**BARNES & NOBLE vs. AMAZON.COM**

**INVESTMENT REPORT**

Prepared for

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November 15, 2012

**MEMORANDUM**

DATE: November 15, 2012

TO: Dan Peters and Ron Connelly, Partners, PC Accounting Services

FROM: Birch Communications

SUBJECT: Recommendation for investment-Amazon.com vs. Barnes & Noble

Here is the report you requested on November 8 regarding an analysis and recommendation about which corporation you should invest in-Barnes & Noble or Amazon.com.

Although on the surface, both companies you are considering appear to be similar, our research has shown there are great differences between the companies. We looked at various areas of Barnes & Noble as well as Amazon.com and analyzed key points so that we could make an informed recommendation. We hope you will find the data and detailed research about each company to be conclusive and allow you to make a decision regarding your investment. We have summarized many aspects of both businesses, including past financial indicators and data, challenges and future direction of each company. Our goal was to present our research to you in an unbiased way, with the exception of the *Conclusions and Recommendations* section. In this section, we have included our group opinion on which company we think would be the wiser investment.

Thank you for the opportunity to report this information to you. We learned a great deal doing the research on both companies and found it to be enlightening. Please feel free to contact us if you have questions or concerns.

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**INVESTMENT REPORT**

**INTRODUCTION**

For the past 20 years, PC Accounting Services has prided itself on providing accurate and affordable payroll and accounting services for small and large companies. Over the years, PC Accounting has also been investing company profits in major corporations in which it sees potential for growth and profitability. Since deciding to reinvest profits in large companies, PC Accounting Services has earned over 2.5 million dollars and currently holds stocks in major corporations that are valued at 1.25 million dollars.

This year, the partners at PC Accounting have asked our firm to thoroughly research Amazon.com and Barnes & Noble, as it plans to invest in one major retail corporation before the end of 2012. Our firm, Birch Communications, was hired to provide an in depth analysis of pertinent aspects of both businesses. The purpose of this report is to provide all the necessary data and background information in an unbiased manner, so that Mr. Peters and Mr. Connelly may make their investment decision knowing all the facts and figures about both companies.

Our report was developed as a result of conducting independent and group research about each company’s background, competitors, success stories, challenges (past and future), strategic moves, philosophical differences in management, as well as key comparative statistics. Our research was compiled using a variety of online sources and is very current. The analysis of these key areas will provide greater insight as to which company to invest the company profits in, Amazon.com or Barnes & Noble, based on the potential for return on investment.

**BARNES & NOBLE, AMAZON.COM AT A GLANCE**

Pioneering the concept of the book “superstore,” Barnes & Noble is a content, commerce and technology company that provides customers access to books, magazines, newspapers and other content across its multi-channel distribution platform.

Amazon.com operates international retail websites and offers platforms that enable third parties to sell products on the company’s websites. Products include books, movies, music, electronics, clothing, groceries, and more.

**NUMBERS & STATISTICS**

Barnes & Noble’s multi-platform channel includes retail stores, Barnes&Noble.com, a publishing program and digital marketplace.

As of July 2012, Barnes & Noble operates 689 retail stores in 50 states and 667 college bookstores, serving more than 4.6 million students and faculty at colleges and universities across the United States. Barnes&Noble.com offers tens of millions of in-print, out-of-print, rare and used books. Through its publishing program and the acquisition of Sterling Publishing, Barnes & Noble obtains publishing rights to over 10,000 titles. Finally, in capitalizing on eBook trends, Barnes & Noble launched the eBookstore, now known as the NOOK Bookstore. The NOOK is Barnes & Noble’s eBook reader, enabling customers to digitally download content from the NOOK Bookstore ("Barnes and noble," 2011).

Barnes & Noble has 40 million customers and sells approximately 300 million books per year between its stores and online operations. The company has a 22% share of the eBook market, selling three times as many eBooks compared to physical books online (Milliot, 2012). As of April 2012, Barnes & Noble’s fourth quarter earnings are down, at $1.38 billion (Bosman, 2012). Barnes & Noble stock is currently up at $15.11 per share ("Reuters.com,").

