

# **BOOKS WITHOUT BORDERS**

**Borders Group Inc.**

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## Abstract

The dynamic capabilities theory has attracted increasing attention within the management literature. The abundant research generated disparate definitions of the dynamic capability concept, but a recent attempt was made to consolidate such efforts into a single, robust definition. This thesis provides an analysis of how the distinct dimensions of the dynamic capability concept are performed in real-world situations. To do so, I chose Borders Group Inc., a company that during decades was known as the second largest American bookseller, but in July 2011 announced its liquidation. The teaching case was designed to clearly illustrate the dynamic capabilities theory, demonstrating the usefulness and applicability of the concept. Specifically, the case shows that the dramatic failure of Borders was due to its low levels in all the four dimensions of the dynamic capabilities concept: sensing opportunities and threats, making timely decisions, making market-oriented decisions, and changing the firm's resource base.

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## Introduction

The concept of dynamic capabilities entered the strategic management literature in 1997 by the hand of David Teece, Gary Pisano and Amy Shuen. Their paper became the starting point for the vast literature about the topic that can be found today. Despite all the criticisms made to the definition of the concept given by Teece et al. (1997), the recognition of the importance of the issue led to the development of the topic through vast research work in different management fields.

The research on the topic of dynamic capabilities has, in its majority, tried to answer the question of how companies shape and adapt themselves to constantly changing environments. The importance of this research was perhaps due to two main factors: (1) the static orientation of the existing, dominant strategic theories and (2) the multiplicity of environmental and organizational contingencies that organizations face and that can affect their strategic fit (Zajac, Kraatz, & Bresser, 2000). Associated with the research on dynamic capabilities came the idea that long-term or sustainable competitive advantage, a major goal of firms, was hard to be achieved in dynamic markets (Eisenhardt & Martin, 2000). According to Zahra et al. (2006) “the competitive landscape simply changes too much, too often, and too unpredictably for any capability to confer a permanently sustainable advantage”. Instead, in these environments the real situation is that long-term competitive advantage implies the creation of a series of temporary advantages responding to successive environmental shocks (Eisenhardt & Martin, 2000; Barreto, 2010).

However, and due to the youth of the approach and the growing interest in the topic, the proliferation of different concepts led to some confusion and to a dispersion of efforts in the field. As many others afterwards, the definition provided by Teece and colleagues in the first paper about the topic (Teece, Pisano, & Shuen, 1997) has been subject to many criticisms not just because of its tautological link to success (Barreto, 2010) but also due to its tight linkage to

notions of general effectiveness and generic formulas for sustainable competitive advantage (Winter, 2003), among other gaps pointed by different authors.

In order to consolidate the concept of dynamic capabilities, Barreto (2010) conducted a review of past research and the different definitions provided, in order to create a new, meaningful definition that could overcome the limitations of previous definitions, while incorporating main old and new suggestions within the field. Hence, this author defined 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 its resource base* (Barreto, 2010: 271).

This new conceptualization of dynamic capabilities raises one interesting question, among others: how the new construct applies in practice? In this study I will analyze how the four dimensions presented in the construct behave in real world situations, jointly and individually. With this goal, the firm chosen to be analyzed was Borders Group, the second-largest bookstore company in the US for decades that failed dramatically when facing significant environmental changes. To conduct this analysis, secondary data will be used to expose the facts that surrounded the history of the company and the happenings that led to its end. Worthy international press and company data will be the main sources for the elaboration of the case study. The theoretical background that will be used for the analysis of the case will be written based on articles on the topic of dynamic capabilities from top scientific journals in the management field.

By developing this research, I intend to bring a valuable, practical application of the dynamic capabilities concept, contributing to the consolidation and practical validation of the dynamic capabilities framework, showing the importance of the topic not just as a theoretical input for the management literature, but also as a practical tool for managers.

## Literature Review

### 1. Introduction of Dynamic Capabilities Theory

Introduced by Teece et al., the concept of dynamic capabilities began its first steps in the management field in 1997. This emerging paradigm has been object of increasing interest in the recent management literature (Barreto, 2010) and researchers have recognized the challenges that companies face in constantly changing environments reinforcing the hypercompetitive landscape of markets. Teece (2007: 1319) said that “in fast-moving business environments open to global competition, and characterized by dispersion in the geographical and organizational sources of innovation and manufacturing, sustainable advantage requires more than the ownership of difficult-to-replicate (knowledge) assets. It also requires difficult-to-replicate dynamic capabilities.”

As any other research theme, the concept of dynamic capabilities came up as a solution for the gaps found in managerial theory and practice. The Porter’s five forces analysis assumes that rents are created at an industry rather than at the firm level, in contrast to the emphasis given to firm-specific resources and capabilities by the resource-based perspective to explain firms' performance (Teece, Pisano, & Shuen, 1997). While using the level of analysis that better explains performance differences, this second approach has not adequately explained how and why certain firms achieve and sustain competitive advantage in rapidly changing environments (Eisenhardt & Martin, 2000) and researchers felt the need to extend the resource base view to dynamic markets.

After identifying the existing gaps in the strategic management literature and conceptualizing the aimed contributions to be made to the field, 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”.

Despite all the criticism made to the definition given by Teece et al. (1997), the dynamic capabilities view has been the subject of increasing

attention in the management field, resulting in the vast literature about the concept that can be found today (Barreto, 2010).

## **2. The Development of the Dynamic Capabilities Theory**

Researchers and managers understood the importance of the dynamic capabilities concept in the management field from its beginning. However, the attempts made to find a solid definition of the concept have been sometimes contradictory in some fundamental areas, generating some confusion.

### **a) Dynamic Capabilities and Market Dynamism**

The definition given by Teece et al. (1997) stated that one of the necessary conditions for the existence of dynamic capabilities was the presence of rapidly changing environments. Eisenhardt & Martin (2000), on the other hand, said that dynamic capabilities could also be found in moderately dynamic markets, and Zollo & Winter (2002) considered that even in environments with lower rates of change firms could develop dynamic capabilities. With the conditions for the existence of dynamic capabilities broadened, Teece (2007) proposed a number of characteristics that the environment should have for multinational firms to possess dynamic capabilities. Although some researchers have broadened the relevant context for the existence of dynamic capabilities, saying that these capabilities are also valuable in more stable environments, other researchers have referred to the environmental dynamism as a critical component (Barreto, 2010).

