



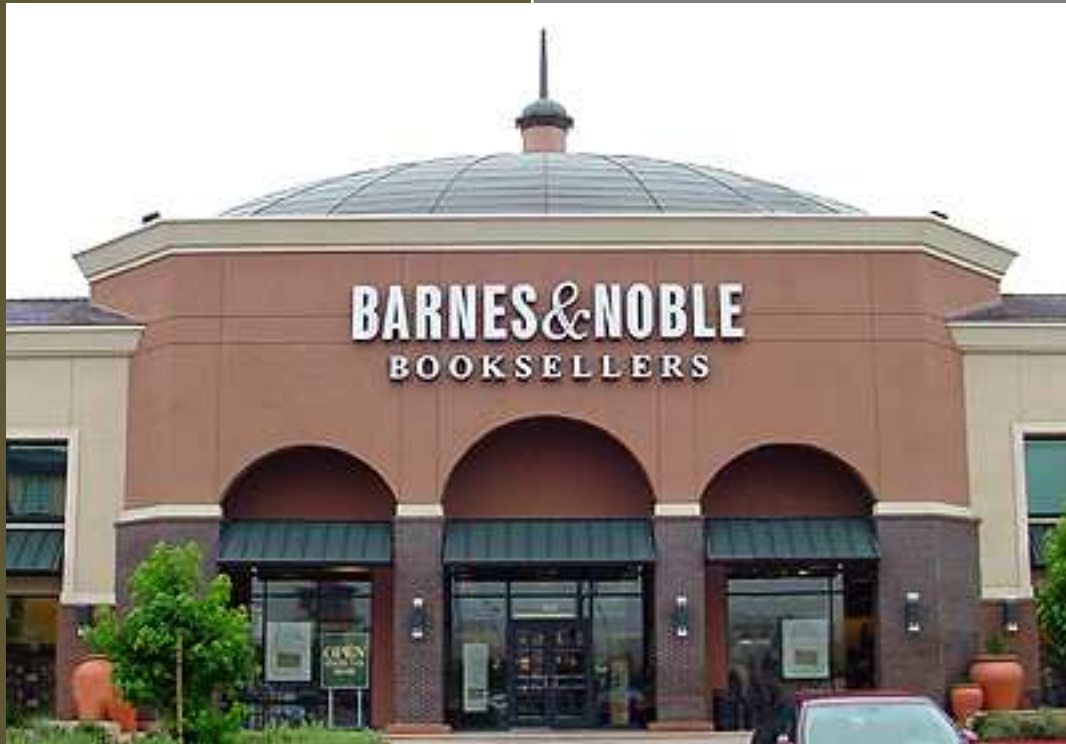
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Barnes & Noble – Reading between the lines

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ABSTRACT

The dynamic capabilities view is one of the most recent theories developed to explain how companies can achieve a sustainable competitive advantage. This perspective emerged from the fact that past theories explaining the same phenomenon did not address dynamic environments. Indeed, the dynamic capabilities view aims to explain firm's success in rapidly changing environments, where business patterns are constantly shifting towards different directions. This thesis was developed to contribute for the consolidation of this theory and its main purpose is to illustrate this view with a real-world business situation through the presentation of a teaching case. The company chosen was Barnes & Noble. The Barnes & Noble case provides insightful information regarding the ability of top managers to understand major trends affecting the market they are inserted in and act accordingly at the right time by reconfiguring resources and capabilities. The main findings of this case suggest that companies with well-established business models might fail to succeed and suffer from significant performance decreases if they are not in possession of these capabilities.

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INTRODUCTION

The strategic management field is currently one of the most important areas in the world of management. The key feature is to understand how firms are able to achieve and sustain competitive advantage over time (Teece, Pisano and Shuen, 1997). For many years, different theories have tried to explain what underlies the success of a company, including Michael Porter's approach (1980) with Industrial Organization (I/O) model and the Resource Base Theory (RBT) (Barney, 1991). The importance of this matter, which concerns managers throughout the world, is what brings us to the dynamic capabilities theory. Indeed, this view is the most recent attempt to explain and answer to this fundamental question of how companies can achieve and sustain competitive advantage.

The relevance of Dynamic Capabilities arises from the fact that we are experiencing rapidly changing environments, which can be characterized by their constant and unpredictable change, such as high-technology industries (Zahra, Sapizenza and Davidsson, 2006). In these high-volatile markets, it is significantly more difficult for companies to achieve sustainable competitive advantages. In fact, on average, the duration of a sustained competitive advantage has decreased over time. In this context, managers should conduct firms in a way that they can build successive temporary advantages in response to the several shocks that constantly affect the environment they are inserted in (Barreto, 2010; D'Aveni 1994; Eisenhardt and Martin, 2000). Hence, the dynamic capabilities view has emerged from the fact that past theories did not address this issue regarding the constant and necessary fit between firm's resources and capabilities and external conditions (Teece, Shuen and Pisano, 1997).

The topic of dynamic capabilities has been evolving over time and has received a lot of attention during the past few years. According to Barreto (2010), from 1997 to 2007, the number of scientific articles that referred to dynamic capabilities reached 1534 and the growing trend remains in the present. Many definitions and many variables for the Dynamic Capabilities (DCs) concept were considered over these years. However, the

focus of this paper will be centered around Barreto's (2010) definition, a recent approach that came up with a rigorous construct that past definitions were not able to offer. Barreto (2010) defines dynamic capabilities as "the firm's potential to systematically solve problems, formed by its propensity to sense opportunities and threats, to make timely and market oriented decisions, and to change the resource base".

Despite all the studies mentioned above, more empirical findings are required in order to consolidate this theory, as it is still a quite recent approach. It would be extremely pertinent to analyze whether DCs are a necessary condition for firms to succeed and what might happen to a firm's performance should it lack dynamic capabilities, especially in rapidly changing environments. Specifically, it would be important to analyze whether one can apply one recent definition of DCs to a real-world situation.

To address these issues, this paper will focus on the four dimensions proposed by Barreto's (2010) DCs concept and apply them to the company Barnes & Noble. For many years, Barnes & Noble was the indisputable market leader in the retail book industry. However, in just a few years, this large company had to face several obstacles that affected its performance and its overall market value. What were the main issues that led Barnes & Noble to decrease its performance? What kind of strategic decisions were important throughout this process? Which of the four dimensions had more impact on the company's survival? This dissertation will hopefully answer these questions and allow a better understanding of the role of dynamic capabilities in high-volatile environments.

Next, I present a review of the existing literature on the topic, the teaching case, a teaching note, a discussion section and a conclusion at the end.

LITERATURE REVIEW

RELEVANCE AND EVOLUTION OF THE DYNAMIC CAPABILITIES CONCEPT

The theory of dynamic capacities (DCs) has been evolving over the past few years since it first appeared (Teece, Psiano and Shuen, 1997). It is one of the most recent theories that attempts to explain firms' capacity to achieve sustainable competitive advantage. However, many other theories have been trying to explain what is behind a company's success for several years. In order to better understand the DCs view, it is important to take a look to at these other theories.

One of the most adopted theories in the Management/Strategy field for the past few years is the Industrial Organizational (I/O) model (Porter, 1980). This approach states that companies' success depends, most of all, on the industry they are inserted in. Porter's five forces framework became a very important tool to measure the attractiveness of a specific industry, and consequently the possibility of a firm to enter in that specific market and profit by implementing a strategy that could surpass their competitors.