Amazon’s four customer sets include consumers, sellers, enterprises and content creators. The company’s e-commerce platform includes retail sites, publishing and a digital marketplace.

Amazon.com operates in two segments- North America and International- consisting of amounts earned from retail sales of consumer products (including from sellers) and subscriptions through North America and international focused websites and locations. Amazon.com has primary locations in 14 countries and all 50 states. Through Amazon Publishing and CreateSpace, authors, publishers, musicians, filmmakers and content creators can market their products. Also capitalizing on the eBook trend, Amazon launched Kindle Direct Publishing in conjunction with their Kindle e-reader device and Kindle Store. Authors and publishers can market their products through the Kindle Store and customers can digitally download content ("Reuters.com,").

More than two million small businesses, well-known retail brands and individual sellers are a part of the Amazon’s e-commerce platform ("Amazon.com," 2011). Amazon has over an estimated 122 million customers worldwide (Stone Brad, 2010). The company has a 27% share of the eBook market (Milliot, 2012). As of April 2012, Amazon’s fourth quarter sales are up, at $13.18 billion ("Amazon.com," 2011). Amazon’s stock is currently down at $226.31 per share ("Reuters.com,").

**MANAGEMENT, PRODUCTS & SERVICES**

Barnes & Noble’s corporate governance focuses on the benefit of stockholders, long-range strategic development, a review of financial goals and performance, and an ethical business environment ("Barnes and noble," 2011). Amazon.com’s corporate governance focuses on customers, long-term, bold investment decisions, cash flows, a cost-conscious culture, and versatility and diversity in its staff (Amazon, 2011).

Barnes & Noble primarily markets through its site, social media and television advertisements. A recent survey conducted by the company’s College division on students’ media habits showed that 42% said that TV and 65% said that social media ads were the most effective forms of advertising (barnes&nobleinc.com, 2012). Barnes & Noble’s marketing focus is on the NOOK. Recent advertisements pushed its newest NOOK, Simple Touch with GlowLight. Amazon primarily markets through its sites, social media and television advertising as well. Amazon’s recent, bold marketing move advertises the new Kindle Fire tablet in comparison with Apple’s iPad “mini.” On Amazon’s website, it emphasizes the Kindle’s low cost and high definition capabilities in a side-by-side comparison with the “mini.”

Barnes & Noble has learned to adapt to the digital world. While the company is primarily known for its retail stores and coffee shop atmosphere (thanks to its partnership with Starbucks), it has tried to keep up in the e-commerce market as well. With the NOOK and NOOK Bookstore, the company has survived the economic climate and highly competitive atmosphere among companies such as Amazon and Apple. Amazon has capitalized on e-commerce by providing connections to millions of products from around the world. From books and movies to electronics and groceries, Amazon has made shopping online simple and affordable. The company has also developed its own tablet to compete with Apple’s coveted iPad. Amazon’s ability to produce at lower costs has created fierce competition in the market.

One facet that these two companies share in common is their membership options for customers. Barnes & Noble offers a $25, per year, membership. As a member, customers receive exclusive deals, discounts on books and free shipping. Amazon.com offers a $79, per year, membership for its customers called, Prime. As a Prime member, customers receive exclusive deals; free shipping, and free TV shows and movies through Amazon Instant Video. These memberships provide customers with a sense of belonging and encourage commerce in order to redeem the benefits inherent in the membership.

