Amazon.Com Case Analysis Essay, Research Paper

AMAZON.COM CASE ANALYSIS

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OUTLINE

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Executive Summary

This case analysis serves the purpose to provide an analytical framework to evaluate Amazon.com from an internal and external perspective, and to provide strategic direction based upon the internal and external evaluation. The case will begin with an introduction to Amazon.com.

Introduction/Background

Jeffrey Bezos, formerly a senior vice president for D. E. Shaw & Company, founded Amazon.com in 1994. D. E. Shaw is a Wall Street-based investment bank, and Mr. Bezos was assigned to find good Internet companies in which to invest. During the summer of 1994, he stumbled across a Web site that showed the number of Internet users was growing by 2,300 percent per month. He quickly realized the vast potential of the Internet, and began putting together a list of possible products that he could sell on the World Wide Web. He eventually narrowed his list to music products and books. Although music products and books both had enormous potential, he eventually selected books because he believed that he could compete more evenly in the book segment due to the lack of a very dominant player. “In contrast, the music industry had only six major record companies. These companies controlled the distribution of records and CDs and, therefore, had the potential to lock out a new business threatening the traditional record-store format” (Kotha, p.11).

To begin his new venture, Mr. Bezos left New York and moved to Seattle. He decided to move to Seattle for two reasons: 1) Ingram Book Group’s warehouse is located near Seattle; and 2) Because of the Seattle area’s reputation for computer expertise. In 1995, Amazon began selling books entirely online, operating out of a rented facility and using doors laid across sawhorses for desks. He soon was able to generate several million dollars from venture capitalists, and sales were astounding. Sales for 1995, 1996, 1997, 1998 and 1999 were $0.5, $16, $147, $610 and $1,640 million respectively.

Amazon’s customer base has increased dramatically from 180,000 in 100 countries in 1996 to 12 million in 160 countries by mid-1999. In 1998, Amazon began to expand into other product categories. The Company began to sell music products and videos, and within two months of these additions, Amazon became the number-one seller of books, music, and videos on the web. During 1999, the Company further expanded its product line. Amazon now offers toys and video games, electronic greeting cards, electronics and software, home improvement supplies, online auctions, DVDs, and an online mall called zShops. More recently, Amazon has begun to expand internationally (Bartlett, p.21). Next, an analysis of Amazon’s mission statement will be performed.

Mission Statement Analysis

A mission statement should be comprised of, or address, nine essential components: customers; products or services; markets; technology; concern for survival, growth, and profitability; philosophy; self-concept; concern for public image; and, concern for employees. While Amazon does not have a formal mission statement, the basic mission and goals of the Company are evident in the words of Mr. Bezos, “We have one strategy at Amazon.com – provide the customer with the best shopping experience.” Additionally, “?our goal is nothing short of building the world’s most customer-centric Company.” Lastly, “our Company mission is to leverage technology and expertise to provide the best buying experience on the Internet” (Balanced Scorecard, p. 1). These quotes from Mr. Bezos could be combined to create an effective mission statement, as follows: The mission of Amazon.com is to leverage technology and the expertise of our invaluable employees to provide the best buying experience on the Internet. Our goal is nothing short of building the world’s most customer-centric Company capable of providing our customers with the best shopping experience online today, and into the future. An evaluation of the aforementioned mission statement follows:

Essential Component Evaluation Justification for Evaluation

Customers Strong Customers are frequently mentioned and are clearly the focus of a “customer-centric” Company.

Products or Services Moderate Identifies online shopping as service.

Markets Moderate The market is the online community.

Technology Strong “?leverage technology?” indicates that technology is critical for the success of Amazon.

Concern for survival, growth, and profitability Moderate Addresses concern for survival and growth, but not profitability.

Philosophy Moderate Clearly indicates that Amazon wants to be the best.

Self-concept Strong “?best shopping experience?”, “?world’s most customer-centric Company?”

Concern for public image Moderate Clearly want Amazon’s image to be the “best”.

Concern for employees Strong “?invaluable employees?” indicates that Amazon realizes that the employees are essential for continued success.

Amazon’s mission statement does a very good job of addressing the nine essential components of a good mission statement, as evidenced by the above chart, where the Company received a strong evaluation on 4 out of the nine categories, and a moderate evaluation on the remaining 5 categories. The mission statement also does a very good job of “hitting emotional hot buttons.” Using phrases like: “?best buying experience?”; “?world’s most customer-centric Company?”; and “?best shopping experience?”, Amazon strives to stir one’s emotions. Next, the external evaluation for Amazon will be performed.