The relevant context and the environmental conditions that surround dynamic capabilities still remain one of the issues that are not yet clear in the field, requiring further research. Barreto (2010) proposes empirical studies to compare the effect of similar dynamic capabilities in distinct environments.

### **b) Dynamic Capabilities and Enterprise Performance**

“The fundamental question in the field of strategic management is how firms achieve and sustain competitive advantage” (Teece, Pisano, & Shuen, 1997: 509). In fact, Winter (2003) alleged that some of the confusion around dynamic

capabilities concept was probably due to the linkage of the concept with notions of generalized effectiveness and generic formulas for sustainable competitive advantage. The criticism made by many authors to Teece et al. (1997) definition of being tautological is not just related with the description of a capability as an ability (Zollo & Winter, 2002), but is mainly linked with the direct relationship between dynamic capabilities and enterprise performance. Teece (2007: 1320) reinforced his view saying that “the development and exercise of dynamic capabilities lies at the core of enterprise success (and failure)” and other authors also share this approach. However, many others have criticized this view reiterating that dynamic capabilities are necessary but not a sufficient condition for the existence of competitive advantage (Eisenhardt & Martin, 2000). Moreover, the same authors explained the tautological problem of Teece et al. definition through the identification of the VRIN (valuable, rare, inimitable, nonsubstitutable) resources that lead to competitive advantage by the observation of superior firms’ performance and the attribution of this performance to the unique resources the company seems to possess.

Nowadays, the environment where firms compete change quickly and unpredictably, disabling any resource to represent a sustainable advantage (Zahra, Sapienza, & Davidsson, 2006). For some researchers the concept of sustainable competitive advantage is nowadays hardly achievable. Eisenhardt & Martin (2000) say that it makes sense that, in rapid change environments, firms compete through the creation of a series of temporary competitive advantages.

### **c) Commonalities vs. Heterogeneity of Dynamic Capabilities**

While some researchers have characterized dynamic capabilities as unique and idiosyncratic processes that result from path-dependent histories of firms’ individual decisions and specific assets (Teece, Pisano, & Shuen, 1997), other authors explained dynamic capabilities as processes where common features can be observed across firms, giving the idea that there are more or less effective ways to execute a specific dynamic capability (Eisenhardt & Martin, 2000). This acknowledgment of the existence of commonalities introduces the idea of “best practices” in dynamic capabilities, contradicting the major objective

of firms that is competitive advantage. The differentiation goal can only be achieved through unique and specific processes and resources.

Although it is assumed by many authors the existence of commonalities in the appliance of dynamic capabilities, the firm specific context, its resources and the past behavior can undertake a crucial importance in the firm's decisions to achieve the desired competitive advantage.

### **3. Consolidation of the Dynamic Capabilities Concept**

The youth of the approach, the importance of the issue and the increasing research in the field led Barreto (2010) to conduct a review of past research addressing some of the issues pointed in this literature review and proposing a new definition that could fulfill the gaps found in previous definitions. Barreto (2010: 271) defined dynamic capability as "a 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".

#### **a) The four dimensions of the construct**

The definition given by Barreto (2010) presents four different dimensions that form this construct enabling the measurement of the dynamic capabilities through the observation and evaluation of each of their four related dimensions.

The first dimension presented in the construct is the firm's "propensity to sense opportunities and threats". The propensity to sense opportunities is closely linked to the entrepreneurial approach, specifically with the discovery view when the opportunities come from exogenous shocks, and with the creation view when they come from endogenous shocks (Barreto, 2012). The relevance of entrepreneurial activities is not just critical for the conception, development and maintenance of dynamic capabilities in new ventures, but also in established companies (Zahra, Sapienza, & Davidsson, 2006). Teece (2007) reiterated this approach saying that companies must continuously examine, pursuit and explore across markets and technologies to identify and shape opportunities.

The second dimension of the definition is the propensity of a firm “to make timing decisions”. Mainly related with the uncertainty of rapid changing environments, making duration of competitive advantage inherently unpredictable, timing reveals to be key in strategy (Eisenhardt & Martin, 2000). The strategic logic behind the concept of timely decisions is the opportunity or threat making urgent the decision of when to change. The potential for competitive advantage also lies in using dynamic capabilities sooner than the competition (Eisenhardt & Martin, 2000).

The third dimension presented by Barreto (2010), known as the propensity of a firm to make market-oriented decisions, presuppose company’s knowledge about what customers really want, what are the market needs, and what are the competitors’ actions regarding those market requirements.

Both second and third dimensions include the decision-making process, reiterating the findings of some authors that identify this process as a key component of dynamic capabilities. The ability of firms to change directions would not be valuable without the action of managers transforming this ability in real actions, that is, without the decision-making propensity (Barreto, 2010).

The fourth dimension highlights the propensity of a firm to “change its resource base”. The role of dynamic capabilities, in the form of strategic routines, is also the alteration, acquisition, integration and recombination of resources as a way to generate new value-creating strategies (Eisenhardt & Martin, 2000). While some dynamic capabilities integrate resources, others focus on reconfiguring them and still others center their effort in gaining or releasing resources.

#### **4. Future of Dynamic Capabilities**

The dynamic capabilities concept has captured attention from its beginning and despite all the criticisms made to the conceptualization of the approach, researchers recognize the importance of the issue and the timeliness of the topic.