**PAST CHALLENGES**

The challenges that these two companies have faced, and continue to face, are the digital landscape and competition. Barnes & Noble became the last hope for bookstores after the collapse of Borders. Barnes & Noble is now the last major bookstore chain standing. The company is in constant competition with e-commerce sites, e-readers and tablets. It is safe to say that Barnes & Noble’s primary competitor is Amazon. Barnes & Noble began to utilize their website, offering more titles and including free shipping for members. After Amazon launched its tablet, the Kindle, Barnes & Noble was forced to step up in the digital landscape. It created the NOOK and the NOOK Bookstore. Several generations later, the NOOK has come a long way in its evolution. The NOOK began as a simple e-reader, dull and boring with limited options. Now it has become a full-blown tablet with color, a built in light, Internet searching and application capabilities. Its newest tablet comes in high definition. While the NOOK looks more appealing than it did in previous years, one thing stands in its way of success- price. Amazon’s Kindle, is priced anywhere from $69-$100 cheaper than the NOOK. This is not to say Amazon doesn’t have its challenges either. Amazon has made a name for itself globally, however it still has competition with other e-commerce sites like e-Bay. EBay allows individual sellers to sell (auction) essentially anything they want for a fee. Amazon has limitations on what individual sellers can sell due to competition with other retailer partnerships with Amazon. EBay’s earnings are up and strong this quarter hinting some added competition for Amazon (Barr, 2012). However, according to a recent Forrester report, 30 percent of all online shoppers start at Amazon to research products as opposed to Google or eBay (Savitz, 2012). Another competitor Amazon faces is Apple. The highly coveted Apple iPad is in fierce competition with Amazon’s Kindle. While the iPad is more expensive than the Kindle, Apple fans might point out that the iPad has far more tablet-optimized apps, options for 4GLTE connectivity, and is the thinner and lighter device of the two. However, Amazon’s Kindle is a cheaper alternative for those who cannot afford an iPad or even the NOOK. It today’s economy, Amazon’s new Kindle Fire might cause some competition during the upcoming holiday season.

**COMPANY SUCCESS STORIES**

Both Barnes & Noble and Amazon.com have experienced great success in their years in business. The company originated in 1873 and opened its first bookstore in New York City in 1917. In the 1970’s they became the first bookstore to advertise on television, as well as the first bookstore to discount *New York Times* bestsellers at 40% off. From 1992 through 2003, Barnes & Noble released a series of literary classics for adults and children under the imprint Barnes & Noble Classics Collection. In 2003, Barnes & Noble revamped and expanded its line of literature classics, releasing books in hardcover, trade paperback and mass-market editions ("Barnes & Noble-Wikipedia," 2012). Barnes & Noble stores are also known for their Starbucks cafés, where people often sit and relax with a cup of coffee or a snack. Undoubtedly, Barnes & Noble’s greatest success comes from the NOOK, their electronic book reader, introduced in November 2009. The original retail price was $259, which was later reduced to $199. The NOOK’s biggest competition for the tablet/e-reader market comes from the Amazon Kindle Fire, and Apple’s iBooks for iPhone, iPad and iTouch.

Although only in business 17 years, Amazon.com has experienced great success and is now the world’s largest retailer. Amazon has separate retail websites for the following countries: United States, Canada, United Kingdom, France, Germany, Italy, Spain, Japan, and China, with international shipping to certain other countries for some of its products. It is also expected to launch its websites in Poland,Brazil, Netherlands and Sweden ("Amazon.com-Wikipedia," 2012). Amazon.com sells a variety of retail goods online-including books, jewelry, baby items, tools, software, toys, as well as health and beauty items, and is a huge third party reseller. Amazon Prime membership is very popular and for an annual fee, a user can join, which entitles them to free two-day shipping on eligible purchases. Amazon Prime also provides Amazon Instant Video and access to the Kindle Owner’s Lending Library. Amazon’s sales of digital media, like books and music, are also a very profitable aspect of their business. Amazon’s greatest success to date is the introduction of its e-reader, Kindle, in November 2007 and the Kindle Fire in September, 2011. Since 2007, Amazon has released multiple versions of the Kindle e-reader and two versions of the Kindle Fire. Its biggest competitors in the e-reader/tablet market are the Barnes & Noble NOOK and the Apple iPad being used in conjunction with the Kindle app.

**IMPORTANT DECISIONS MADE BY THE TWO COMPETITORS AND HOW THOSE DECISIONS AFFECTED THEIR COMPANY**

In our research, there was one main decision made by Barnes & Noble that had permanent implications for their company, as well as Amazon.com. Barnes & Noble realized early on that e-books could appeal to consumers, but allowed Amazon.com Inc. to get an early leg up. Now it is locked in a battle with Amazon and another deep-pocketed rival, Apple Inc., to sell both electronic books and the high-tech devices consumers use to read them (Trachtenberg & Peers, 2012).