External Evaluation

The first step in the external evaluation is to perform an external factor evaluation (EFE) matrix, which describes the external opportunities and threats facing Amazon. The EFE matrix follows:

EFE MATRIX FOR Amazon.com

Critical Success Factors Weight Rating Weighted Score

Opportunities

Growing number of e-commerce bankruptcies 0.1 3 0.30

Platform monetization 0.15 4 0.60

Number of Internet users is continuing to rise 0.15 3 0.45

International expansion 0.1 3 0.30

Technological advancements can improve productivity 0.05 2 0.10

Threats

Weakening economy 0.05 2 0.10

US BMV segment experiencing anemic growth 0.15 3 0.45

Increased competition 0.1 3 0.30

Minimal barriers to entry 0.1 4 0.40

E-commerce may be a slowing consumer trend 0.05 2 0.10

TOTAL 1.00 3.10

The above chart would indicate that Amazon is responding to existing opportunities and threats in its industry slightly better than the average competitor, as indicated by a EFE Matrix score of 3.10. Several factors have varying levels of effect upon the online shopping industry. For instance, the number of Internet users is continuing to rise exponentially. In 1996 and 1998, there were 61 and 147 million worldwide users of the Internet, respectively. Projections for 2002 are 300 million worldwide Internet users. Growth such as this obviously has a dramatic effect upon the online retail industry, as evidenced by a weight of 0.15 on the EFE Matrix. Additionally, companies, such as Amazon, that have an established platform (technology, distribution centers, customers, brand, etc.) have an increased ability to monetize their platform through partnerships like Toys “R” Us and Borders Group. “After all, what if [Amazon] becomes the online commerce partner (customer service, order fulfillment, inventory management, marketing services) for a wide swath of brick-and-mortar partners: Blockbuster for videos, Ace Hardware for tools, Tower Records for music, Best Buy, Circuit City for electronics, etc.? Then, in aggregate, those deals could hasten profitability (slightly) and/or make steady-state profitability larger” (Reamer, p. 2). This platform monetization can have an enormous impact upon this industry, as evidenced by a weight of 0.15 on the EFE Matrix.

“Amazon posted $410MM in U.S. books, music, and video (U.S. BMV) sales. At 58% of total revenue, U.S. BMV remains the single largest contributor to total revenue. Growth in this sector continues to be fairly anemic: U.S. BMV grew just 2 [percent year over year]” (Reamer, p.2). Moving into other segments of the online retailing industry (i.e., consumer electronics) could dampen this negative trend. Lastly, “the growing number of bankruptcies among pure-play e-commerce companies should enhance the competitive position of companies, such as Amazon, longer term. In other words, fewer industry participants should lead to increased potential scale for survivors such as Amazon. Not only will fewer companies lead to less distribution of e-commerce revenues among smaller e-tailers, but [surviving companies] should also benefit from less price competition over time. Note that less discounting among pure-play e-tailers should result in higher gross margins longer term” (Patel, p. 10).

However, “one could argue that the rapid e-commerce growth over the last few years reflected more of a fad that is losing momentum than a powerful secular trend. This is not to say that e-commerce is going away, rather that the overall e-commerce market may not be as large as once was projected” (D’Eathe, p. 3).

Another potential threat for Amazon is that the barriers to entry in the online retailing market are minimal. Start-up costs are minimal, and anybody can start their own Internet shop. “According to Mr. Bezos, Amazon differentiates itself from potential rivals in many ways, besides just marketing and aggressive brand promotion. He observes (Fast Company, 1996): People who just scratch the surface of Amazon.com say-’oh, you sell books on the Web’-they don’t understand how hard it is to actually be an electronic merchant. We’re not just putting up a Web site. We do 90% of our customer service by e-mail rather than by telephone. Fourteen of our 110 employees do nothing but answer e-mail from customers. There are very few off-the-shelf tools that help do what we’re doing. We’ve had to develop lots of our own technologies. There are no companies selling software to manage e-mail centers. So we had to develop our own tools. In a way this is good news. There are lots of barriers to entry” (Kotha, p. 10).

Some additional threats, while not as threatening, do exist. For instance, online e-tailers are being sued over shipping delays. “The FTC alleges that some online stores did not give shoppers enough notice of impending shipping delays or that they continued to promise deliveries they could not make during the holiday season” (Farmer, p.2). Lastly, security concerns are limiting the growth of online retailing. Consumers often “surf” the Web to obtain information about a product, but do not purchase the product online for fear of putting their credit card number and other personal information on the Web. However, encryption technology is so advanced today, that it is actually safer to give a Web page your credit card number than it is to give your number to a salesperson over the phone.

