Short Case

Barnes & Noble

Turning the page to compete in a digital book market
In June 2019, investment firm Elliott Management announced that it would acquire Barnes & Noble for about $683 million and take the company private.¹ The largest U.S. book retailer had experienced a long decline over the last decade. The number of stores dropped by more than 100 since their peak in 2009, from 726 to 630 in 2018, and revenue fell by more than $2 billion in the same timeframe. James Daunt, who runs the British bookseller Waterstones since 2011, became CEO of the ailing company. James Daunt is known to be book enthusiast who believes in the cultural and emotional value of print. With the funds from Elliott and less short-term financial pressure from the stock market, he hopes to change the fortunes of Barnes & Noble. His initial assessment of the company, however, was less than flattering:

“Frankly, at the moment you want to love Barnes & Noble, but when you leave the store you feel mildly betrayed. [...] Not massively, but mildly. It’s a bit ugly — there’s piles of crap around the place. It all feels a bit unloved, the booksellers look a bit miserable, it’s all a bit run down. And every year, fewer people come in, or people come in less often. That has to turn around. Otherwise ...”²

Otherwise, the last remaining national bookseller in the United States would have to close shop, just like its largest rival Borders did in 2011. A failure of James Daunt to revitalize Barnes & Noble would not only have severe social consequences for its employees and the communities around the bookstores. The infrastructure behind brick-and-mortar book retail, for instance publishers and wholesalers of books, would also suffer from the bankruptcy of a large player. Even Barnes & Noble’s competitors, like independent booksellers, could feel a negative impact from its market exit. And yet, Barnes & Noble has been, for most of its history, the arch-enemy of independent booksellers.

**Strategic position of Barnes & Noble**

Barnes & Noble’s expansion to become the largest book chain in the U.S. began in 1971, when Leonard Riggio purchased the company. From a single New York location, the chain quickly expanded to hundreds of locations nationwide. Leonard Riggio’s approach of mass-market stores stocking more than 100,000 titles was a radical departure from the prevailing model at the time, when independent booksellers dominated the traditional, not very lucrative industry.³ Mr. Riggio wanted to make books accessible to the large public. “Our bookstores were designed to be welcoming as opposed to intimidating. These weren’t elitist places. You could go in, get a cup of coffee, sit down and read a book for as long as you like, use the restroom. These were innovations that we had that no one thought was possible.”⁴ Amenities like comfortable seats and a café attracted a crowd of readers that spent time in the store. Barnes & Noble also sold books at significant discounts. Barnes & Noble’s expansion came at the expense of independent booksellers. Thousands of bookstores closed during the mid- to late 1990s, to the chagrin of book enthusiasts all over the country.⁵

In 2018, Barnes & Noble had 630 stores in the US, the second largest book seller Books-A-Million had 260 stores. Barnes & Noble stores average a square footage of 26,000, with some “superstores” going up to 60’000 square feet and millions of book references. In comparison, a typical independent book store has a size of 1’500 to 3’000 square feet. Barnes & Noble’s approach to mass-market book retailing is reflected in the role of the headquarter. “Each store was told: ‘This
is your display. This book should be in this exact spot," an employee recalls. One reason for this strict policy of standardization are so called “coop fees”, that is, incentives which booksellers receive for stocking and displaying books selected by the publishing houses. While financially attractive to retailers, this policy can increase the amount of unsold books that are returned the publisher – because the centralized decisions fail to match the needs of local readers. That return rate at Barnes & Noble is between 20 and 25 percent of books, a spokeswoman for the company said.

Barnes & Noble’s dominant position in book market began to erode with Amazon’s arrival. Customers started to order more and more books online, choosing from a larger catalogue than any brick-and-mortar bookstore could offer. Furthermore, in 2007, Amazon introduced its e-reader, the Kindle. Customers now could not only order books online, but also receive them instantly in a convenient, small device. In 2010, Barnes & Noble introduced its own e-reader platform called Nook. However, the Nook has captured only about 2% of the e-reader market, compared to 84% for Amazon’s Kindle. In total, estimates are that Barnes & Noble lost more than $1 billion on the Nook. Strong competition, technical problems, and an unclear positioning of the Nook between tablet and e-reader all contributed to these problems.