Another theory that aims to explain how companies achieve high levels of performance and sustainable competitive advantage is the Strategic Conflict Approach (Shapiro, 1989). This theory derives from game theory, which tries to explain how firms behave considering the actions that might be adopted by their rivals. Hence, firm's performance will depend on the way companies interact with their competitors.

Finally, the Resource Base Theory (RBT) (Barney, 1991) states that whenever firms have resources that are valuable, rare, inimitable and non-substitutable (VRIN) they can achieve sustainable competitive advantage. This theory focuses much more on the core competences of a given firm rather than the industry it is inserted in.

Even though all of these theories have had significant impacts in the way we look at companies' performance, they all seem to ignore important factors. Indeed, in rapidly changing environments, which can be characterized by their constant and

unpredictable change, such as high-technology industries (Zahra, Sapizenza and Davidsson, 2006), companies will have much more difficulties to achieve and sustain competitive advantage. In fact, these competitive advantages are becoming shorter over time, and firms will often have to cope with problems they are not well prepared for (Winter 2003).

The dynamic capabilities view is one new perspective that addresses dynamic external environments. But what are dynamic capabilities? How can they be defined? The definition of dynamic capabilities is far from being consolidated (Barreto, 2010). Teece et al. (1997: 516) defined dynamic capabilities as “the firm's ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments”. Other authors considered dynamic capabilities as “processes” (Eisenhardt and Martin, 2000) and others as routines (Winter and Zollo, 2002). Later, Winter (2003) considered that there are two levels of capabilities: the zero-level capabilities, those that allow the firm to execute their day-to-day activities; and the high order capabilities (dynamic capabilities), those that influence those zero-level capabilities.

Nevertheless, some important limitations were pointed out to these definitions, namely the fact that they are tautologically linked with success (Williamson, 1999) or vague and elusive (Kraatz and Zajac, 2001).

A New definition

Barreto (2010: 271) was able to come up with a new definition that addresses the criticisms previously cited. He defines dynamic capabilities as the “firm’s potential to systematically solve problems, formed by its propensity to sense opportunities and threats, to make timely and market oriented decisions, and to change the resource base”.

In this new approach, dynamic capabilities are considered as a multidimensional construct, which allows different levels of dynamic capabilities (rather than a dichotomous "have it or not"), where the correlation among the involved dimensions

does not necessarily have to be high. All the dimensions should be taken into consideration for the purpose and construct of the theory, and, even though they might not be highly correlated with each other, each of them only make sense when considered with the other. For example, the propensity to reconfigure resources achieves higher effects only when bundled with a propensity to make market-oriented decisions (Menguc and Auh, 2006). This approach represents a significant improvement on the existing literature and it allows for future research to develop empirical testing on the DCs concept.

Most of these dimensions had already somehow been exploited by other authors, but have not been solidified into one single construct. Regarding the propensity to sense opportunities and threats, Teece (2007) expressed that dynamic capabilities could be disaggregated into the capacity to “sense and shape opportunities and threats”, and that the existing knowledge obtained from the path each company has followed would influence the way they will sense these opportunities and threats.

Moreover, the propensity to make timely decisions was addressed by Eisenhardt and Martin (2000), expressing that there might be some potential for competitive advantage by acting “sooner” than competitors . Furthermore, Adner and Helfat (2003) stated that timing was a fundamental dimension for companies to succeed.

In what concerns market-oriented decisions, Adner and Helfat (2003) stated that content is a crucial factor for success. Therefore, firms will achieve higher performances when managers are able to adapt and take the correct course of action in times of uncertainty by delivering superior value to their customers.

Finally, the propensity to change the resource base was also addressed by other authors (e.g. Teece et. al 1997; Eisenhardt and Martin (2000)) alluding to the propensity for firms to create, extend, and reconfigure its resource base.

Relevant topics related to DCs

Among the existing literature, there are some topics that have been constantly approached and debated by several authors. Next, I present three of these topics and the different perspectives that exist among them.

The relevance of dynamic capabilities in what concerns its applicability in different contexts has been widely covered among authors in this area. Opinions here are not consensual, generating different perspectives. The first perspective noted that dynamic capabilities are only relevant in the presence of rapidly changing environments (Teece, Pisano and Shuen, 1997). However, many researchers started to question this perspective and expressed the idea that although dynamic capabilities are much more valuable in high-volatile markets, its existence is not a mandatory condition (Zahra, Sapienza and Davidsson, 2006). If companies are in the presence of volatile conditions, they will be much more aware of the need to reconfigure their resources and capabilities, but even when firms are not in the presence of these types of markets, they still need to integrate, build and reconfigure their resources (Zollo and Winter, 2002).

The topic of heterogeneity has also been constantly discussed by several authors. The literature states that each company has its specific set of dynamic capabilities. These dynamic capabilities come from different path dependent processes (Teece et al 1997; Zollo and Winter, 1999), and thus firms may uniquely be able to pursue a given strategy (Barney 1989). However, even though dynamic capabilities are idiosyncratic in most of their formation, there are some specific capabilities that display common features among firms, which Eisenhardt and Martin (2000) called as “best practices”. This means that even if dynamic capabilities might be unique for each firm due to their past dependence, there are more and less efficient ways to execute them (Helfat and Peteraf, 2003).

Finally, to conclude, the link between dynamic capabilities and companies' performance has also been an area of discussion. In this regard, opinions are not

consensual and different perspectives have emerged on whether dynamic capabilities lead to sustainable competitive advantage. Teece et al. (1997) stated that “dynamic capabilities lay at the core of enterprise success (and failure)”, suggesting a direct relationship between firms’ dynamic capabilities and performance. On the other hand, other authors argue that dynamic capabilities are not necessarily linked with firm’s success (Barreto, 2010; Eisenhardt and Martin, 2000). Authors defending this view stated that dynamic capabilities by themselves are not a source of competitive advantage in the long run, rather on the resource configuration they generate.

Indeed, the use of dynamic capabilities might even hurt the company if not used at the right time, given the costs associated with the development and usage of these capabilities (Zahra, Sapienza and Davidsson, 2006). So, firms’ success may come from different paths, such as ad-hoc problem solving (Winter, 2003) and luck (Barney 1986). In fact, Winter (2003) stated that firms that rely on ad-hoc problem solving might be carrying less costs than those who systematically invest in dynamic capabilities.

Nevertheless, the question of how firms can achieve sustainable competitive advantage remains the focus point of the dynamic capabilities theory. Why is that companies like Compaq, Kodak or Blockbuster became extinct after they were market leaders? The Dynamic Capabilities concept has been evolving and trying to cover these issues. Its acceptance and importance in the strategic field has been increasing over time and more empirical findings are being conducted in order to consolidate the theory.

TEACHING CASE

BARNES & NOBLE – READING BETWEEN THE LINES

In 1873 began the history of the world’s biggest bookstore – Barnes & Noble. No one could ever imagine that Barnes & Noble would manage to expand in such a significant way and become the number one bookstore chain in America. Many were the people that have entered on one of its several bookstores to buy a book, a music CD or simply to drink a cup of coffee and enjoy the ambiance of its “superstores”.

However, by the end of 2012, the market value of Barnes & Noble was less than half of what it was 15 years before. As the company continued to struggle for survival, these years were characterized by the appearance of obstacles and challenges that have put the company in a situation where it was no longer the market leader in its industry. Throughout this process, many stores were closed and many strategic decisions had to be made in order to adapt the firm to the changes that were occurring in the external environment.

What has changed in the book retail industry that didn’t allow this company with more than 100 years of history to maintain its performance? What types of strategic decisions were conducted in order to face the several challenges that were appearing in the market?