Many related issues have been addressed in research articles but the majority of them are not yet consensual in the field. While for some it is clear that dynamic capabilities are only applicable in high-velocity environments (Teece, Pisano, & Shuen, 1997), for others the concept can also be valid in moderately dynamic markets (Eisenhardt & Martin, 2000) or even in more stable environments (Zollo & Winter, 2002). Whereas for Teece (2007) it is clear that dynamic capabilities are especially relevant for multinational firms, open to global competitions, other authors suggest a broaden variety of firms to which dynamic capabilities are pertinent (Barreto, 2010). For instance, Zahra et al. (2006) advocate that the topic works for both new and established firms. As Barreto (2010) proposes, it is important not just to find the types of firms for which the concept is most valuable but also to identify the ones for which the topic is less useful. Other articles raise questions in the attempt to draw the attention of other researchers to the existing gaps in the field. Eisenhardt and Martin (2000) talk about the lack of empirical grounding, while Zajac et al. (2000) question the factors that drive a firm to its strategic choices.

There is no doubt that the increasing research around the concept of dynamic capabilities predicts an important shift in the strategic management field, namely, by drawing the attention of managers and scholars to the global market dynamism where the companies live today and its influence in managers' decisions when struggling to achieve a competitive advantage.

## Teaching Case

Greg Josefowicz joined Borders in 1999. He was a 47 years old food and drugstore executive with 30 years of experience in the retail business. Borders was facing times of complete change in the industry and Mr. Josefowicz was expected to overcome those challenges.

In the middle 1990's, when a major competitor entered the industry, Amazon.com, with a completely different approach to the retail and bookselling industry, Borders did not realize the importance of such changes. The emergence of Internet, online retailers and e-books did not seemed to threat the company, which continued to grow in the physical world, increasing the number of stores in and outside the US. "They never really harnessed the power of the Internet," said David Dykhouse, a manager of Borders' Arborland store from 2002 to 2007. "As someone once said, the Internet is the comet that killed the dinosaur. I'm afraid Borders is one of those dinosaurs."<sup>1</sup>

Despite the strategic changes that its competitors were undertaking, Borders was not prepared to face the challenges of the online world. After a succession of many failures, in 2011 Borders filed for the Chapter 11 bankruptcy protection, first, and announced its liquidation, later. What led to such a dramatic end?

### Company History

Thomas and Louis Borders grew up in Louisville Kentucky and both were students at the University of Michigan although at different stages of their studies. Louis went there for his undergraduate and then moved to MIT while Thomas went to the University of Michigan for an M.A. in English literature after going to college in Notre Dome. Louis joined his brother in Ann Arbor later, when he dropped the MIT.

Life in Ann Arbor was pulsed by the University of Michigan. The majority of the people in town was either employed by the university or enrolled in it. Being one of the best public universities in the United States, the University of Michigan was known by its advanced research activities, its faculty accounted for

more than 3000 and the student body was nearly 25000. Both students and faculty members spent hours of their days reading and a great deal of what they read was books. Although Louisville had not been a great book town, the Borders brothers always shared that common interest for books that increased over time. Together in Ann Arbor, the brothers were now struggling to find what to do and where to do it and they found that maybe there was a place for them in the book trade.<sup>2</sup>

In late 1960's the Borders brothers started a used bookstore, a business that is both frustrating and uninteresting since the good acquisitions sell quickly and the bad ones stay. The brothers quickly found that the business of used books was a matter of collectible objects where the emotional relationship between the book and the customer was key rather than the intellectual relationship. There were no opportunities to make right or wrong decisions and the Borders brothers were young and seeking for a challenging activity. It was just not the right life for them and they started to think about different business models.

The existing bookstores in Ann Arbor were located close to the university and their portfolio was mainly texts and other assigned books, a small selection of other books, schools supplies and university merchandising. The opportunity was found and there was no real competition.<sup>3</sup>

In 1971 Thomas and Louis Borders opened the first Borders Book Shop, a thin and deep 2000 square feet bookstore placed at 211 S. South State Street, in Ann Arbor, Michigan, perfect for drawing customers in. The success of the first bookstore led the Borders brothers to move to an 11,000 square feet site, with two floors, located in the same attractive street. Initially, only the first floor was used as a bookstore while the second floor served the store's needed operations, but as the brothers started to introduce different titles contrary to what the other bookstores in town were used to do and found that the incremental value of adding titles was strongly positive, the bookstore rapidly was extended to the two floors, encouraging the brothers to continue adding more and more titles. The increasing number of offers in the store led the brothers to systematically

control their stock.<sup>4</sup> To do so, Louis Borders developed a simple computer program to track inventory, but the modifications and improvements of the program created a successful Book Inventory System that led them to a separate business with the company selling it to other bookstores.<sup>5</sup> The first inventory system was created not long after 1971 and the program quickly became one of the central points of the business and the major source of Borders brothers' success.

The success of the first bookstore and the desire to expand the business jointly with the ambition to capitalize the inventory system, routed the company to new openings. The first one was in Birmingham, Michigan, in the suburbs of Detroit, a store that worked well. After the first one, the second was in Atlanta but the wrong choice of the specific location in the city determined the store failure. The following bookstore was in Indianapolis and it was again a success. As the company started and continued to expand, strategy was becoming more and more relevant.<sup>6</sup> The company was seeking for specialized human resources that could lead the company in its expansion, and in 1988 the Borders brothers recruited Robert Di Romualdo, a former naval aviator and a graduate of Harvard Business School<sup>7</sup>. Di Romualdo became the CEO of the company the following year and stayed in that position for a decade<sup>8</sup>.