Ever since, Barnes & Noble has been in a downward spiral. At the end of 2019, Barnes & Noble had about 24,000 employees, half of what it had in 2003. Many of the layoffs were more experienced workers, which are more expensive than entry-level employees. Despite these cuts, Barnes & Noble cumulated an operating loss of more than $200 million from 2010 to 2018 – but in contrast to long-time rival Borders, Barnes & Noble did not have to file for bankruptcy protection. Still the largest book chain, Barnes & Noble clings to about 8 percent share of the American book market, versus 50 percent for Amazon.
Digitalization of the book market
While Barnes & Noble’s sales are faltering, the overall American book market has stabilized during the last years. After a sharp drop in volume and value of book store sales from 2007 to 2012, the decrease in value has bottomed out and unit sales started to grow slightly (please refer to the appendix for detailed statistics on the U.S. book market).

E-books, once thought to be the death of paperbound books, are ebbing in popularity, and printed books are making a modest comeback. According to Publishers Weekly, unit sales of printed books rose 1.7% per year from 2015 to 2019. As a result, independent bookstores are showing a resurgence: from 2009 to 2015, their number grew by 35%.10

The outlook for the paperback book market and brick-and-mortar book retail, however, is uncertain. Has the market permanently stabilized and found its equilibrium? Or is it a calm before the storm as behavioural changes of consumers towards electronic books (or other forms of entertainment) take time to materialize?

A look around the globe shows very different strategies of booksellers to adapt to digital competition.

Booksellers’ response strategies

Waterstones (United Kingdom)
Waterstones is the UK’s largest bookstore chain. On the verge of bankruptcy back in 2011, it managed a remarkable turnaround after James Daunt took over as CEO. Daunt describes the beginning of his tenure at Waterstones as “horrendous”, as he had to cut costs by closing stores and laying off about 200 employees.11

The real turnaround of Waterstones, however, did not come from cost cutting measures. James Daunt transformed the company into a collection of independent book stores focusing on providing a shopping experience to local book lovers. Waterstones even allows some locations to omit the Waterstones branding. He empowered store managers to adapt their location to the tastes of the consumers. To that end, he ended the practice publishers deciding what books to stock and display, at the cost of foregone “coop fees”. “We were filling our stores with books that customers didn’t want,” James Daunt recalls.12 Store Managers can decide over the display of books, with astonishing results. Just 4 percent of books at Waterstones are returned to publishers.13 James Daunt also cut back on non-book products. While stationary, greeting cards, and other paper-based items remained part of the portfolio, all non-paper related items, be it scented candles or travel accessories, were discontinued.

Online sales are not a priority for Waterstones. It has invested relatively little in its website, which accounts for approximately 5 percent of sales.14

With its return to “old-fashioned” independent bookselling targeted at book enthusiasts, Waterstones achieved a return to profitability in 2015 and earns a 10 percent margin on sales of roughly $500 million. Its market share in Britain has stabilized at around 25 percent market share, compared to Amazon’s 40 percent.15
**Indigo Books (Canada)**

Indigo is Canada’s largest bookstore chain. Under CEO Heather Reisman, Indigo has positioned itself as “cultural department store,” with gifts, toys, music and lifestyle products in its product range. These include picnic blankets, scented candles, wall art, pillows, lunchboxes, cheese knife sets, glassware, throws and scarves. The idea behind the business model as a “cultural department store” is that when customers who come to buy books often end up lingering as they impulsively buy adjacent products that fit the topic of the book.

Books still account for just over 50 percent of Indigo’s sales and remain the core product. Indigo stores are relatively large and frequently stock around 55,000 titles. Nevertheless, the strategic shift from book retailing to cultural department store has entailed significant changes. Heather Reisman appointed fashion retailing experts to executive positions. While book sellers can return unsold books to publishers, putting more risk on the supplier, for most other consumer goods the retailer bears the risk. Non-book products that do not sell need to be cleared out at big discounts, and avoiding these losses requires special general retail know-how.

Indigo was early to invest in digital books as well. In 2009, it created the Kobo, its own e-reader. The Kobo business was growing fast, but required significant amount of investment to scale up, competing with the likes of Amazon’s Kindle and Barnes & Noble’s Nook. In 2011, Indigo sold its majority stake in Kobo to Japanese Rakuten Group, a deal that valued the Kobo business at $315 million.

