.8% to a loss of 31.0%. At first glance, both Borders and Barnes & Noble appeared to adopt the innovations that were influencing their industry. Nevertheless, Borders' implementation was not as rigorous as it needed to be, and it contributed to the firm's failure.

2. Valuation of Firms' Associated E-readers

The previous subsection commented on Borders' and Barnes & Noble's actions towards the e-reader innovation. This subsection will assess the success of each firm's associated e-reader devices.

Reviews, such as consumer search and consumer reports, found pricing among industry leaders to be extremely similar. This finding is expected in oligopoly markets and supports the Bertrand Model. For firms will want to remain cognizant of rivals' prices to ensure satisfactory sales revenue. While cartels—a formal pricing agreement between or amongst rivals that is most common in oligopolies—are not permitted in the bookstore industry, careful monitoring of competition is imperative so price-sensitive consumers are not drawn to rival firms.

There was not a significant variation between Borders' and Barnes & Noble's prices for e-books, but reviews on the associated e-readers were extremely different. Various consumer report sites rated the NOOK as superior to Borders' associated e-reader device, the Kobo. According to Consumer Search, the NOOK was rated as having the best touch screen and best color screen e-readers available in the market (2011). Assessment was not limited to a side-by-side Borders/Barnes & Noble comparison; Consumer Search included multiple e-readers in its consideration and found NOOK to be superior in the aforementioned categories. An additional advantage with NOOK lies with its unique ability—Amazon and Kobo do not offer this feature—to download free library books (Basten, 2010). NOOK's capabilities provide Barnes & Noble with distinct advantages over Borders. The factors mentioned also offer it competitive standing against online retail giant Amazon. Barnes & Noble's second version of its NOOK was also rated higher than the Amazon Kindle (Gross, 2011). While the superiority margin is not significant, Consumer Reports praised Barnes & Noble for offering consumers a product "without all the bells and whistles" (Gross, 2011). Other versions of NOOK do feature amenities, such as a color screen and web browser, but Barnes & Noble managed to apply its core e-reader competency in a manner conducive to maximizing consumers' options and utility. The firm

clearly invested time, money, and effort into developing a product that can carry it into the next generation of literature.

Borders did not emerge as victorious as Barnes & Noble in its reviews. There is one primary category, however, that Borders obtained positive evaluations in: selection/variety. For starters, Kobo (Borders' e-book provider) offers approximately 1.5 million e-book titles (Whaba, 2010). To place Borders' e-book offerings into perspective, Barnes & Noble's e-book scope was only 1 million as of July 2010 (Wahba, 2010). The other main advantage of purchasing from Borders is the device neutrality previously discussed. Customers' purchases could go on devices, such as iPads, smartphones, the Kobo e-reader, and others.

Unfortunately for the firm, its wide variety of e-books, combined with its device neutrality, was not enough to earn Borders high e-reader reviews. As stated, Borders' main advantage came with the wide selection of e-books that its e-reader ally, Kobo, offered. This did not carry the Kobo to the top of the e-reader review charts though. Furthermore, many reviews failed to even mention the Kobo e-reader in its valuations, which makes an entirely different statement: Borders and Kobo did not promote the e-reader device well enough. A short term investment in advertising and promotions would have been beneficial for expanding brand awareness and attracting customers away from rivals Barnes & Noble, Amazon, and others.

In general, Borders' associated e-reader was not well-publicized and received subpar ratings. As a result, Borders' late attempt to enter the e-reader market can be characterized as unsuccessful. The strategic moves Borders took—a bland device that failed to enhance brand awareness in the retail (physical and digital) book industry—were insufficient to carry Borders out of its financial slump and contributed to detrimental changes in its earnings per share and debt ratios. Barnes & Noble's alternative route of integrating a new, relevant core competency

(e-book and e-reader production) into its business deemed successful and greatly aided the firm in making a name for itself in the e-book market. Figure 5.4 shows the last decade and each firm's earnings per share (EPS). There is a sharp decline in Borders' EPS in 2007 when losses came to $2.59 per share, and the losses continued through its bankruptcy and liquidation in 2011 when losses per share were recorded at $4.37.