COMPANY’S BACKGROUND

Early days

The history of Barnes & Noble can be traced back to 1873, when Charles Montgomery Barnes opened a book printing business in Wheaton, Illinois. Years later, in 1917, his son William, president of the Barnes firm at the time, sold his share in his father company and moved to New York to take an interest in the educational bookstore

Noble & Noble, which was soon renamed to Barnes & Noble. In 1932, Barnes & Noble opened a large bookshop on Fifth Avenue, which became the company's flagship¹.

In 1971, Leonard Riggio, a young bookseller from New York bought an interest on Barnes & Noble. Riggio quickly improved the old retail store on Fifth Avenue, and in 1972, the store earned a place in the *Guinness Book of World Records* as "the World's Largest Bookstore" with more than 150,000 textbook and trade titles². During the next few years, Barnes & Noble would revolutionize the book industry and be pioneer in several areas. In 1974, it was the first bookseller in America to advertise on television with the slogan "Of course! Of course!"³, and in 1975, it became the first bookstore to offer discounts on books and offer 40% off on New York Times best sellers.

Expansion and the "superstores" concept

Throughout the 1980s, Barnes & Noble expanded at an enormous pace by acquiring several bookstores, with the most significant being the acquisition of the second-largest bookstore chain in America, B. Dalton, in 1986, for 300\$ million⁴, which brought the company into the national panorama.

During the 1990s, the company developed the "superstore" concept (**Exhibit 1**). These "superstores" were very large, combining a wide selection of books with a comfortable atmosphere, including coffee bars, children's play areas and music departments⁵. Leonard Riggio was determined to turn bookstores into a fun place as he recalled that the bookstore business was "an elitist, stand-offish institution"⁶.

The company continued to grow and in 1995 opened 90 additional "superstores", bringing the total to 358⁷. However, the costs associated with this expansion were too high. In that same year, despite the total revenues reached almost \$2 billion, the company reported a loss of \$52 million in end⁸. In 1993, in order to keep up with the expansion, Barnes & Noble went public to raise the necessary capital to face the continuous debt.

By the end of 1999, Barnes & Noble was the number one bookstore in America and had a total of 1,468 stores operating in all 50 states of America⁹. Other major players in this industry included Borders, the biggest rival of Barnes & Noble, Crown Books and Books-A-Million, Inc. Smaller bookshops could not handle the pressure of these big “superstore” giants and many had to close, mainly due to the high levels of investments needed to compete with these bookshops. Both Borders and Crown Books would end up liquidating its business throughout the new millennium.

THE ONLINE BUSINESS

The advent of the Internet

Throughout the late-90’s, the Internet became very popular. In just a few years, the percentage of the population in the United States with access to Internet had grown from 18% in 1997 to 41,5% in 2000 (**Exhibit 2**). Worldwide, the number of Internet users was 248 million by the end of 1999, which meant a penetration rate of approximately 4.1% of the world’s total population¹⁰.

This growing trend had a tremendous impact in the business world and has opened many doors for new business formats, changing traditional business models. Products and services could now be bought and sold through electronic systems and the easy access to information correlated with the global supply and demand was redefining old conventions¹¹. The book industry wouldn’t be left out from this shift, and neither would Barnes & Noble.

Amazon

*“I’m going to do this crazing thing. I’m going to start this company selling books online”
– Jeff Bezos*

In 1994, a young man named Jeffrey Bezos quit his job as a programmer on Wall Street and came up with a business plan proposition for a company that would retail books

on the Internet. He set up an office for this new company in his garage in Seattle and began developing the necessary software¹². It was the beginning of Amazon.com Inc.

Amazon's business model was completely different from traditional booksellers. Most orders placed through its website were directly sent to publishers, so there was no need to keep unnecessary inventory. Moreover, Bezos found a way to offer a range of services that traditional bookstores like Barnes & Noble couldn't match. Customers could search a book by subject or name and when selected, Amazon would retain that information in its database in order to give further personalized information, namely other recommended books based on preferences, follow-up-emails and other readers' comments¹³.

In 1997, Jeff Bezos said the following about the bookselling industry: "In the on-line world you can't do the same kinds of things that you do in the physical world to make bookstores fun. We cannot have the lattes and the cappuccinos and the soft sofas and the chocolate chip cookies but we can do other things that are completely different"¹⁴.

Book readers were adhering to Amazon. The idea of buying a book with a click on the mouse was simple and convenient. Amazon's business model quickly became a success and one year later, in 1996, made 15.75 million in sales¹⁵.

Barnes & Noble's online venture and the e-battle with Amazon

With Amazon's quick success, Barnes & Noble decided that it was time to follow the moves of its emerging competitor. In 1997, two years later after Amazon's foundation, the bookstore entered in the online market through a venture with America Online Inc. (AOL)¹⁶. Later on that same year, Barnes & Noble launched its own bookselling website, barnesandnoble.com¹⁷.

The website was able to provide the same key features that Amazon did. Barnes & Noble used the technology from the company Firefly Network in its website so as to set up a similar program used by Amazon that could recommend similar books according to its users preferences¹⁸. Moreover, Barnes & Noble conducted a

partnership with Microsoft, which gave the company the possibility to be the exclusive bookseller on Microsoft's popular MSN network¹⁹. Since most of the books were already in-store, the delivery times were frequently shorter²⁰. The CEO for the online unit was Stephen Riggio, Leonard's Riggio younger brother²¹. Stephen Riggio said at the time: "We expect to be the dominant bookseller on line"²².

The e-commerce battle between Barnes & Noble and Amazon soon became very intensive and competitive. In 1998, Barnes & Noble joined forces with Bertelsmann, a giant German multimedia conglomerate, in order to raise cash and compete with Amazon, selling 50% of barnesandnoble.com to the German company for \$100 million.²³ Barnes & Noble would end up buying back the shares of its subsidiary in 2003. During the following year, in 1999, barnesandnoble.com went public and was able to raise more money than any other Internet company up to that time, bringing a total of \$486 million²⁴.

During that year, barnesandnoble.com had an increase of more than 200% in sales comparing with the fiscal year of 1998. In 1998, revenues achieved \$61.8 million whereas in 1999 total revenues were 193.7 million²⁵. As for Amazon, sales also increased an impressive 169%, totalizing \$1.6 billion (**Exhibit 3**).

After making a name for itself in the book industry, Amazon expanded its product range by launching in June of 1998 its music store. Later on that same year, Amazon ventured into other categories selling electronics, software, videos, tools and hardware²⁶. Barnes & Noble, once again, one year later, in 1999, followed the steps of its rival and opened as well its online music store²⁷.

In 1999, in a letter to the shareholders of the company, CEO Leonard Riggio stated that "although it is clear the World Wide Web, with its profound possibilities, will become a major component of the future of bookselling and publishing, we believe retail bookstores will remain the foundation of our industry"²⁸.

Leonard Riggio's beliefs turned out to be wrong years later. In 2012, for the first time ever, the e-commerce surpassed the physical bookstores in what concerned book

purchases in the U.S (**Exhibit 4**). Throughout the years, many stores closed as consequence. In 2000, there was total of 908 stores (including B. Dalton stores) and this number rapidly decreased to 778 in 2008. The importance of the e-commerce was now more evident than ever.