**Thalia (Germany)**

Thalia, Germany’s largest book store chain, has embraced cooperation with its rivals as a means to respond to a digitalized book market. In 2013, it established together with Weltbild, Bertelsmann, and Hugendubel the Tolino Alliance. With Deutsche Telekom as a technological partner, the alliance developed an e-reader alternative to Amazon. While the partners of the Alliance compete in traditional book selling, they all brand and commercialize the Tolino together. Over the years, more partners have joined the Alliance, not only in Germany but also in the Netherlands, Belgium and Italy.

“With our network of strong partners we are able to create an interesting bundle for the digital readers, in particularly for customers who like to use all channels, which is more attractive and more open than Amazon’s Kindle,” says Michael Busch, CEO of Thalia. The Tolino uses an open ePub standard for digital books, which allows customers, for instance, to lend e-books from the local library – an advantage compared to the closed system of Amazon. With about 40% market share, the Tolino is head-to-head with Amazon’s Kindle in the German market.

Furthermore, Thalia has started an initiative to promote reading in Germany and hopes other book sellers will join. This initiative is part of a new store concept and design, developed in a collaborative process with about 100 employees from all hierarchical levels. Thalia hopes its stores will become a meeting point for local communities, with a play corner for kids, co-working desks and cafés. With partners, Thalia wants to offer books and non-books that are exclusive to Thalia, for example a Loriot collection.
**Fnac (France)**
The French retailer Fnac, once known for its books, has long transformed into a cultural superstore with music, movies, games and electronics. Its market share in books is close to 20% in France, making it the leader in the space.\(^{23}\) On a corporate level, however, the book section now pales in comparison to other products, especially after the merger with electronics and white goods retailer Darty in 2016.

Fnac has invested significantly in its online presence, and sees the possibility to combine the website with its physical locations as a source of advantage against online specialists like Amazon. In particular, in-store and after-sales service are such elements that allow a differentiation to online retailers. Fnac has also a large loyalty program with over 5 million members.\(^{24}\)

The French government is also taking steps to protect its retailers against what it perceives as unfair competitive practices by foreign online retailers. “In the e-commerce space, Amazon, because of its know-how and because of the pressure it puts on prices, is building a monopoly, helped by advantages derived from its fiscal domicile and property taxes it doesn’t pay,” said Fnac CEO Alexandre Bompard in 2017.\(^{25}\) Regulatory initiatives like an online service tax have since been introduced in the French legislation.

**James Daunt’s strategy for Barnes & Noble**
James Daunt’s turnaround strategy for Barnes & Noble has a clear core message: In a world where Amazon offers unbeatable convenience and prices, the key for big book stores is to improve the physical stores and make them more like independent book shops. “A good independent bookshop is something pretty special,” he says. “It has personality and character, and that’s primarily driven by the people working in it, the booksellers. Also the manner in which they display their books, the amusement and serendipity of how they curate their shops.”\(^{26}\)

Nevertheless, he plans to continue the Nook to give customers more options on how to interact Barnes & Noble. He also wants to improve Barnes & Noble’s website and better link it to the physical locations, for example with the option to pick-up online orders in store. His main focus remains the book shopping experience. “If you improve the stores, everything else will rise.”\(^{27}\) However, he is not the only one to believe in brick-and-mortar: Even Amazon is investing in physical bookstores across the country.

**Case study questions**
1. How has digitalization affected the book market in general and bookstore chains in particular?
2. What strategies of book sellers in response to digitalization do you observe? Are there other strategies you can think of?
3. What assumptions about the future development of the book market underlie the announced strategy of James Daunt? What strategy would you recommend for Barnes & Noble going forward?
4. How should James Daunt implement the strategy? Differentiate between the first 100 days and the longer term.
Appendix

Statistics on the US book market

Figure 1: Format Shares in the US Book Market (Source: Publishing Perspectives, via Statista)

Figure 2: Book store sales in the US book market (Source: US Census Bureau, Publishers Weekly, via Statista)

Figure 3: Book store unit sales in the US book market (Source: Publishers Weekly, Nielsen BookScan, via Statista)
### Financials Barnes & Noble