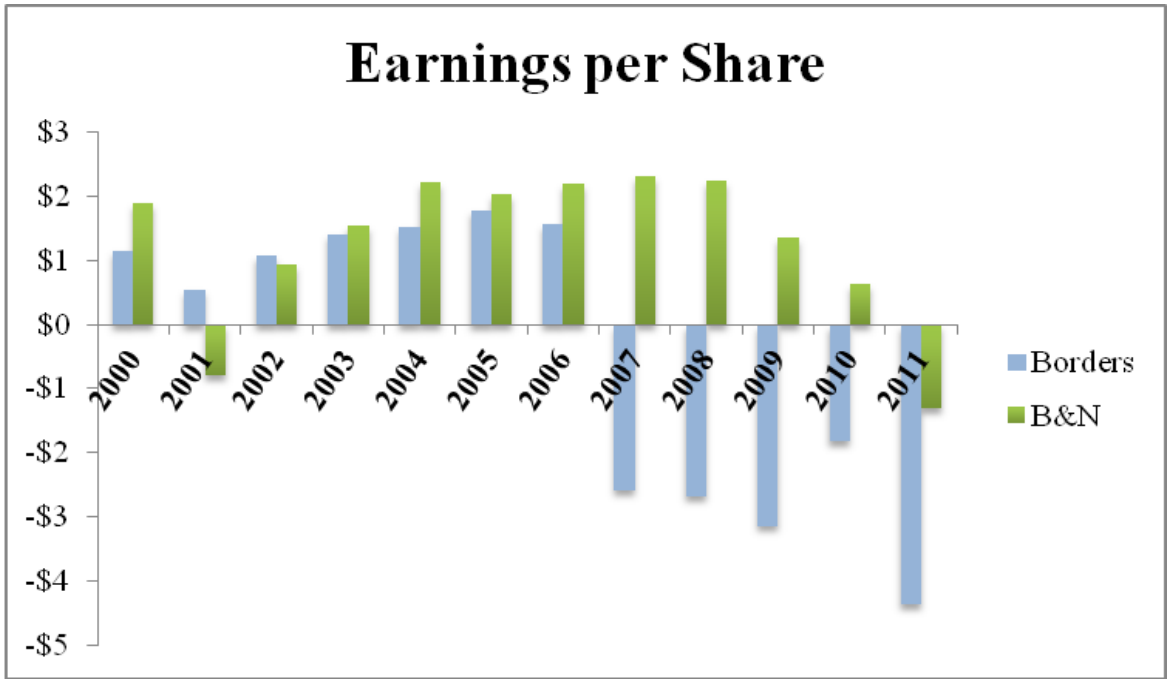


Figure 5.4: Earnings Per Share Comparison

Additionally, Figure 5.5 (below) illustrates the sharp increase in Borders' debt ratio that began in the mid-2000s. The steepest increase occurs between 2009 and Borders' liquidation, when its debt ratio went from 88.9% to 115.9%, respectively. Clearly, Barnes & Noble's yearly EPS and debt ratios have been superior to Borders for a majority of the last decade. However, the former firm, as evidenced by the graphs, is faced with concerning financial indicators. Barnes & Noble has made a name for itself in the e-reader market, but it may not be enough to sustain the firm.