At that time, it was not just the company that was growing; the stores were then bigger with an average of 28,000 square feet and offering roughly 150,000 titles.<sup>9</sup> But the magic of book superstores was not just in their size or in the number of titles but in the overall environment that consumers could find inside the store. Borders furnished its superstores with comfortable chairs and nooks for browsers in the shelves' area. The company incorporated coffee bars and café tables where potential customers could sit and read or simply meet and talk with friends. The stores kept an unusually broad selection of magazines and out-of-town (and even overseas) newspapers in stock as a way to attract customers. At the same time, Borders coffee bars were also stage for book presentations and even for local groups to give readings or concerts. Borders became more than a bookstore, a destination for customers. Borders bookstores were also admired and known by their customers because of their well-educated

and trained staff that had great knowledge about books.<sup>10</sup> The combination of four crucial characteristics made Borders superstores different from any other bookstore in the US: The huge selection of titles that could be found in the stores, the knowledgeable staff, the in-house coffee inviting customers to enter and stay, and the browser friendly environment.<sup>11</sup>

Although Borders bookstores chain was not yet too big or even acting at a national level, the company's expansion was inevitably forcing Borders to look at both regional and national competitors. In the 1980s there were two major national chains of bookstores owned by department store holding companies, Waldenbooks and B. Dalton that were both mall based bookstores.<sup>12</sup> There were also a number of regional chains and Borders was starting to have its place in the market as well as other bookstore chains as Barnes & Noble. The mall based stores were smaller with a few number of titles and with a different concept, inviting customers just to enter, search and buy, a completely different approach than the book superstores.

Barnes & Noble, that soon became the biggest Borders' competitor, turned out to be a huge bookstores company by the hand of Leonard Riggio. Riggio went to New York University as a night school undergraduate in the middle 1960s and, to be able to pay his bills, he took a day job in a campus bookstore. He started at the university as an engineering major but soon shifted over to business, opening a bookstore with a larger variety of books than other bookstores, which could be found in town near the university, had to offer. To open his own business, in 1965, Mr. Riggio borrowed the \$5000 he needed to get started. The personalized purchases and the close relationship with his customers made Riggio's bookstore a success, but his ambition made him search for a way to grow. He took on other college bookstores and succeeded in making them profitable. In 1971, a 42,000 square feet store that belonged to Barnes & Noble family business was for sale. Just three quarters of a mile of Riggio's store and located in the NYU neighborhood. The 29 years old man borrowed money again and bought the first of many other Barnes & Noble bookstores for \$1.2 million. By 1986, there were already 33 of Barnes & Noble bookstores, mainly in the Northeast.<sup>13</sup> Barnes & Noble claimed to be the inventor of book superstores

while Borders argued the title of being the first ones having in-store coffee bars creating an completely different concept of book superstores.<sup>14</sup> Although Borders was first to add café bars to its stores, Barnes & Noble took a bigger step when it made a partnership with Starbucks in 1990.<sup>15</sup>

The 1980's were marked by mergers and acquisitions in the American Book Industry. In 1984 Waldenbooks acquired Brentano's and later that same year, Kmart purchased Waldenbooks. In 1986, B. Dalton, one of the national mall bookstore companies, went for sale and Leonard Riggio, the owner of Barnes & Noble became determined to bid and although there was some competition for the property, Riggio returned to New York with the deal. In fact, The B. Dalton inventory management software was better than the one that Barnes & Noble had, and it was a better fit to a bigger and more complex network.<sup>16</sup>

### **Borders under Kmart**

When Kmart decided to acquire Borders, in October 1992, the Specialty Retail Group had already a group of bookstores that included Waldenbooks and Brentano. In fact, since the beginning of 1992 that Waldenbooks, the book unit of Kmart, was looking for a way to enter in the book superstore business, trying to compete with its rival B. Dalton, that then was already integrated in a company with book superstores included in its operations, Barnes & Noble. When Kmart acquired Borders, the book superstore chain had 21 bookstores and was valued at about \$190 million.<sup>17</sup> Borders was well known by its impeccable customer service and great inventory system that was considered by many as “the envy of the industry”<sup>18</sup>. Once the company was sold to Kmart, Borders brothers stepped out of the company management and Kmart formed the Borders-Walden Group. Although Kmart did not know yet how they would integrate Borders Group in the company's book operations<sup>19</sup>, it was somehow understood that the Borders superstores could be important for the group. In fact, Kmart already owned three Basset Book Shops, a chain of book superstores, in the Northeast, and expected to open 11 more until the end of 1992<sup>20</sup>. Book superstores were taking an increasing share in the bookstore business and Kmart was investing in it with the opening of Basset Book Shops and the purchase of Borders.<sup>21</sup> “We think

superstores will become the dominant channel of book distribution within five years,” said Lois Connelly, the assistant director of investor relations at Kmart.<sup>22</sup> Book sales were growing reaching \$7.9 billion in 1991, 8.4% above the level of the previous year. Smaller chains were also initializing their investments in the book superstore niche. However, for some people in the industry it was not so clear that there was a huge new market for big bookstores and other executives in the industry were concerned with the future mall based bookstores, stating that mall bookstores were just not as profitable as they were before.<sup>23</sup>

Whereas the Borders superstores continued growing, the Borders-Walden combination had been outshined, since October 1992, by Barnes & Noble that owns B. Dalton chain of mall based bookstores. At that time, some industry officials said that making Borders the dominant chain in the Kmart group could make the difference increasing the competitiveness of the group. “People in the business have been asking for a year why this hadn't occurred,” said a publisher. “Walden had trouble competing with Barnes & Noble, and Borders was considered a well-managed superstore.” The success of the book inventory system and the prominence of book superstores were some of the reasons that were pointed by the critics for the need of making Borders the dominant chain of Kmart book unit.<sup>24</sup> Despite some publishers' concern with the eventual phasing out of mall bookstores, Walden-Borders executives had a different opinion; “We believe the mall business is here to stay and Waldenbooks continues to be a very important part of our business,” stated Rick Vanzura, a Borders vice president, in 1994.<sup>25</sup> With 1109 Waldenbooks stores placed in malls and only 62 Borders superstores, and with Waldenbooks making sales of \$1.14 billion while Borders was achieving \$225 million, in 1993<sup>26</sup>, the statement of the vice president had an apparent plea, but the evidence was that in 1994 the company was closing 60 Waldenbooks stores and was making plans to close 140 more<sup>27</sup>.