In the beginning of the new millennium, some partnerships were conducted on both sides. Barnes & Noble teamed up with Microsoft to open the first major store selling digital books that were available for downloading and reading on the screen²⁹. On the other hand, Borders, once the main rival of Barnes & Noble, linked its online store to Amazon in 2001, which gave Jeff Bezos's company a share of the total revenues coming from the website.³⁰

E-BOOKS

In 2009, a small team of engineers was set up to rethink the future of Barnes & Noble. These engineers were focused on the new way books were sold and read: e-books, digital versions of original printed books that were distributed over the Internet. The engineers were preparing the production of a new e-reader, an electronic portable device designed to read the e-books. Top executives at Barnes & Noble believed that the success of this device would be determinant for the future of the company, which was declining its market value since 2007 (**exhibit 5**).

However, back in 2007, companies like Amazon and Sony had already made their moves on the e-readers industry. In 2006, Sony introduced the Reader PRS-500 and Amazon in November of the following year, the Kindle. The Kindle was a revolutionary product in the market and quickly became a huge success despite its high price (359\$)³¹.

The Kindle was able to store up to 200 books. It was incorporated with an electronic ink that looked close to ink on a paper. The device came with high-speed wireless connection, which enabled it to be constantly online and allowed users to download

more than 90.000 titles, including New York Times bestsellers for 9.99\$ in less than a minute³².

Turning the attention back to Barnes & Noble, Stephen Riggio hired William Lynch, a former executive from smartphones producer Palm Inc. to run barnesandnoble.com online unit and help the company develop its own electronic device³³. Mr. Lynch would become the CEO of the company in 2010, emphasizing the importance of the digital area for the company³⁴. By the time Stephan Riggio hired Mr Lynch, he said that the appointment “sends a signal to the marketplace that we are serious about the business and the way this business is evolving”³⁵.

In March, 2009, Barnes & Noble acquired Fictionwise, a leading online retailer of electronic books and owner of eReader.com for \$15.7 million³⁶. The acquisition of this e-book retailer provided Barnes & Noble with the necessary expertise and software for a growing industry that the company was not used to deal with. The Nook ended up being released in November of 2009.

The Nook was somehow similar to the Kindle on its major functions but many analysts considered it as a slight improvement of Amazon’s device. It was the first Android-based e-reader and unlike the Kindle, it came with two screens, a 3.5 inch color touch screen and another display where users could read the book, a virtual keyboard as opposed to a physical keyboard and a replaceable battery³⁷ (**exhibit 6**). The device initially cost \$259, at a time where Amazon had already launched the Kindle 2, which was priced as well at \$259. The prices of the e-books were less expensive than the real printed books and were relatively the same among both companies.

The e-readers were getting popular. In 2010, the percentage of Americans with more than 18 years who owned an e-reader was 4% and this number rapidly grew in 2011 to 12%³⁸. In the beginning of 2011, the Nook claimed about 22% of market share, just behind the Kindle, with 67%³⁹.

The battle over the e-reader market was very intense. Many new versions of both the Kindle and the Nook were being released. In September of 2011, Amazon launched the

Kindle Fire, a mini tablet computer priced at 199\$ that was considered to be one of the biggest threats to the iPad dominance in the tablets industry⁴⁰. Barnes & Noble would end up launching in 2012 the Nook Tablet in order to compete with the Kindle Fire⁴¹.

As the Nook continued to struggle within the competitive market of e-readers and tablets, many challenges were being imposed to the company in order to survive and succeed in this turbulent market. The quick success that characterized the Nook slowed down as sales decreased from 2011 to 2013. Analysts suggested that the Nook was not being able to compete with full-featured tablets from giants like Google, Apple and Amazon⁴² and estimations pointed out only a 4.1 per cent market share of the tablet market for the Nook by the end of 2012⁴³.

The introduction of the Nook tablet was a completely new experience for Barnes & Noble, as it was shifting the focus from selling books to enter to crowded and competitive market of tablets, clearly dominated by Apple. During an interview, CEO William Lynch expressed its beliefs that “there's a space in the market below the iPad for a larger-format tablet that's half the price”⁴⁴. The Nook tablet was priced at 249\$, cheaper than the iPad and more expensive than the Kindle Fire.

The device offered many new features, especially media-content features, illustrating the determination of Barnes & Noble to expand its offerings and orient its products towards media-content technologies. This new contents included the Nook Video, a service that allowed users to stream and download movies and TV shows on their televisions sets and mobile devices.⁴⁵ However, although both the Kindle and the Nook were evolving towards tablets-like products, neither one of them could actually do all the things the iPad did.

The investments conducted on the e-book market were very high for Barnes & Noble, especially to a company whose core business was low-tech related. Analysts estimated that the bookseller was spending around \$200 million to \$250 million annually with Nook's operations⁴⁶. Barnes & Noble didn't have the necessary resources to keep up with Amazon's expansion, and knowing that, Mr. Lynch searched for partners to invest

in the Nook business. In 2012, Microsoft invested more than 600 million in a deal with Barnes & Noble. This deal gave Microsoft 17,6% stake of Nook's profits⁴⁷, valuing the Nook business as \$1.7 billion worth, more than Barnes & Noble itself.⁴⁸ . This strategic partnership was seen as a way for both companies to improve the reading experience for their costumers and a way for Barnes & Noble to use Microsoft's international presence to expand its products.

THE PATH AHEAD – THE END OF BOOKSTORES?

Despite the Nook's quick beginning success, by the end of 2012, more than 75% of its revenues still came from retail stores. However, as time went by, the importance of physical stores was becoming surpassed by the Nook's unit division. From 2007 to 2012, revenues from Barnes & Noble stores decreased from \$5,286 to \$4,852 million⁴⁹. During that same period of time, more than 100 bookstores closed (**exhibit 7**), including all the stores operating under B. Dalton's name.

The competitive advantage that Barnes & Noble had for many years – a wide selection of books in just one store – was becoming threatened by the new wave of digital business⁵⁰. The main issue for the book retail industry was to understand if bookstores would become obsolete over time due to devices like the Nook, Kindle and the iPad. Borders, once the main rival of Barnes & Noble during the 80s and the 90s, ended up liquidating its business in 2011⁵¹. In fact, Barnes & Noble acquired Border's customer list after it filed for bankruptcy⁵².

One of the main challenges for Barnes & Noble is whether the company can leverage its brand name and convince consumers to go to bookstores when they can easily get into the digital world, where most of the books are less expensive than printed books. Since the creation of the Nook division, the company continued to integrate its electronic offerings with its traditional business model, using physical stores to promote and sell the Nook. In 2010, Barnes & Noble expanded the space on its bookstores dedicated to the Nook kiosks, encouraging customers to try and feel the

device in their own hands, providing them with an opportunity to see the product's capabilities⁵³.

In its 2012 annual report, Barnes & Noble stated that "to address dynamic changes in the book selling industry, Barnes & Noble is repositioning its business from a store based model to a multi-channel model centered in Internet and digital commerce". Mr. Lynch too came to describe Barnes & Noble as "as much a technology company as we are a retail company"⁵⁴.

All the strategic decisions that were conducted by the top managers at Barnes & Noble throughout the years had the intention to keep up with the constant changes affecting the market, and after more than 100 years of history, Barnes & Noble managed to survive. However the digital revolution that has affected many other industries, like the music and movie industry, is changing the rules of the game and the path ahead seems complicated. The big question that remains at this point is what does the future hold for Barnes & Noble.