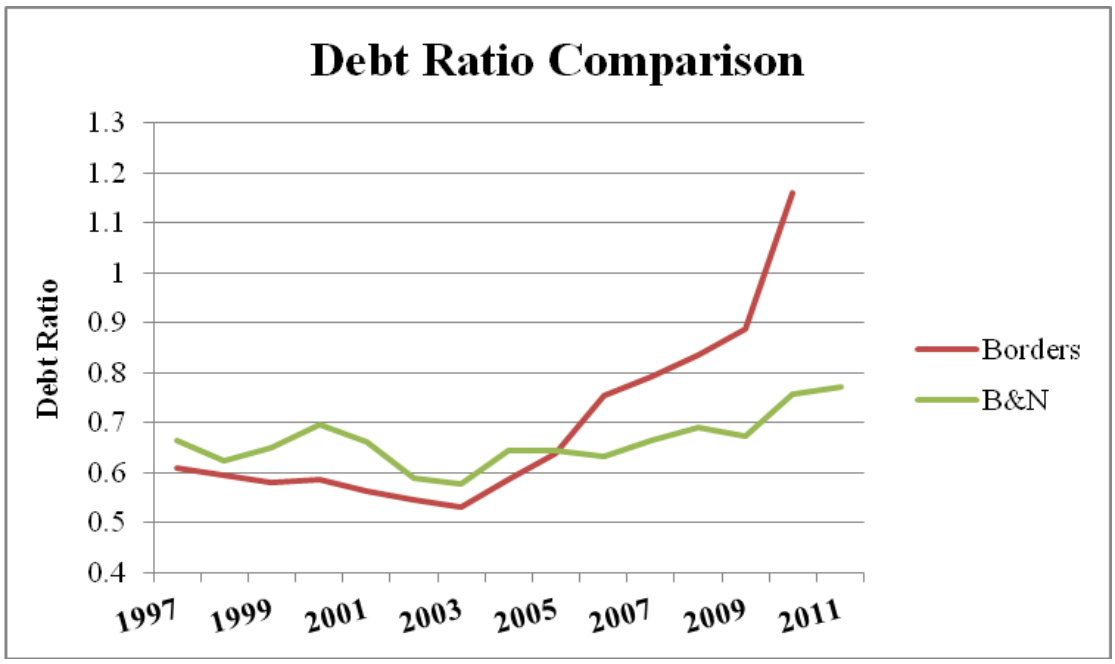


Figure 5.5: Debt Ratio Comparison

V. Comprehensive Remarks on Borders' and Barnes & Noble's Strategies

Arguably, the two most powerful changes to affect the bookstore industry in the last two decades are e-commerce and e-reader technologies. Each of these influencers has been discussed in this study. Table 5.5 (below) aims to provide a comprehensive view of Border's and Barnes & Noble's achievements and struggles. Comparing the data, it is possible to reasonably conclude how each firm's strategic decisions either helped or harmed the respective firm's degree of market share.

Industry sales figures are from the United States Census Bureau's Retail and Food Services Sales by Kind of Business. To derive each firm's market share, sales figures from Mergent Online were divided by the Census Bureau's industry sales figures. While the Census Bureau's sales figures strictly include retail bookstores and exclude some competition, such as Amazon, the calculations still provide valuable insight into Border's and Barnes & Noble's influence within the bookstore industry.

It is necessary to mention that, since Barnes & Noble's fiscal year changed in the late 2000s, analysis concerning its 2009's fiscal sales and market share figures are affected. To generate an accurate representation of Barnes & Noble's market share for February through April of 2009, the firm's sales for that quarter were utilized in calculations. The Census Bureau's sales reports are broken down monthly and yearly, which allowed an accurate calculation of Barnes & Noble's market share for the transitioning fiscal quarter in question.

There are noticeable variations between Borders' and Barnes & Noble's market share figures beginning in the late 1990s. While Borders' and Barnes & Noble's market shares were 15.6% and 17.6% in the 1995 fiscal year, respectively, the difference grew to over 7% in the 2000 fiscal year. As discussed, this time period coincides with the popularity of e-commerce and Barnes & Noble's superior ability to form strategic alliances with other firms, such as AOL, *USA Today*, and Disney.

The most recent figures also indicate Barnes & Noble's superior market share over Borders. During the e-reader popularization, Barnes & Noble was able to increase its market share to over 35%, while Borders' decreased below 20%. And although it is important to put the market share estimates into perspective based on other competition (i.e. Amazon), the table clearly demonstrates Barnes & Noble's advanced growth in comparison to its primary rival, Borders.

Fiscal Year	Industry Sales	Barnes & Noble's Sales	B&N Market Share	Borders' Sales	Borders' Market Share
1992	$8,338	$1,086.7	13.0%	$ 1,183.7	14.2%
1993	9,119	1,337.4	14.7	1,370.6	15.0
1994	10,119	1,622.7	16.0	1,511.0	14.9
1995	11,208	1,976.9	17.6	1,749.0	15.6
1996	11,918	2,448.1	20.5	1,958.8	16.4
1997	12,755	2,796.9	21.9	2,266.0	17.8
1998	13,294	3,005.6	22.6	2,595.0	19.5
1999	14,185	3,486.0	24.6	2,999.2	21.1
2000	14,892	4,375.8	29.4	3,271.2	22.0
2001	15,110	4,870.4	32.2	3,387.9	22.4
2002	15,450	5,269.3	34.1	3,486.1	22.6
2003	16,236	5,951.0	36.7	3,698.6	22.8
2004	16,877	4,873.6	28.9	3,879.5	23.0
2005	16,989	5,103.0	30.0	4,030.7	23.7
2006	16,983	5,261.3	31.0	4,063.9	23.9
2007	17,184	5,410.8	31.5	3,774.8	22.0
2008	16,870	5,121.8	30.4	3,242.1	19.2
Feb through April 2009	2,875	1,105.2	38.4	----	----
2009	16,051	----	----	2,791.1	17.4
2010	15,662	5810.6	37.1	2,252.8	14.4
2011	13,850	6998.6	50.5	----	----