In 1994, Kmart announced a shake-up in its book operations with the intention to strengthen the book unit for a public stock sale the following year. The company initialized an whole process of changes in its Borders Inc. and Waldenbooks Co. units “Kmart's strategy appears to be to create a new entity so it won't drag down the corporate bottom line, and so that when they go public

with the bookstores, they will look to be positioned for the future,” explained an executive in the field; “If I were going public, that's also what I'd do”. One of the changes that occurred in the Kmart book unit was the creation of a separate corporate unit. From Walden-Borders Group unit, the new company was named Borders Group Inc. and the existing separation in the management of Borders and Waldenbooks was dismissed with the nomination of Robert DiRomualdo as the CEO of the group while both the president and vice-president of Waldenbooks leaved the company.<sup>28</sup>

In August 1994, Kmart made a public announcement stating its intention to reduce its ownership on Borders Group to 48%, revealing the bookseller's plans to public soon with an offering of at least 20.8 million shares of stock at an estimated price of \$13-\$16 a share, expecting to raise \$300 million.<sup>29</sup>

### **Borders Group goes public**

In May 1995, Borders Group Inc. files statement with Securities and Exchange Commission increasing to 35.9 million the number of shares of its IPO. This reduced the share of 100% that Kmart had over Borders Group to nearly 13%.<sup>30</sup>

Borders Group IPO occurred just year and a half after Barnes & Noble, that claims to be the US biggest bookstore chain<sup>31</sup>, have gone public. Borders Group and Barnes & Noble were very similar companies. Being in the bookstore business they were present in local malls through Waldenbooks and B. Dalton chains and each one had a chain of book superstores with related concepts where customers could seat, read a book and have a cappuccino. However, in the IPO market, stock that sells a repeated idea is usually not as successful as the original. Barnes & Noble's stock was an instant best seller at the time of its IPO, in 1993, climbing 47 percent over its \$20 offering price in one day. According to Charles Ronson, head of the IPO Value Monitor “There's not much 'sizzle' here, the deal is fairly priced”, clarified him referring to Borders stock valuation and the overvaluation that often comes with market affection. In fact, there were reasons for Barnes & Noble to be more expensive and Borders cheaper. In 1994, Barnes & Noble registered sales of \$1.6 billion in sales profiting \$573 million

against the Borders profits of \$386 million out of a revenues' total of \$1.5 billion. At the same time, Borders sales came mostly from its mall based Waldenbooks stores, with only 75 Borders superstores at the end of 1994, while Barnes & Noble summed a total of 268 superstores in the same period, being the only player in some large American cities. Even more, Borders was leaving Kmart umbrella, being completely by its own. The Borders Group could no longer count on the deep pockets of the discount retailer and its influence and protection.<sup>32</sup>

In August 1995, Borders bought its remaining 13% stake from Kmart at a price of \$13.5 a share, representing \$72.8 million for 5.39 million shares.<sup>33</sup>

### **Borders Expansion**

**“The Company’s growth strategy is dependent principally on its ability to open new superstores and operate them profitably.”<sup>1</sup>**

In 1994, when preparing for the IPO, Borders said that its principal strategy for growth was “continued rapid expansion of its Borders books and music superstore operations”<sup>34</sup> and that was what described the following years of Borders Group. Borders expanded not just at the national level but also internationally. In June 1997, Borders had 163 book superstores and 930 mall based stores under the name of Waldenbooks, the leading mall book retailer in the US.<sup>35</sup> Nevertheless, these numbers represented a significant decrease in the mall based bookstores field and a rapid growth in the superstores business (**see Exhibit 1**).

In 1997, Borders Group entered the UK market with the purchase of Books etc., and later in that year, opened one store in Singapore. Books etc., that was planning a public stock sale early in 1997, cancelled its plans taking into account the demonstrated Borders’ interest. “Over the last month it became increasingly clear to the board that Books etc. would be best placed to develop in the rapidly changing UK book market as part of Borders” explained Richard Joseph, the chief executive of Books etc..<sup>36</sup> There was also some speculation

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<sup>1</sup> Borders’ 10-K SEC filing (April 10, 2003. March 6, 2004. April 8, 2005 and April 5, 2006)

around Borders entrance in the Singapore market with people saying that Borders could be setting its sights further. “I am sure they have done their homework. I think they are looking at the regional market.”<sup>37</sup> In fact, Borders continued expanding entering in markets as New Zealand and Australia with one book superstore in each location at the end of 1999. In the same period, Borders was also summing 5 Borders superstores in the UK.<sup>38</sup> Later, in 2001, Borders Group entered in Puerto Rico market with the book superstore concept.<sup>39</sup> In July 2004 Borders bought United Kingdom-based Paperchase Products Ltd.<sup>40</sup>, paying \$30 million to raise its stake in the British stationary retailer to 97%.<sup>41</sup> In the same year, Borders Group started branding some Waldenbooks stores as Borders Express.<sup>42</sup>

Borders didn't stop to grow until 2007, almost a decade after its market value reached the pick of \$2,365 billions, in 1998 (**see Exhibit 2**), and its share price have reached an all-time high of \$42, in the same year (**see Exhibit 4**).

## Borders Online

Although Internet began in the 1950's with the development of computers, its growth became more significant in the 1990's. At the Internet World '93 conference in Manhattan, it was announced that Internet was attracting roughly 150,000 new users each month. At that time, the Internet estimated population was close to 15 million. In 1991, the first commercial Internet connection services appeared, and suddenly the system was opened to anyone, not just the community of academics and computer gurus. As millions of new users linked themselves to the Internet, the world started to view the Internet as a service, not as an electronic community.<sup>43</sup>

Amazon.com entered the online retailing world in 1995 as a bookseller but soon diversified selling almost any kind of retail products from toys and furniture to CD's and software, turning into the world's largest online retailer.<sup>44</sup> Jeff Bezos, started developing the website in 1994 and although online retailing was just in its beginning, it didn't take too long to be clear to the world the success of Amazon.com. The exponential growth in the market value of the

company (**see Exhibit 2**) and its increasing sales (**see Exhibit 10**) were a clear evidence of Amazon.com success even in its first years.