EXHIBITS

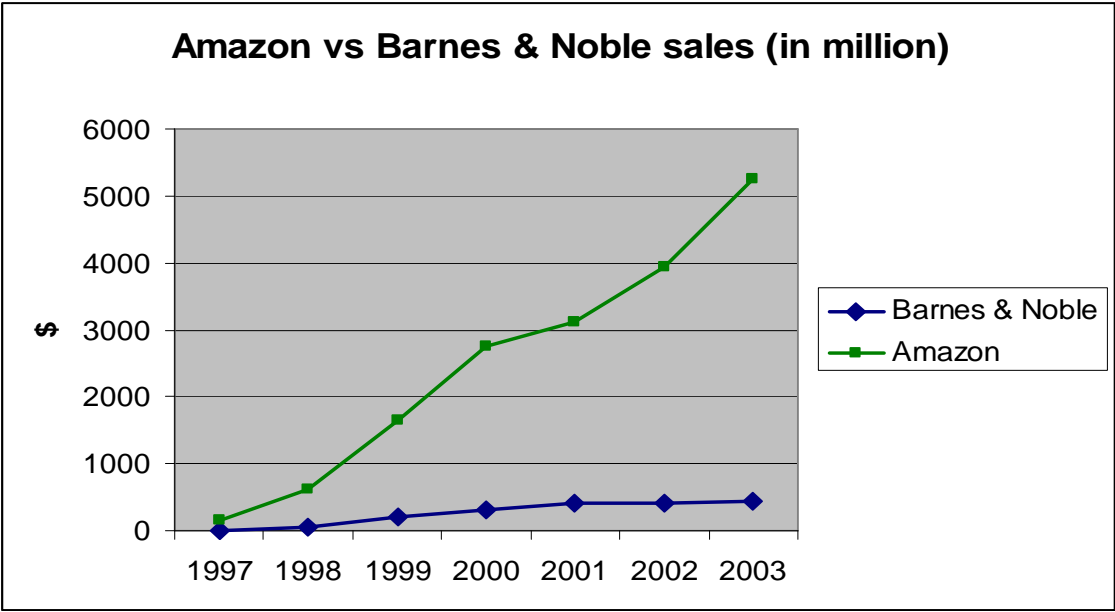
Exhibit 1 - Barnes & Noble “superstores”



Exhibit 2 – Households with Internet: 1997 to 2003	1997	2000	2001	2003	2007
Households with Internet use at home	18.00%	41.50%	50.40%	54.70%	61.7%

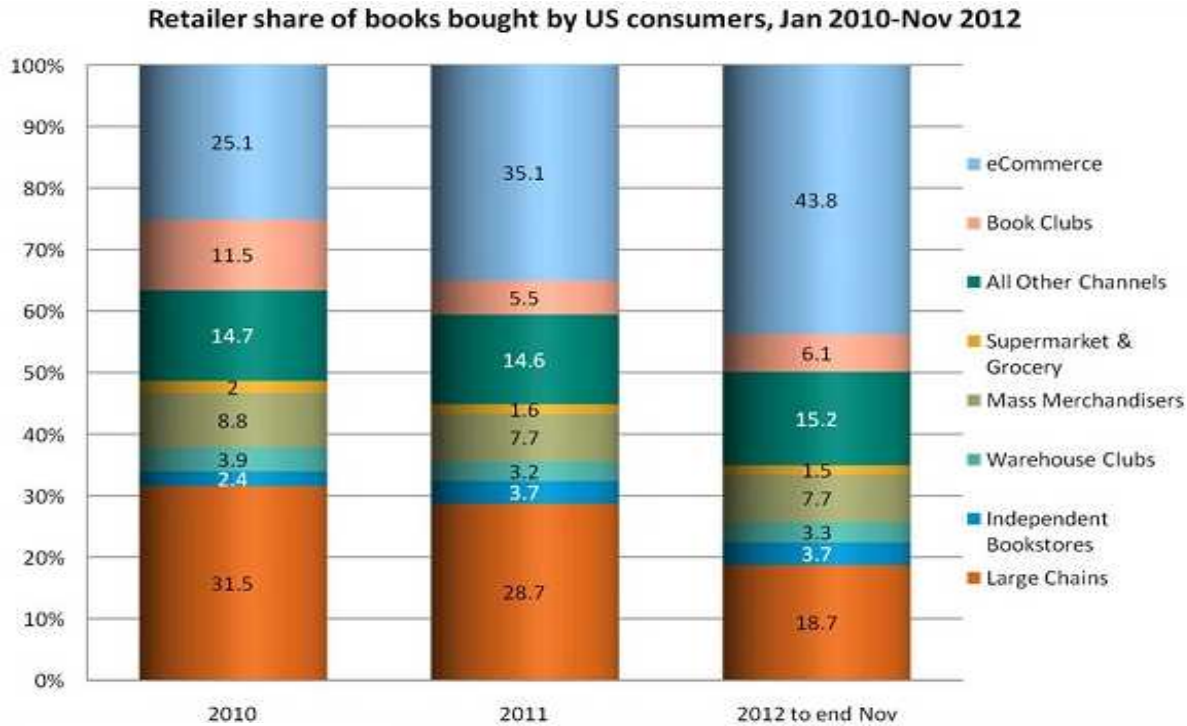
Source: Adapted from de U.S. Census Bureau

Exhibit 3 - Amazon vs barnesandnoble.com sales (in million \$)



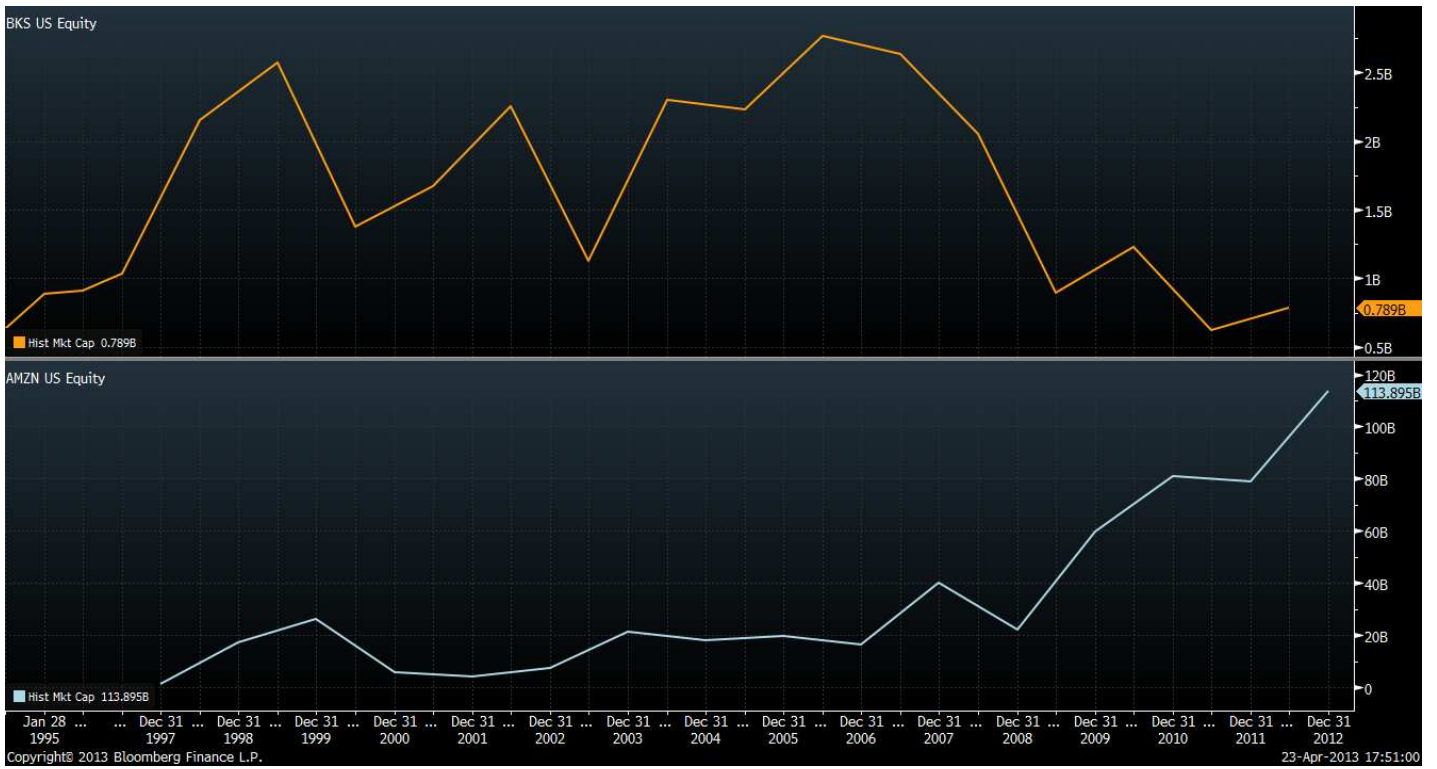
Source: Barnes & Noble annual reports and Amazon’s annual reports (from 1997 to 2003)