Next, a competitive profile matrix (CPM) will be performed to demonstrate how well Amazon performs relative to its competitor group. The CPM follows:

Amazon.com Barnes & Noble Barnes & Noble eBay

Critical Wtd. Wtd. Wtd.

Success Factors Weight Rating Score Rating Score Rating Score

Market Share 0.20 4 0.80 4 0.80 4 0.80

Management 0.15 2 0.30 3 0.45 3 0.45

Financial Position 0.25 1 0.25 2 0.50 2 0.50

Product Quality 0.15 3 0.45 3 0.45 2 0.30

Consumer Loyalty 0.25 3 0.75 3 0.75 3 0.75

Total 1.00 2.55 2.95 2.80

The CPM score of 2.55 indicates that Amazon performs slightly worse than its competitor group. The above chart indicates that market share, consumer loyalty, and financial position are the most important critical success factors, as indicated by a weight of 0.20, 0.25, and 0.25, respectively. Amazon’s financial position is the critical success factor that hurts its long-term viability the most. However, Amazon “has created the leading online shopping hub – from both the customer-experience vantage point and market share – that over time should harness the efficiencies of the Internet and could become highly profitable. Amazon’s robust technology platform and 30 million unique users make the Company attractive to traditional offline merchants via its “virtual storefront”" (Legg, p. 3).

A financial comparison of Amazon and the competitor group follows:

Amazon continues to focus on developing its business, which has translated into market share gains. Amazon’s sales growth is exceptional, as evidenced by a 5-year growth rate of 457.91%. Additionally, the Company’s turnover ratios are excellent compared to its competitor group. However, the Company’s net profit margin is atrocious at (37.98%). “The Company’s fulfillment costs as a percentage of revenues remain well above traditional retailer levels making it difficult for [Amazon] to compete in the long-term as it would hold a significant competitive disadvantage in terms of outbound distribution costs” (D’Eathe, p.2).

“However, Moody’s believes that management’s focus on achieving profitability, and a clearer strategy to harvest investment in existing operations rather than expend capital on new businesses, holds the potential for positive cash flow within the medium term. Amazon invested heavily in distribution capacity during 1999, well in advance of need. Moody’s believes that Amazon is unlikely to grow sales rapidly enough to cover the costs of carrying its current infrastructure. However, Moody’s believes that Amazon may be able to generate cash from sources other than retailing. The Company has an opportunity to use its reputation in fulfillment, bolstered by the initial success of its recent alliance to fulfill online orders for Toys “R” Us, to generate high-margin fee revenues and absorb operating costs” (Reamer, p. 5).

The aforementioned opportunity will not come without challenges. Amazon has been facing increased competition. The Company’s primary competition is Barnes & Noble, Inc. (BKS) and eBay Inc. (EBAY). “The site that is rapidly becoming known as The Place To Find Anything is eBay. Trouble is, it doesn’t have the simplicity that Amazon does. That’s still the image that many people have of eBay. They see it as a Turkish bazaar, where the stuff is garbage, you have to haggle for a price, and no one can be trusted. eBay is taking steps towards creating simplicity, however” (Lund, p. 2). Additionally, eBay and Barnes & Noble both are financially sound to compete with Amazon. “Amazon has done a solid job of aggregating products and making the experience simple, but its debt has put itself into a position of weakness” (Lund, p.1).

Lastly, Barnes & Noble is in the somewhat enviable position of being a “bricks-and-clicks” or “clicks-and-mortar” establishment. This mitigates the threat of security concerns. If a consumer did not feel comfortable purchasing online, he/she could go into the physical store location and make the purchase. However, since Amazon only has “virtual storefronts”, the Company does not have the high overhead associated with having physical sites. So, there are advantages and disadvantages to only being online.

Next, an internal factor evaluation (IFE) matrix will be performed that summarizes and evaluates the major strengths and weaknesses in the functional areas of business at Amazon. The IFE matrix follows:

IFE MATRIX FOR Amazon.com

Critical Success Factors Weight Rating Weighted Score

Strengths

Powerful brand name 0.15 4 0.60

Management experience 0.05 2 0.10

Distribution and technology infrastructure 0.15 4 0.60

Customer database 0.1 3 0.30

Distribution and technology infrastructure 0.1 3 0.30

Weaknesses

Financial situation 0.2 1 0.20

Seasonal dependence on strong 4th quarter sales 0.05 2 0.10

Board of Directors’ lack of independence 0.05 2 0.10

Declining repeat rate and increased customer churn 0.1 2 0.20

Management lacks retail experience 0.05 2 0.10

TOTAL 1.00 2.60

The IFE score of 2.60 demonstrates that Amazon has a strong internal position. However, it is necessary to avoid the illusion of precision when using the aforementioned matrices. Rather, a thorough understanding of the factors included is more important than the actual numbers. “To its credit, the Company has been successful in leveraging its powerful brand name, management experience and distribution and technology infrastructure, to gain a leadership position in each of [its] markets. Amazon’s powerful brand name is recognized around the world as a leader in e-commerce. This brand recognition has allowed Amazon to develop leadership positions very quickly when it enters new markets” (Becker, p.1). Additionally, being one of the first online retailers has provided a significant first mover advantage for Amazon.