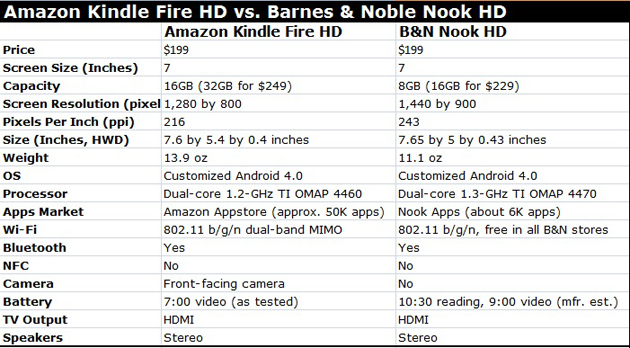
By Amazon.com launching the Kindle two full years prior to Barnes & Noble’s NOOK, they had a tremendous advantage in introducing the e-reader to the public, as well as developing the technology to introduce a tablet. Had Barnes & Noble acted on their theory that e-books would be so popular with consumers, it would have allowed them to have a greater market share for e-readers and digital downloads. If Barnes & Noble had introduced an e-reader before, or around the same time that Amazon did, they would be much more competitive in the area of e-readers/tablets and selling digital books. Their two-year delay in bringing their idea to market would have a lasting effect on the company. It seems they have been playing catch-up with Amazon ever since.

Here is a comparison of pricing and specifications of the Amazon Kindle Fire HD and the Barnes & Noble NOOK HD. These e-readers/tablets are locked in a heated competition for the small tablet market and are the most successful products each company produces.

**Figure 1**

Comparison of the specs of the Amazon Kindle Fire HD and the Barnes & Noble NOOK HD

*Source: PCMag.com*



Another major decision on the part of Amazon.com had a tremendous impact on their company as well as other e-reader and tablet competitors. Amazon knew when the iPad was introduced; it would be a hit, so they created a Kindle app. When Amazon decided to launch its iPad app, essentially giving users a reason to buy a competitor's tablet over its own, analysts called it a brave and bold move. But AT&T CEO Randall Stephenson said it is now clear that Amazon's decision was incredibly intelligent. (Goldman, 2011) Amazon had the foresight to realize how important cloud computing would become in the future and by creating the app, put itself in direct competition with Apple the iPad. This move also put Barnes & Noble at a greater disadvantage and allowed Amazon and Apple to lead the industry in the area of e-reader/tablet sales. In addition, it allowed Amazon to reap the benefits and profits of books that were being purchased though Amazon and downloaded through Kindle apps. The development of the Kindle app helped Amazon catapult its digital book download sales.

**STRATEGIC MOVES MADE BY ONE RIVAL THAT MIGHT AFFECT THE OTHER**

Barnes & Noble and Amazon.com are similar in some aspects, but how they operate their businesses varies in many ways.

Although recently closing underperforming stores, Barnes & Noble has stuck to the premise of operating brick and mortar stores across the United States. The cost operating these stores is cutting into their revenue and retail store sales aren’t growing like digital business is. Amazon.com operates their business online and sells third party goods as well as their own goods and downloadable media without operating retail stores. Amazon.com has a clear advantage as it operates online and is worldwide, whereas Barnes & Noble is primarily thought of as a book chain operating in the United States only.

Barnes & Noble is also being criticized for trying to duplicate Amazon in a particular strategy. Barnes & Noble is imitating Amazon, willing to take a hit on profit in a quest for growth. This may not work out as well for them as it has for Amazon, which is considered an e-commerce giant. Lowering the cost of e-readers in hopes selling more digital products works for Amazon. Barnes & Noble's strategy is very similar to that of Amazon's, which has never had issue hemorrhaging money in its goal of becoming an e-commerce powerhouse. Now, it seems, Amazon is once again sacrificing its bottom line to reinvent its business into a digital distributor (Poggi, 2011). Amazon is in a financial position to do this, whereas Barnes & Noble is not. Cutting the prices of NOOKs may seem like a great way to sell more, but unlike Amazon, they need to make a profit on their product. Amazon has so many other streams of revenue, it will sell Kindle e-readers and Kindle Fires at cut rate prices because they know they will make money on what each consumer will spend in downloading media.