#### Income Statement

Annual Standardised in Millions of U.S. Dollars

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<tbody>
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<td><strong>Revenue</strong></td>
<td>5,121.8</td>
<td>5,807.8</td>
<td>6,998.6</td>
<td>7,129.2</td>
<td>6,839.0</td>
<td>4,633.3</td>
<td>4,297.1</td>
<td>4,163.8</td>
<td>3,894.6</td>
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<td><strong>Cost of Revenue</strong></td>
<td>3,540.6</td>
<td>4,131.0</td>
<td>5,197.3</td>
<td>5,211.7</td>
<td>5,156.5</td>
<td>3,214.4</td>
<td>2,871.2</td>
<td>2,836.5</td>
<td>2,682.4</td>
<td>2,551.1</td>
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<td><strong>Gross Profit</strong></td>
<td>1,581.2</td>
<td>1,676.7</td>
<td>1,801.3</td>
<td>1,917.5</td>
<td>1,682.5</td>
<td>1,418.9</td>
<td>1,425.9</td>
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<td><strong>Selling/Gen./Admin. Expenses</strong></td>
<td>1,252.6</td>
<td>1,379.1</td>
<td>1,622.7</td>
<td>1,727.2</td>
<td>1,666.2</td>
<td>1,252.4</td>
<td>1,190.4</td>
<td>1,172.0</td>
<td>1,038.2</td>
<td>996.8</td>
<td>935.2</td>
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<td><strong>Depreciation/Amortization</strong></td>
<td>173.6</td>
<td>207.8</td>
<td>228.6</td>
<td>232.7</td>
<td>227.1</td>
<td>168.8</td>
<td>143.7</td>
<td>135.9</td>
<td>117.9</td>
<td>106.3</td>
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<td><strong>Unusual Expense (Income)</strong></td>
<td>11.7</td>
<td>16.6</td>
<td>6.8</td>
<td>12.3</td>
<td>9.2</td>
<td>34.8</td>
<td>1.7</td>
<td>4.7</td>
<td>1.8</td>
<td>135.9</td>
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<td><strong>Operating Income</strong></td>
<td>143.3</td>
<td>73.2</td>
<td>(56.8)</td>
<td>(54.6)</td>
<td>(220.0)</td>
<td>(37.0)</td>
<td>90.2</td>
<td>14.7</td>
<td>54.3</td>
<td>(127.9)</td>
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<td><strong>Interest Inc.(Exp.)</strong></td>
<td>(2.3)</td>
<td>(28.2)</td>
<td>(57.4)</td>
<td>(35.3)</td>
<td>(35.3)</td>
<td>(29.1)</td>
<td>(17.7)</td>
<td>(8.8)</td>
<td>(7.5)</td>
<td>(9.8)</td>
<td>(13.4)</td>
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<td><strong>Provision for Income Taxes</strong></td>
<td>55.6</td>
<td>8.4</td>
<td>(45.3)</td>
<td>(25.1)</td>
<td>(97.5)</td>
<td>13.0</td>
<td>39.6</td>
<td>(8.8)</td>
<td>24.8</td>
<td>14.9</td>
<td>(0.7)</td>
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<td><strong>Net Income After Taxes</strong></td>
<td>85.4</td>
<td>36.6</td>
<td>(68.9)</td>
<td>(64.8)</td>
<td>(157.8)</td>
<td>(79.1)</td>
<td>32.9</td>
<td>14.7</td>
<td>22.0</td>
<td>(152.6)</td>
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<td><strong>Total Extraordinary Items</strong></td>
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<td>--</td>
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<td>31.9</td>
<td>3.7</td>
<td>(39.1)</td>
<td>0.0</td>
<td>27.1</td>
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<td><strong>Net Income</strong></td>
<td>75.9</td>
<td>36.7</td>
<td>(68.8)</td>
<td>(64.8)</td>
<td>(157.8)</td>
<td>(157.8)</td>
<td>36.6</td>
<td>(24.4)</td>
<td>22.0</td>
<td>(125.5)</td>
<td>3.8</td>
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Table 1: Income statement of Barnes & Noble (Source: Thomson Reuters)
1 Hirsch, Lauren (June 7, 2019) Elliott Management to acquire Barnes & Noble for $683 million. CNBC.
19 Greiner, Lynn (June 20, 2019): Kobo: 10 years of Canadian innovation. IT World Canada.
20 Börsenblatt (February 6, 2014): Die Mittel reichen. Interview with Michael Busch.
21 Krüger, Alfred (March 17, 2018): Tolino: Buchhandel gegen Goliath. ZDF.
22 Börsenblatt (September 20, 2018): Wir hoffen, dass die Kollegen schnell dabei sind. Interview with Michael Busch.
23 Payot, Marianne (September 3, 2016) : Fnac, Leclerc et Cultura en ordre de bataille pour la rentrée littéraire. L’Express.