Exhibit 4 – Retailer share of books bought by US consumers



Source: Bowker’s Books & Consumers US

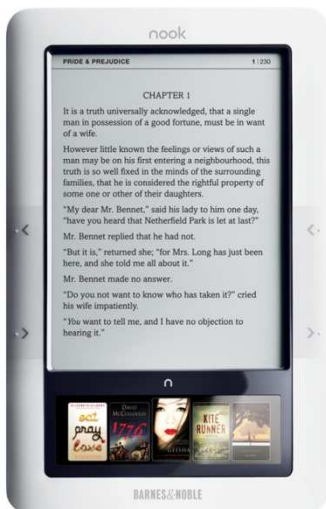
Exhibit 5 – Amazon vs Barnes & Noble market capitalization



Source: Bloomberg Finance L.P.

Exhibit 6 – The first Nook and the first Kindle

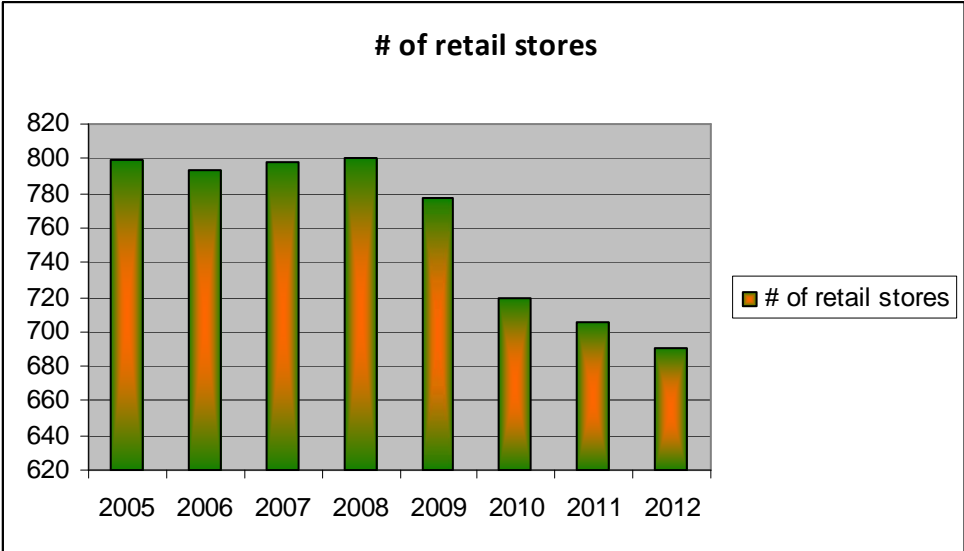
Nook



Kindle



Exhibit 7 – Number of retail stores of Barnes & Noble



Note 1: Stores include Barnes & Noble stores and B. Dalton stores

Note 2: Barnes & Noble college book stores are not accounted here. Barnes & Noble college was acquired in 2009.

Source: Barnes & Noble annual reports (from 2005 to 2012)

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TEACHING NOTE

SYNOPSIS

The first Barnes & Noble bookshop opened in 1932 on Fifth Avenue. In 1971, a man named Leonard Riggio acquired the flagship Barnes & Noble and since then, the brand quickly grew to become the biggest bookseller in the world.

Throughout the 80s and the 90s, Barnes & Noble adopted a strategy of expansion, opening several stores and acquiring many others throughout the country, being the most significant the acquisition of B. Dalton, at the time the second-largest bookstore in America. Simultaneously, Barnes & Noble brought the “superstore” concept: very large stores, combining a wide variety of books and a comfortable atmosphere that were not only a place to buy a book, but a cultural place to enjoy and spend some quality time.

However, those glorious times were soon to be challenged. The advent of the Internet made room for new business models, and in 1995, Jeff Bezos, a young programmer from Silicon Valley found an online book retailer, Amazon.com. Bezos found a way to offer services that traditional booksellers couldn’t match, and as Amazon continued to grow, its market value quickly surpassed Barnes & Noble’s. In 1999, only 4 years after Amazon’s foundation, Amazon was worth almost 20 times more than Leonard Riggio’s company.

As Barnes & Noble’s dominance within the book retail industry was becoming threatened by this emerging force, the company decided that it had to adapt and extend its services and in 1997, two years later after Amazon’s foundation, came up with its own online business.

Years later, after all the struggles, Barnes & Noble would have to face a new challenge. In 2007, Amazon launched the Kindle, a small device that would revolutionize the entire industry, by changing consumers reading habits towards books. Once again, Barnes & Noble followed the moves of its competitor and two years later launched its own device, the Nook. The Nook quickly achieved a strong position in the market, taking in consideration its late entrance. In 2012, Barnes & Noble had about 27% of the e-book market share.

This case examines how a giant company as Barnes & Noble decreased its overall market capitalization in less than a decade by failing to quickly respond to new market trends and technology innovations that were being introduced in the market, decreasing its overall performance and putting the company at risk.

The first section describes Barnes & Noble's early phases and how the company was able to achieve the number one position within the book retail industry under the leadership of Leonard Riggio.

The second section emphasizes the growth of the online business, namely the appearance of Amazon and how it was able to compete with traditional bookstores like Barnes & Noble. Furthermore, it describes the sequence of moves conducted by Barnes & Noble to respond to this emerging threat.

The following section describes and analyses how the new digital format to read books that emerged in the book industry, the e-readers, completely changed the market. Moreover, this section characterizes how Barnes & Noble reacted in order to survive another technological shock.

Finally, the last section describes and highlights the main obstacles Barnes & Noble will have to face in order to survive the difficult conditions that characterize the environment surrounding the company.

TEACHING PURPOSE:

The Barnes & Noble case study is suitable for students that have some basic knowledge on Strategy. It's intended to be taught at undergraduate level or Masters' programmes, in courses related with Business Administration.

The case requires students to:

- Analyze and highlight the main changes that have occurred in the book industry during the time span presented in the case;
- Analyze and assess what were the key strategic decisions made by the top management team at Barnes & Noble;
- Analyze how these strategic decisions affected Barnes & Noble's performance, taking in consideration the time frame in which they were undertaken;
- Understand the changes in the resource base of the company.