**SPECIFIC COMPETITIVE ADVANTAGES**

If one were to judge these companies solely on the basis of stock value it would appear that Amazon.com has the advantage. Amazon.com's stocks are currently valued at around $226.31, while Barnes & Noble’s are a mere fraction of this figure at $15.11.

Amazon.com has a specific competitive advantage simply because it is a much larger company than Barnes & Noble. In addition to the company's 69,100 employees, Amazon.com also provides a platform for individual sellers to sell their products on the website (Amazon Current Report, 2011).

In an attempt to compete with Amazon.com, Barnes & Noble has recently launched its own e-commerce website called Barnes & Noble Marketplace. However, Barnes & Noble has said that it will limit the number of sellers trading on www.bn.com to 200, whereas with Amazon.com the number of sellers is unlimited. This large number of sellers selling their own products means that Amazon.com sells a much wider range of products than Barnes & Noble (Moore, 2011).

Barnes & Noble argues that by limiting its number of sellers to 200, it is providing higher quality products because it only allows expert sellers to sell on its site. That may be the case but according to CNN Money’s Fortune 500 listing for 2012; Amazon.com was ranked No.53 and made profits of $631 million. In comparison, while Barnes & Noble is still a fortune 500 company, currently ranked No. 360, it actually incurred a loss of $73.9 million (CNN Money, 2012).

The bottom line is; more sellers mean more products, more products mean more profits, and more profits mean higher stock values. Therefore, Amazon.com has clear competitive advantages over Barnes & Noble.

**RESPECTIVE VISIONS FOR THE FUTURE OF THE INDUSTRY**

It is difficult to compare both companies’ visions for the future of the industry because in many ways they actually trade in different industries. It is true that Barnes & Noble and Amazon.com sell books, they have also developed successful reading tablets, the NOOK and the Kindle, and now they both have an e-commerce website.

With that being said, there are still fundamental differences in how each company operates. Barnes & Noble’s main stake has always been, and continues to be in its bookstores, selling books. Recent expansion to the Barnes & Noble Marketplace on [www.bn.com](http://www.bn.com) has provided a platform for an increase in product and consumer range. However, most of the products sold on the site are mainly related to reading, education, and office-work. It also offers a range of children’s toys, household gift items, DVDs and Music, but in comparison to the multitude of products offered by Amazon, this range is really quite limited.

Amazon does not operate any physical retail stores; it functions solely online. Not only does Amazon.com sell books and related products, it also sells just about any other product one can think of. Amazon.com realizes that the book industry is struggling. It understands that in order to be a successful company it cannot afford to operate solely in this industry. This is why it has expanded to a range of other industries including; electronics, clothing and most recently wine (Amazon Current Report, 2012).

In addition, Amazon has the capital to sell its products at cheaper prices than Barnes & Noble. For instance, the cheapest Kindle currently retails at $69, whereas the cheapest NOOK costs $99.

Amazon operates on an international basis, while Barnes & Noble is based in the United States alone. The charts below give an overview of the number of categories of products sold, when these categories were first introduced, and the numbers of countries in which these categories are sold.