Barnes & Noble launched its online bookstore in 1997 with more than a million titles available and with better discounts than those that their customers could find in-store. B&N was making a huge investment in the Internet retail business and the objectives of Mr. Riggio, B&N CEO, were no less than to become the no.1 in the field. The company had a team of 50 people that had been preparing this aggressive entrance for a year.<sup>45</sup> At that time, Borders announced that the company was also preparing its own website that went online only in 1998. An electronic commerce analyst said “I think what we're seeing is the realization that the Internet is a viable channel, and Borders and Barnes & Noble realize that it's time to build a brand online.”<sup>46</sup> Nevertheless, Amazon prepared itself for the entrance of competitors and extended the number of books it offered to 2.5 million at the same time that roughly 500 titles would be priced at 40% below their publisher's retail price. Amazon.com CEO, Jeff Bezos, denied any connection between the price cut and the threat of potentially tough competition arguing that “if we make our plans based on what our competitors do, we might not do anything.”<sup>47</sup>

Though late, on May 7, 1998 Borders entered the World Wide Web with the creation of borders.com website where customers could buy books, music and videos.<sup>48</sup> In November, Robert DiRomualdo, who served the company as CEO for almost a decade, was succeeded by Philip Pfeffer.<sup>49</sup> The hiring was intended to lead the company in its Internet and overseas expansion strategy.<sup>50</sup> However, just after five months as Borders CEO, Mr. Pfeffer announced on the 21<sup>st</sup> of April 1999 its resignation of Borders. The abrupt departure of Pfeffer was so surprising that even some executives were not at the company's headquarters at the announcement. Trying to not create big buzz around the issue, some executives only stated that Pfeffer did not fit the company and Borders wanted to move on.<sup>51</sup> DiRomualdo, who was at the time chairman of the company was named president and CEO of Borders in an interim basis<sup>52</sup> while the company was seeking for a leader with an “open mind” to preside over a company, with interests in both electronic commerce and retail stores, according to a telephone

interview given by DiRomualdo. After the resignation announcement of Mr. Pfeffer, DiRomualdo conducted several sessions with hundreds of employees to explain management changes, which also included the promotion of Cedric Vanzura as president of Borders Online.<sup>53</sup> Philip Pfeffer was criticized for being too much focused in the superstores rather than developing an online strategy. In 1998, Borders' online book sales were \$5 million against \$610 million for Amazon.com and \$70 million for Barnes & Noble.<sup>54</sup>

Despite the executive changes in the company, when Borders launched its online store, there were already two major players in the field, Amazon.com and the online store of Barnes & Noble. In fact, customers were already saying “I’ll go to Borders to find a book, and then I’ll go to Amazon to buy it, generally.”<sup>55</sup>

Finally, on November 15, 1999, Borders found a new CEO, Greg Josefowicz, a 47 years old food and drugstore executive and an avid book reader with more than 30 years of experience in the retail business. However, the big question was if Greg Josefowicz would be prepared to face the fiercest competition he had ever encountered.<sup>56</sup> The battle of the three online booksellers had just started and the Borders’ late entry in the e-commerce made it a distant third competitor in the online retail business with \$27 million in sales at the end of the year 2000 while Barnesandnoble.com registered \$320 million and Amazon.com made \$1.7 billion sales in the same period.<sup>57</sup>

### **Borders Online: The pact of the evil**

In fact, the poor online sales led the company to decide that there was no need to own an Internet store in order to protect its core business<sup>58</sup>, leaving to Amazon.com, Borders biggest online competitor, the operation of its money-losing online bookstore. The deal between the two companies was announced on the 10<sup>th</sup> of April 2001 and started in August that year.<sup>59</sup> The controversial partnership was not a surprising deal for some people in the industry. “It’s not a shocker at all. Both companies need this”,<sup>60</sup> said an e-commerce analyst. However, Borders President Greg Josefowicz justified the company’s decision: “This allows us to do what we do best and transfers management of our online site to those who do it better than anyone,”<sup>61</sup>

Jeff Bezos, Amazon.com founder, was one of the enthusiasts about the deal. “Borders is best of breed in the physical world and a company that shares our passion for serving book, music and movie lovers everywhere,”<sup>62</sup> said Mr. Bezos. This was not the first partnership that Amazon.com was making with retailers that wanted to outsource their online business. Bezos said in an interview that the deal between Borders and Amazon.com along with other previous partnerships in the online retailer business showed the “flexibility of Amazon e-commerce platform to meet the needs of other leading companies.”<sup>63</sup>

The e-commerce was clearly a misadventure for Borders. The book company launched its web store three years after Amazon.com and one year after Barnesandnoble.com, and in January 2001 the company announced that Borders.com made a lost of \$18.4 million.<sup>64</sup>

In August 2001, Borders closed down its online service center, cutting 70 jobs. Though Borders.com remained online, it was co-branded with Amazon’s logo and the shipments became responsibility of Amazon’s distribution centers. It worked the same way as before for customers with only a physical difference that could be noticed, the Amazon logo in boxes where books, CD’s or other goods were delivered.<sup>65</sup> “Amazon is working to make the Borders experience better for customers,” Bezos said in an interview. “In exchange, we get up-front payment and revenue. There is financial benefit to Borders and to us.”, he added.<sup>66</sup>

For Borders the deal removed a major headache. Greg Josefowicz could not deny the feelings of Borders executives that it was “a graceful exit”. The losses of Borders.com were dragging Borders Group to a difficult financial situation and the CEO of the company explained “Borders couldn’t see an end to the tunnel of losses from their online site.”<sup>67</sup> While Borders was exiting the online retailing business its biggest competitor and largest American bookstore chain, Barnes & Noble, acquired Sparknotes.com, a website that offered free access to literature notes and study guides. The purchase was made in March 2001 and Barnes & Noble was showing to its competitors that it was awake and expanding its Internet offerings.<sup>68</sup>

Almost a year later, Waldenbooks' online operations made a similar partnership with Amazon and Borders entered another agreement with the most successful online retailer allowing customers to buy its products through the co-branded website and pick up their products in a Borders' store.<sup>69</sup> Online shoppers were able to purchase the product online at Borders online store and check its availability at as many as five Borders stores on their zip code area. Choosing the in-store pick up option, products were held in the stores waiting for customers to pick them up.<sup>70</sup>