INTENDED CONTRIBUTION

The main purpose of this case is to help students understand the importance of strategic decisions regarding the constant fit that needs to exist between a company and surrounding market environment. Furthermore, this case intends to analyze whether dynamic capabilities are a necessary condition for firms to succeed and what might happen to a firm's performance should it lack dynamic capabilities, especially in rapidly changing environments.

This case seems interesting because, as many firms, it is not a total success case, nor a total failure case. It is not a clear case of a company that has completely failed, since

Barnes & Noble is still surviving and conducting its operations, unlike Borders group, which filed for bankruptcy late in 2011. However, this case undoubtedly demonstrates that Barnes & Noble was unable to maintain its position as market leader within the book industry and has decreased its market value over time upon Amazon's appearance in the market.

INSTRUCTORS PREPARATION

Before handing the case to students, the instructor should be prepared and have some knowledge on the dynamic capabilities' concept. My suggestion is that both the instructor and students read the article "Dynamic Capabilities: A review of Past Research and an Agenda for the future" (Barreto, 2010), which presents an extensive review of the existing literature about this topic. Moreover, the article presents a definition of dynamic capabilities which is one of the main focus points of this case.

The instructor should also have some deeper knowledge on Barnes & Noble. The annual reports available on their website (since 1997) provide insightful information regarding the company's main direction and consolidated financial data for further analyses.

Finally, the instructor can benefit from the article "The future of the bookstore; A real cliff-hanger", *The Economist*, February 27, 2013. This article provides very insightful information about the main changes that have occurred in the book retail industry and the main challenges for the future of bookstores.

SUGGESTED ASSIGNMENT QUESTIONS:

1) Characterize Barnes & Noble’s competitive environment during the 80s and the 90s and highlight the main differences with the competitive environment by the end of 2012.

During the 80s and until mid-90s, the transaction of books was the traditional book-selling prototype, involving the publisher, the wholesaler, the retailer and finally the customer. During this time, the superstores made their first appearance in the U.S and were dominating the book selling industry. Smaller bookstores could not handle the pressure of these superstores since they were able to charge very competitive prices due to economies of scale and negotiating power held with publishers. Starting a new bookstore was very difficult. The high levels of required investment combined with the fact that many of these large bookstores were already located on prime locations, was an obvious obstacle to new entrants. Therefore, the competition was among the big bookstores, namely Barnes & noble, Borders, Crown Books and Books-A-Million.

However, by the end of 2012 the situation was completely different. Most of traditional bookstores had disappeared, and the main competitors were now centered on the online and digital formats. Amazon was the new market leader and the traditional business model was reshaped. New competitors were becoming part of Barnes & Noble’s world, such as Apple and Google. The industry changed drastically, and Barnes & Noble, once the unequivocal market leader, was now struggling to compete with these giants.

2) What were the two main exogenous shocks that affected Barnes & Noble's performance?

Students should be able to identify that the main shock that occurred in the market was the foundation of Amazon in 1995. Once the shock has been identified, students should now understand and describe how Amazon changed the industry paradigms.

Amazon began to sell books online. It was a major innovation that completely disrupted the market. Amazon had an alternate distribution channel in comparison with traditional bookstores, relying only on the internet to reach their customers. All the necessary information regarding the books was available online, and Amazon took a step further by providing reviews from other consumers that had already read the same books. Amazon was able to provide an online experience that no other supply chain could. Furthermore, it was extremely convenient and secure to make these transactions. People could now buy books with a simple click on the button, just providing a credit card number and an address for the book shipment.

Having already the correct assessment of the first shock, students should now identify and describe the other two shocks presented in this case. First of all, the proliferation of the e-books during the 00's, and later on, the development of digital platforms that allowed consumers to read this digital books, the e-readers.

The e-books and the e-readers changed consumer's behavior towards reading books. The purchase of books became much easier and people are actually buying more books than they did before. The e-readers are small devices, not heavy to carry, with a size of a normal paperback which can hold more than a thousand books. Furthermore, another plus side of these new digital formats is the fact that most e-books cost less when compared with traditional printed books.

3) Taking into consideration the four variables In “Dynamic Capabilities: A review of Past Research and an Agenda for the future” (Barreto, 2010), analyse Barnes & Noble response to the shocks identified on question 2.

For this question, students should first of all identify the 4 dimensions used for the construct of the dynamic capabilities theory.

The four dimensions are:

D1. Sensing opportunities and threats

D2. Making timely decisions

D3. Making market oriented decisions

D4. Changing the resource base

D1. Regarding sensing opportunities and threats, students should be able to identify that Barnes & Noble had some difficulties understanding the enormous potential of the Internet. Indeed, Barnes & Noble failed to realize that the Internet was threatening traditional business models by providing a major opportunity for new business formats. Students should be able to recognize evidences of this situation in the case. One clear example can be the statement of Leonard Riggio “Although it is clear the World Wide Web, with its profound possibilities, will become a major component of the future of bookselling and publishing, we believe retail bookstores will remain the foundation of our industry”. This is major evidence that Barnes & Noble executives did not see Amazon or the online business as threat in the beginning, but only as an important component for the future of bookselling.

D2. In what concerns the propensity to make timely decisions, students should be able to realize that this was one of the biggest problems for Barnes & Noble. The company was very late entering in the online business. Amazon was launched was in 1995, and

only 2 years later, Barnes & Noble was able to make a move and follow its new competitor. By the time Barnes & Noble entered in the online business, Amazon had already \$9.3 billion in sales. The same rationale can be applied for the e-readers and tablets. Sony had already made its first move in 2006 and Amazon with the Kindle in 2007. Once again, only 2 years later, Barnes & Noble launched its own e-reading device, the Nook. Barnes & Noble did not recognize on time that the market environment was changing, and allowed its competitors, especially Amazon, to gain advantages by failing to react on time. Once Barnes & Noble understood that it had to adapt its offerings towards media-content features, the tablet market was already under the dominance of Google and Apple, which constituted, once again, a big obstacle for the company.

D3. Regarding the third dimension – potential to make market-oriented decisions - Barnes & Noble was able to deliver products that satisfied consumers' needs. When they have managed to enter in the online business they came up with similar services as Amazon. In fact, because Barnes & Noble was in possession of most of the books in-store, the delivery times were often shorter. Similarly, the Nook was somehow the prototype of a device that consumers wanted for an e-reader. Although very similar to the Kindle, Barnes & Noble tried to differentiate its device in small details, such as the color screen, a software keyboard, a replaceable battery, which were considered added value for consumers. As consumers were moving its preferences towards tablets with more media-content features, Barnes & Noble launched its Nook Tablet that was able to fulfill the void existing in its offers.

D4. To address dynamic changes in the book selling industry, Barnes & Noble repositioned its business from a store-based model to a multi-channel model including the Internet and digital commerce. In order to set up its online business, Barnes & Noble used the technology from the company Firefly Networks and conducted a partnership with Microsoft, which gave the company the possibility to be the exclusive bookseller on Microsoft's popular MSN network. At first, when Barnes & Noble

entered in the online business, they had somehow the necessary resources, namely the books and the several stores across the country. The company developed an in-stock of 750.000 titles that were ready for immediate delivery and the long relationship they had with publishers, allowed them to instantly place an order for a specific book. However, Barnes & Noble did not change its focus of books. On the other hand, Amazon was constantly increasing its offerings to more diversified areas and recruiting a broader range of consumers. When these consumers wanted to buy a book, because they were already Amazon's clients, they would not turn to Barnes & Noble. On the other hand, the digital commerce was a completely different history. Barnes & Noble was considered a low-tech company, and developing a device like the Nook would require resources and capabilities that the company did not have. The managers at Barnes & Noble understood that and hired William Lynch, a former executive from smartphones producer Palm Inc. to run barnesandnoble.com. Lynch would become a very important asset for the development of the Nook. Furthermore, Barnes & Noble acquired Fictionwise, an online retailer for electronic books. As the market was moving towards tablets with more media-content, Barnes & Noble tried to adapt and add resources to its portfolio that it did not possess, but the capabilities of tech-companies used to these markets, like Apple and Google, was very difficult to match.