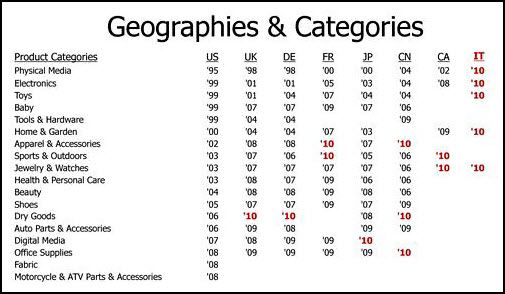
**Figure 2**

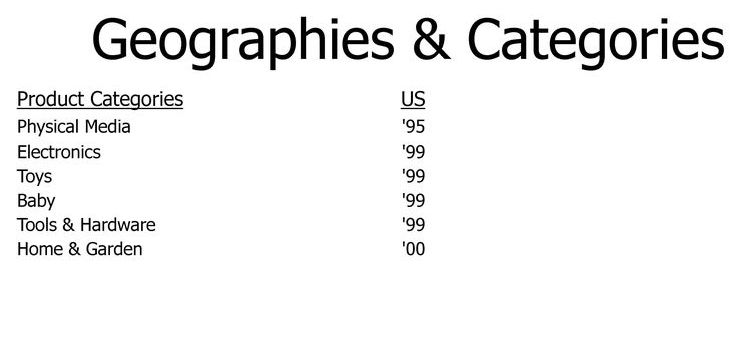
Amazon Geographies & Categories

*Source: McIlroy, Thad, (2012)*

**Figure 3**

Barnes & Noble Geographies & Categories

*Source: McIlroy, Thad, (2012)*



If one word could sum up Amazon’s vision for the future it would be: expansion. It is constantly evolving to new products, new locations, and new customers. As regards Barnes & Noble, in order sum up its vision for the future in one word, one would use the word: specialization. It has resolved to remain one of America’s leading bookstores by investing in innovations geared toward improving the overall quality of the reader’s experience.

**FUTURE CHALLENGES**

Any company trying to survive in today’s economy will undoubtedly face challenges. The key to success lays in predicting these challenges and implementing strategies to overcome them. The places where Amazon finds opportunity seem to be the same to be the same places where Barnes & Noble faces challenges.

Firstly, Amazon continues to make it very attractive for authors to self-publish their titles with their publishing services including, the Kindle Direct Publishing option for online books, and the CreateSpace option for print books. Barnes & Noble does offer its own self-publishing service, PubIt, but its services are only offered for e-books, not print and its 65,000 titles are nowhere near the huge volumes sold by Amazon. In fact, 28% of the top-selling titles on Kindle are not even available on the NOOK (McIlroy, 2012). If Barnes & Noble wants to compete it will have to expand its self-publishing services and offer better incentives to authors.

Another challenge that Barnes & Noble faces is its lack of an international presence. The fact that Amazon operates in so many countries worldwide is a serious challenge for Barnes & Noble. The Kindle is available internationally, but the NOOK is not. The NOOK is one of Barnes & Noble’s most successful products. Therefore, it would seem logical to expand the number of locations where this product can be purchased. However, it still remains unclear as to when and if Barnes & Noble plans to expand to international markets. While doing so may present a challenge in the short-term, not doing so will most likely present countless more in the long-term (McIlroy, 2012).

One challenge that Amazon could face may be the law. Since it allows an unlimited number of people to sell on the site, from all over the world, it is inherently difficult to monitor every single product that is sold under the Amazon.com brand. In order to prevent future lawsuits it is imperative that Amazon.com employs a highly skilled legal team, and closely monitors its sellers and their products.

**CONCLUSIONS & RECOMMENDATIONS**

Overall, we have found that Barnes & Noble and Amazon may appear to be head to head competitors, rivals even, but this appearance is only visible on the surface. Upon further examination of the facts, it is evident that one company is far more successful than the other. We have concluded that Amazon.com is that company. These are the main factors that have contributed to our conclusions:

* Amazon’s stocks are currently valued at $226.31. Barnes & Noble’s stocks are valued at $15.11.
* Amazon is currently ranked No.53 on the Fortune 500 list. Barnes & Noble are ranked No.360.
* Last year, Amazon made profits of $631 million. Barnes & Noble incurred losses of $73.9 million.
* Amazon sells internationally. Barnes & Noble only operates in the US.
* Amazon allows an unlimited number of sellers to do business on its site. Barnes & Noble restricts its number of sellers to 200.
* Amazon.com is more attractive and rewarding for self-publishing which is set to play a leading role in the future of industry.
* Amazon has the capital to sell its products cheaper than Barnes & Noble.

Therefore, in concurrence with the evidence provided in this report, we have determined that the most secure investment opportunity of these two companies is Amazon.com. Barnes & Noble is certainly a successful company. However, based on current performance, and the opportunities for future success that were outlined in this report, it is now clear that Barnes & Noble simply cannot compete with Amazon.com’s current success and future potential.

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Figure 1- *PCMag.com*

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