E-commerce was evolving very quickly. On the 28<sup>th</sup> of March of 2003, Apple launched the iTunes, a revolutionary online music store where music lovers could find, purchase and download the music they want with the possibility of buying just one song or an entire CD or DVD.<sup>71</sup>

In 2004, Borders took its partnership with Amazon to an international level, making a similar deal between Borders UK subsidiaries and Amazon.co.uk. Again, the arrangement was well accepted by the largest e-commerce company. Robin Terrell, managing director of Amazon.co.uk said "Amazon.co.uk is committed to providing customers with the best possible online shopping experience and we are excited that Borders has chosen to work with us to help launch, power and manage its online presence in the U.K."<sup>72</sup>. The words used by Mr. Terrell to describe the deal with Borders were making clear that it was Amazon and not Borders that was making its online presence even stronger. Borders was not teaming with an equal partner. At the same time, Amazon was always the one to close the sale, owning the relationship with the customer. The Borders' lack of presence in its own website disconnected the company from tech-savvy customers who became followers of the easy online shopping experience provided by Amazon. Even more, it was giving the customers who were benefiting from the alliance, the disincentive to go and live a Borders physical bookstore shopping experience.<sup>73</sup>

### **Borders Loyalty Program**

In February 2006, Borders launched its loyalty program named Borders Rewards.<sup>74</sup> Borders membership program was free, contrarily to any other

loyalty program in its industry. Borders was getting into a price war and it made no sense. Every retailer knows that cutting price always lead to a price war until it becomes a zero-sum game, and Borders was competing with companies as Amazon that could threat almost any product in the book industry.<sup>75</sup> “We listened to what our customers told us they wanted from a loyalty program, and we designed something that responds to their needs. Borders Rewards is easy to join, easy to use and membership is free, all the things our customers told us they wanted.” said Vin Altruda, president of Borders US operations.

Six years after Barnes & Noble have launched its Readers’ Advantage loyalty program where customers were offered 10% discount in-store and 5% through the online store for a \$25 annual membership fee,<sup>76</sup> and almost a year after the launch of Amazon Prime membership program through which customers would have advantages and discounts for a \$79 annual fee,<sup>77</sup> Borders entered late again in the boat and made its program free, differentiating itself from the competition. Customers see paid relationships differently than those that are free. Their though usually is ‘I paid for this relationship, I want to get as much out of it as I possibly can.’ The fact that Borders Rewards was free made it appealing to customers and the loyalty program that had been launched in February 2006, could count more than 20 million members in August that year<sup>78</sup>, but customers were not making the most of it and the company was not making money.

The most intriguing issue around Borders late and free enter in the loyalty programs field was related with the fact that Borders Group actually had experience in the field since Waldenbooks created in 1990 the Preferred Reader Program, a paid loyalty program that enabled the company to make \$25 million annually between 2000 and 2003. In fact a company statement in 2002 revealed the following: “Waldenbooks operates one of the longest-running customer loyalty programs in the nation, the Preferred Reader Program. The lessons learned via this program are helping the Company in considering the development of customer loyalty programs across its other business channels.” In October 2004, Waldenbooks ended its loyalty program but reached \$15.3 million in revenues until the Preferred Reader Program was completely phased

out. Incredibly, Borders Rewards was only launched 16 months after the end of Waldenbooks membership program.<sup>79</sup>

### **Borders under George Jones leadership**

Greg Josefowicz announced in January 2006 that he was planning to retire within two years.<sup>80</sup> Since then, the company started a search for a new CEO that could lead Borders in the difficult times that the company was living in. In July 2006, Borders Group named George Jones, a former executive at Saks Inc., as the company's CEO. In August, the company announced that its previous profits forecast of \$1,42 a share didn't have support and reduced it to 65 cents. Analysts were worried with the company's performance. "We have not seen a downward revision of this magnitude out of a hardline retailer in a long time," wrote a New York analyst, in a report. "Even if this is simply a new CEO cleaning house upon arrival, the deterioration in financial performance is disturbing." Other analysts said they were not totally surprised: "The part of the puzzle that wasn't there was the merchandise skills, and it looks like a merchandiser has shown up. Now let's see what he does."<sup>81</sup> The expectations with the then hired CEO were high and soon he started making major changes in the company.

In March 2007, Borders announced its intentions to sell its international operations in order to focus on the US market and reposition the brand in America. An extensive list of potential buyers was attracted by the possible sale of the Australian and New Zealand Borders' stores.<sup>82</sup> The company was also concerned with its 71 money-losing stores in the UK and hired Merrill Lynch to lead the sale "exploration" that could affect, in the UK case, 2000 jobs.<sup>83</sup> In fact, on the 21<sup>st</sup> of September, Borders sold its UK and Ireland subsidiaries to a private equity firm for \$20 million, retaining a 17% stake in UK operations.<sup>84</sup> On the 10<sup>th</sup> of June of 2008, Borders Group sold its stores based in Australia, New Zealand and Singapore to A&R Whitcoulls Group Holdings Pty. Ltd. in a deal valued up to \$104 million.<sup>85</sup> "This transaction represents an attractive valuation, permits us to forgo further investment in these businesses, and provides our company with a significant cash infusion to further reduce debt, which is one of our key financial initiatives," said George Jones, Borders CEO.<sup>86</sup>

In the 2000's other changes started to shake the book industry. Although electronic books appeared in the 1990's, their growth became evident in the 2000's, and between 2002 and 2003 the number of e-books sold rose 71% with 2.2 billion books sold in the United States in 2003. E-book readers used cellphones, "smart" phones, Palm Pilots and other P.D.A.'s and pocket P.C.'s. In minutes, readers could purchase and download a digital book suitable for a mobile device or a personal computer from one of the several sites specialized in e-books that were entering the field.<sup>87</sup> In 2004 Amazon.com also started selling e-books in its website.