Students can summarize the levels for each dimension of the dynamic capabilities as in the following table:

Dimensions	Level
D1. Propensity to sense opportunities and threats	Low
D2. Propensity to make timely decisions	Low

D3. Propensity to make market-oriented decisions	Medium/High
D4. Propensity to change its resource base	Medium/High

In the end, students should conclude that the main reason for Barnes & Noble to decrease its performance was the fact that they were always late reacting to major trends in the market. Amazon was able to steal the market leader position from Barnes & Noble by acting much faster, leaving Barnes & Noble as the follower. However, students should also emphasize the fact that Barnes & Noble has changed as a whole company and has managed to survive when many others have failed, including its old time rival, Borders.

TEACHING PLAN:

Assuming a time class of 90 minutes, time should be distributed as follows (assuming that students are already familiarized with the dynamic capabilities' concept:

Topic	Time
Review of the Dynamic Capabilities concept	15
Summarize the Barnes & Noble case	15
Question 1	10
Question 2	15
Question 3	20
Final considerations and doubts	15

DISCUSSION

The following section will be dedicated to connect the literature on the dynamic capabilities view with the case of Barnes & Noble. In order to do so, it is important to recall Barreto's (2010) definition of the concept: "A dynamic capability is the firm's potential to systematically solve problems, formed by its propensity to sense opportunities and threats, to make timely and market-oriented decisions, and to change its resource base".

In this new approach, dynamic capabilities are considered as a multidimensional construct, which allows different levels for the dynamic capabilities (rather than assuming that firms have it or not), where the correlation between the four dimensions does not necessarily have to be high. For example, the fact that a company has a high propensity to make market-oriented decisions does not mean that it will have a high level of dynamic capabilities, as all the other dimensions must be considered for the overall effect. Next, I will make an assessment for each variable to the Barnes & Noble case.

As described by past research in this area, companies' success in fast changing environments depends upon the discovery and development of opportunities (Teece, 2007). Barnes & Noble failed to assess and evaluate the changes that were occurring in the market environment. Indeed, the company did not identify the enormous potential of the Internet for the future of the bookselling business nor the major threat that was constituted by Amazon.

In what concerns the propensity to make timely decisions, Eisenhardt and Martin (2000) stated that companies can have advantages by doing "sooner" than its competitors – first mover advantages. One of the main reasons for Barnes & Noble to decrease its performance was the fact that the company failed to react on time. Amazon took an opportunity with the online retailing industry and Barnes & Noble

only 2 years later launched its own website, allowing Amazon to gain market share and grow its business. The same questions can be posed to the e-readers, where Barnes & Noble was too late entering the market. Timing is a key factor for an organization to succeed (Adner and Helfat, 2003) and Barnes & Noble history is filled with poorly timed decisions.

The third key variable for firm's success is related with the propensity to make market-oriented decisions. Timing of the decisions is a fundamental factor for higher performances in dynamic markets, but so is the content of the decisions (Adner and Helfat, 2003), that is, delivering superior value to customers in order to better satisfy their needs than its main competitors do. The competitive advantage that supported Barnes & Noble for many years – a superstore with thousands of titles available – was no longer a success factor by the end of 2012. In fact, in order to offer what the market was asking for, Barnes & Noble had to adapt its offerings and focus more on high-tech products like the Nook.

Finally, the propensity to change the resource base, which contemplates the creation, extension and reconfiguration of firm's resources, is also fundamental to display dynamic capabilities (Teece, 2007; Eisenhardt and Martin, 2000). This propensity to change the resource base has higher effects when bundled with the ability to make market oriented decisions (Menguc and Auh, 2006). In fact, Barnes & Noble repositioned its business from a store based model to a multi-channel model centered in the internet and digital commerce because that was the pattern displayed on consumers behaviors.

The relevance of dynamic capabilities in what concerns its applicability in different contexts has been widely discussed among several authors. Some argued that dynamic capabilities are only relevant in the presence of rapidly changing environments (Teece, Pisano and Shuen, 1997), whereas others stated that the link does not necessarily has to exist (Zahra, Sapienza and Davidsson, 2006).

Zollo and Winter (2002) stated that if companies are in presence of high-volatile markets, they will be much more aware of the need to reconfigure resources and capabilities. Until the mid-90s, the book retail industry was not considered as a dynamic environment. However, by the end of 2012, the situation had shifted with the digital era of e-books and tablets. Indeed, back in the 90s, Barnes & Noble was much less conscious of the need to adapt and reconfigure its resources due to the fact that it was inserted in a low-tech industry that did not seem to change. However, as years went by, as Barnes & Noble was moving its business towards technological industries, the need for adaptation and reconfiguration of its resources was seen as a crucial part for success.

It is important to recall that the dynamic capabilities view emerged from the fact that past theories trying to explain firm's performance did not address rapidly changing environments.

The Resource Based View (RBV) (Barney, 1991) theory is one of the most consecrated theories within the world of management. This theory could easily be adopted to explain Barnes & Noble's superior performance until mid-90s. The company possessed resources and capabilities that allowed them to achieve the number one position in America. But once the market shifted towards online and digital directions, this theory would fail to explain Barnes & Noble performance, since it does not address dynamic environments.

Winter (2003) stated that competitive advantages are becoming shorter over time, and firms will often have to cope with problems they are not well prepared for. Indeed, Barnes & Noble's path was characterized by numerous challenges that ended up influencing the company's performance. By the end of 2012, the resources and capabilities that made Barnes & Noble the number one retail bookstore chain in America were no longer the main source of competitive advantage.

To sum up, it is important to refer that the new definition brought by Barreto (2010) allows to evaluate Barnes & Noble's performance in the online and digital book industry, attending to the importance of each dimension considered in the construct of the theory. This case provides very insightful information and makes a bridge between how actual management practices are related with the strategic change of firms.

CONCLUSION

The dynamic capabilities concept tries to explain how firms can achieve sustainable competitive advantages and emerged from the fact that past theories trying to explain the same phenomenon did not address companies' success in rapidly changing environments.

The main theoretical groundwork that supported this thesis was the definition of dynamic capabilities provided by Barreto (2010). The work that has been conducted aims to illustrate this concept with a real-world case.

The company chosen for this purpose was Barnes & Noble. Barnes & Noble managed to achieve the number one position bookstore chain in America, but in just a few years, was confronted with many obstacles that threatened its dominance in the market. Barnes & Noble had to adapt to a new reality, but the company was too late to react and lost the leadership to Amazon.

By the end, of 2012, Barnes & Noble had a different business model in comparison with 20 years before, and this thesis aims to verify the importance of dynamic capabilities and strategic change in turbulent environments. The relevance of this concept in today's world is a certain fact, and it is important for firms to understand the necessary fit that needs to constantly exist with the environment surrounding them.

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