Table 5.5: Sales and Market Share Comparison (sales in millions)

Borders' 2011 bankruptcy and liquidation were unquestionably influenced by numerous factors, many of which this study discusses. The firm's failure to remain flexible and incorporate new technologies into its core competencies in a timely manner greatly contributed to its struggles. More specifically, declining sales, negative return on assets, and ever-increasing debt culminated into bankruptcy. Furthermore, these issues contributed to vendors' hesitancy to do business with Borders based on its large outstanding account balances. Insufficient confidence in Borders' plans for improving its performance and salvaging the firm, when combined with its poor financial standing, confirmed Borders' need to liquidate.

The following table summarizes this chapter's characterization of Border's and Barnes & Noble's actions. Its content is based on each of the strategic and financial performance indicators discussed in this chapter.

	BORDERS	BARNES & NOBLE
Strategic Focus	Distinct focus	Relatively general focus
Response to E-commerce	Relatively slow; partially committed	Accepting and innovative
Response to E-readers	Slow to implement	Accepting and innovative
Review of Associated E-reader	Poor	Positive
Debt Ratio	Extremely high	Approaching alarming levels
Return on Assets	Unstable	Stable; slightly below industry average
Goodwill	Poor	Moderate until sharp increase in 2009
Earnings per Share	Unstable	Declining; cause for concern
Sales	Poor	Steady improvement

Table 5.6: Overall Evaluation of Border's and Barnes & Noble's Strategic Actions

CHAPTER 6: CONCLUSION

The purpose of this study was to identify competitive strategies within the bookstore industry. Based on their superior market positions, Borders and Barnes & Noble were chosen as focal points in the analysis. Annual reports, financial statements, and consumer evaluations were utilized in order to identify any differentials in strategy between the liquidated Borders and still profitable Barnes & Noble. Then, quantitative performance indicators were used in evaluating the success of the firms' strategic actions.

My research suggests that Barnes & Noble's superiority over Borders is fundamentally linked to the firm's adoption of emerging technologies. As the Internet began to emerge in the United States, both Borders and Barnes & Noble recognized the need for online sales strategies. The paths they chose in crafting those strategies, however, varied. Borders failed to have proprietary control over Borders.com until 2008, and its sole strategic alliance occurred in 2004 with Amazon. Conversely, Barnes & Noble integrated online operations into its business and partnered with many other firms in order to establish itself as a firm dedicated to e-commerce and its possibilities.

The popularization of e-readers placed Borders and Barnes & Noble in a situation similar to that of e-commerce. Again, Barnes & Noble's behavior classified the firm as a prospector, which looks to the potential that industry changes bring and view many of them as a new niche as opposed to a creative destructor. Yet, between Borders' struggles with a mature book industry and its defender attitude towards industry changes, the firm entered the e-reader market too late and with a low-publicized product independent of the Borders name. Barnes & Noble's decision

to acquire Fictionwise and produce an e-reader of its own contributed to its success in e-reader trends.

The technological core competency that Barnes & Noble integrated into its strategic web altered the resources available for its future investments and enabled it to triumph in e-commerce and e-readers. Furthermore, the vertical integration ultimately strengthened its brand awareness and reputation in the book industry. Rival Borders failed to recognize the importance of maintaining a flexible strategy and leveraging brand name as a means of sustaining a competitive advantage over other dominant industry firms.

Future trends in the bookstore industry may lead to further decreases in the number of bookstores. Barnes & Noble is the United States' largest book retailer, but it must continue to remain flexible and proactive if the firm desires a viable future and significant market share. Books-a-Million and Amazon are the firm's primary competitors and represent rivalry from both the physical and digital sales formats, respectively. As it has done with e-commerce and e-readers, Barnes & Noble must recognize consumers' tastes and how the firm can best serve them. It is possible that awareness of industry changes and a flexible strategy can provide Barnes & Noble with a feasible and profitable future. Sales and goodwill indicate Barnes & Noble's strategic actions are benefitting the firm and that its responses have been made after careful analyses. Yet, increased competition and other financial performance indicators—earnings per share and debt ratio—are causes for Barnes & Noble's concern. Barnes & Noble will have to improve its financial figures, while existing in a unique market facing competition from both digital and physical book retailers, if it is to avoid Borders' fate.

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