“It appears that Bezos recognizes that many of the competitive advantages that Amazon has developed are transient in nature. With a few exceptions (e.g., proprietary software, reputation, the sense of community, and first mover advantages), many of the mechanisms that are at this Web site can be imitated by competitors, albeit not easily. To defend itself against competitors, for the past year Amazon has been developing a detailed purchasing history and profile of its customers. It now has a vast and unique database of customers’ preferences and buying patterns, tied to their e-mail and postal address (Economist, 1997a). Notes Alberto Vitale, chairman of Random House, Inc. (Wall Street Journal, 1996): ‘Amazon is creating a database that doesn’t exist anywhere else. Book publishers have never had much market data about readers, and some are already salivating for a peek into Amazon’s files’” (Kotha, p. 16).

“Amazon.com is considered to have one of the best senior management teams in the industry. Heavy reliance on stock options in employee compensation packages (and a [once] high-flying stock attracting lots of press attention) has enabled Amazon.com to fill its ranks with very motivated and bright people looking to ‘make a difference’ in the world of e-commerce” (Balanced Scorecard, p.1). “Meanwhile, Amazon’s board is facing mounting criticism for apparently never having questioned Bezos on strategy, judgement, or financial matters. The board is too small, too clubby, and lacks the necessary independence to make serious judgement or interventions in Amazon’s affairs. The board is too heavy with venture capitalists [that] are looking to cash out rather than build long-term shareholder value. [Critics also] decry the lack of retail experience on the board. All of this is complicated by the large ownership stake of Bezos, who holds some 32% of the Company’s stock. That stake is a serious obstacle to anyone looking to shake up the board. The board certainly has a lot of brainpower. But it remains a tiny body to run a Company with thousands of employees and a $4 billion market capitalization” (Eads, p.1).

Another concerning trend is customer churn increasing while repeat business declines. However, “sequential revenue growth has slowed meaningfully for most e-tailers in recent quarters” (D’Eathe, p.3), possibly indicating that the increased customer churn and declining repeat business are more a symptom of the general decline in the U.S. economy, as opposed to an internal weakness of Amazon. “If Amazon can capitalize half as well on the myriad of large retailing opportunities before it as it has to date, it can own the space. However, the Company must execute flawlessly on its march toward profitability and overcome early signs of a possible slowing in the U.S. online commerce activity” (Reamer, p.1).

It would be the desired outcome for Amazon to use its competitive strengths (powerful brand name, management experience and distribution and technology infrastructure) to achieve its objectives. Amazon current stated objectives are: 1) To put customer satisfaction first by using the Internet to transform book buying into the fastest, easiest, and most enjoyable shopping experience possible; and 2) To sell anything that can be sold on the Web. These objectives are reasonable. However, objectives should be specific and measurable. Some alternative objectives would be to focus the Company’s resources toward achieving profitability by the fourth quarter of 2000 (an annual objective), and to increase profitability by 5 percent per year for the next 3 years (long-term objective). These objectives would give meaningful, measurable goals that management would need to obtain, or it would require management to re-evaluate the Company’s objectives or the Company’s strategy to achieve the objectives.

With the aforementioned objectives in mind, the Company needs to implement a strategy to achieve the desired results. It is necessary to evaluate alternative strategies before selecting the actual strategy to implement. The SWOT or TOWS, SPACE, Grand Strategy, IE, and QSPM Matrices are tools to help in the evaluation and selection of alternative strategies. The matrices indicate that Amazon is in a strong competitive position, and that the Company should build and grow. The matrices indicate that, despite Amazon’s financial position, the Company has some distinct competitive advantages in a high-growth or unstable industry. Some strategies for companies that fit this profile are backward, forward and horizontal integration, market penetration, market development, product development and joint venture.

One strategy that would fit into the aforementioned categories would be international expansion. Expanding internationally is a market penetration strategy in which a company introduces its present products or services into new geographic areas. “As it stands, Amazon.com is well-positioned to remain the world leader in both the development of e-commerce strategy and its implementation” (Balanced Scorecard, p.6). There are several advantages to selecting this strategy. For instance, “Amazon has invested heavily in product development in the United States, building a state-of-the-art Web site that is generally considered the best in e-commerce. This technology is highly scalable and has been used for each new market the Company has entered. Furthermore, much of the personalization technology and U.S. content has already been created, and can be shared across markets. By leveraging this existing technology and infrastructure, Amazon has been able to keep product development costs low.

Amazon also benefits from certain centralized costs that can be leveraged across multiple markets. [For instance], the Company does not have to hire a new team of engineers for every new market it enters, as it already has a base working out of Seattle. Clearly, these streamlining efforts give Amazon a significant advantage over single country e-tailers” (Becker, p. 5). For all of its strengths, the strategy of international expansion does have some weaknesses. For instance, “In the United States, Amazon built its brand essentially free through public relations and word-of-mouth advertising. Clearly, the Company benefits from its global brand – having shipped products to over 200 countries in the past five years. However, in Europe [for instance], e-commerce has not taken off as much, and Amazon will never be able to replicate the hype and excitement that it received in the United States during the ‘Internet bubble.’ Furthermore, Amazon must spend aggressively in each of its countries because media audiences are less likely to cross borders” (Becker, p.9). Amazon is not in the financial position to spend aggressively to achieve additional revenues, and, even if it were, the additional revenues alone would not help Amazon to reach its objective to achieve profitability. For this reason, an alternative strategy was selected for implementation.

The strategy that was selected was a hybrid strategy of product development and joint venture. As was previously mentioned in the EFE Matrix evaluation, a tremendous opportunity for platform monetization exists for Amazon. The Company could sell “access to either its customer base, brand, inventory management, or customer service and order fulfillment infrastructure (or all of them simultaneously), then the economics of the Amazon.com business model could be a lot better than 2-3% margin. Operating margin could then start to creep toward double digits over time, which would indeed support a premium valuation relative to other retailers” (Reamer, p.6).

Amazon has recently entered into two such deals. One deal was with Toys “R” Us and the other was with Borders Group. “Under the terms of the strategic partnership between [Amazon] and [Borders], [Amazon] will assume fulfillment and inventory for the co-branded Borders.com Web site. Amazon.com will be the seller of record, providing inventory, fulfillment, site content, and customer service for the co-branded site. The new site will continue to offer content unique to Borders.com, including store location information and in-store event calendars” (Legg, p.3).

“With the announcement of its e-commerce partnership with ToysRus.com last year, Amazon launched into an innovative e-business services model that represents a win-win scenario for both Amazon and its retailer customers. As in the case with ToysRus.com, the Company has leveraged its core assets to provide three critical components of a successful e-commerce strategy to retailers, including: (1) a scalable and proven e-commerce technology platform, (2) marketing capabilities in terms of access to 30 million e-commerce buyers at Amazon, and (3) outstanding back-end products fulfillment capabilities (that represent one of the Company’s core differentiators versus competitive e-commerce distribution capabilities).

In turn, retailers typically enjoy similar core competencies in their land-based retailing business, namely merchandising, pricing control and inventory risk. As with the ToysRus.com relationship, both companies leverage the strengths of their respective business models to share in the costs of conducting e-commerce. In this regard, ToysRus.com has the potential to lower its timing to breakeven earnings in its e-commerce business, while Amazon has the potential to scale the number of e-commerce orders through its fixed-cost distribution network, thereby increasing the likelihood of breakeven earnings [by the fourth quarter of 2001]” (Patel, p.7).

In addition to the aforementioned justifications for selecting this strategy, is the fact that the QSPM Model favored this strategy over the international expansion strategy. The platform monetization strategy yielded an attractiveness score of 6.30, as compared to a score of 5.15 for international expansion, primarily due to reasons already mentioned. The only drawback to this strategy was a “report that the key finding signaling a challenge to Amazon’s growth is that consumers view the online retailer as an outlet for media products-books, CDs, and videos-rather than as a store carrying an array of items such as kitchenware, garden furniture and hardware tools” (Junnarkar, p. 1).

However, the advantages appear to far outweigh the disadvantages. If Amazon is able to formalize several more deals with other traditional retailers, then the Company’s financial performance should drastically improve. Finally, implementation of this strategy will be relatively easy, as the Company has already began to implement the strategy on a small scale. There should be few management conflicts to work through, as there should be no political maneuverings to obtain additional resources to grow one department over another. If properly implemented, this strategy should help Amazon to achieve its objectives to focus the Company’s resources toward achieving profitability by the fourth quarter of 2000, and to increase profitability by 5 percent per year for the next 3 years.

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