Amazon Kindle, an e-reader device, entered the market in November 2007. The company had been preparing and developing the device for three years and the Amazon Kindle was entering the market at a perfect time to attract customers on their Christmas shopping.<sup>88</sup> With lots of books now available in a digital format, and as Amazon.com was already one e-book seller, the e-reader device was just the missing piece of the puzzle.

Although in a different way, Borders was already selling Sony e-readers in its stores since 2006. Contrarily to its competitors, Borders didn't develop its own device but offered several e-reader devices, although Sony e-reader was the most important. However, the separation between Borders and the manufacturer (Sony), the inexistent link to an e-book store and the poor characteristics of the device resulted in a failure for both Sony device and Borders entrance in the e-readers market. While Barnes & Noble just entered the e-readers market late in 2009, with the release of Nook, the clear control of the product line, its positioning in store, the packaging design were key factors for the devices success (see **Exhibit 9** to compare e-reader devices).<sup>89</sup> Simba estimated 8% of the U.S. adult population bought at least one e-book in 2008 and the number rose to 9% in 2009. This means that about 20 million adults bought at least one e-book in 2009 and 17.6 million bought e-books in 2008.<sup>90</sup>

In February 2008, Borders Group opened its first of 14 concept stores that included a digital center where customers could create their own CDs, download digital books and music, look up their family history, create photo

albums and even publish their own novels. “We've stayed true to what our customers have always loved about Borders, yet we've brought a fresh new look and exciting interactive dimension to the store”, the company said.<sup>91</sup> The company was hoping its new concept stores to become a hub of knowledge and entertainment, making Borders a tougher competitor in the book industry.

The entrance of George Jones brought severe changes to Borders Group. When Mr. Jones joined Borders, he quickly decided that the arrangement between the company and its competitor Amazon.com was not a good one and undertook the necessary efforts to end up with the deal and launch Borders own website.<sup>92</sup> In fact, Mr. Jones putted a plan into action at the same month he started his role as Borders CEO. The company began by creating an internal team, adding experts in technology, online operations and online merchandising. By the fall of 2007, a beta site was ready for customer feedback.<sup>93</sup> However the standards for online service were raised so high within the years Borders was out of the online business that the company had huge difficulties trying to succeed. At the same time, Amazon was far ahead from Borders, and Barnes & Noble was already making 10% of its revenues from its own website.<sup>94</sup> Seven years after Borders had teamed with Amazon in the online book market, the former launched its own website on the 27<sup>th</sup> of May of 2008. “We've invested significant capital and resources in the development of this new site and we are delighted with its launch, we can move it forward from pure investment to a sales and profit generator,” said the company’s CEO, George Jones. Borders.com was then undoubtedly property of Border Books and Music superstores. Members of the Borders Rewards program could then sign in and use their coupons and discounts online, and customers could also access the web store from local Borders stores’ search kiosks.<sup>95</sup> For Kevin Ertell, the vice president for e-business at Borders, “The decision to partner with Amazon, at the time it was made, was made I think for very good reasons,” said him. “Now the world has changed significantly. It’s right for us now to own our own e-commerce experience and to tie into stores and really connect with our customers in a way we could not do in a partnership with another company.”<sup>96</sup>

In March 2008, Barnes & Noble began looking into the possibility of acquiring Borders and created a team of 30 experts to explore this purchase opportunity.<sup>97</sup> Credit Suisse analyst Gary Balter expressed some reservations. “We see little opportunity in the near term for Borders to be sold, with the No. 1 candidate Barnes & Noble not likely to pursue a deal at this price”, he said.<sup>98</sup> After some months of studying the pros and cons of acquiring Borders, Barnes & Noble ruled out its proposal.<sup>99</sup>

As part of a \$120 million cost-cutting plan, in June 2008 Borders announced a cut in 275 corporate jobs, including 156 in its headquarters in Ann Arbor. The company wanted to reach 1000 employees in its Ann Arbor’s office. Although George Jones confessed that this was an unpleasant experience, he felt like he was making the right decisions for the future of the company<sup>100</sup> (**see Exhibit 6**).

### CEO Needed

On January 5 of 2009, George Jones was fired and replaced by a private equity executive, Ron Marshall, the first of three management shakeups in the company in two years. In April that year Borders also announced that 7 of the 10 members of the company’s board of directors would also leave the Ann-Arbor based bookseller.<sup>101</sup>

Ron Marshall continued the cost-cutting plan in order to avoid bankruptcy as a consequence of the financial crisis that the world, and the US in particular, was living. Despite the company’s announcement of a \$187 million loss in 2008, Borders received an extension on a loan.<sup>102</sup> “The extension of the loan gives us some necessary breathing room, which is important in the current economic environment,” CEO Marshall said in a written statement.<sup>103</sup>

Borders didn’t stop its efforts to avoid more layoffs and the possible end of the company. “We have taken some very difficult medicine to make sure we are going to be there for our associates and customers for the long term,” Marshall said. “We are really focused on re-engaging our customers in a way that Borders did for years and years and (the company) really hasn't been, for a

while, ... the serious bookseller for the serious book lover.”<sup>104</sup> Borders continued closing unprofitable stores and, in November 2009, the company announced its intentions to close 200 more of its small stores, reaching 170 stores down from more than a thousand in 1995.<sup>105</sup>

On October 20 of 2009, Barnes & Noble launched its own e-reader device, named Nook, as a response to the very successful Amazon’s e-reader, the Kindle.<sup>106</sup> In fact, it didn’t take too long until another giant entered the market with a powerful device that would completely change the game. The iPad, an Apple’s device, was launched in April 2010 and could be used as an e-reader but its functionalities went far beyond the e-books.<sup>107</sup>

The hard times that Borders was facing were revealed in the holiday season sales drop of 13.7%, in 2009, disappointing the company’s executives in a critical period for any retailer. Barnes & Noble also suffered from the financial crisis but its sales fell only 5%.<sup>108</sup>

On January 26 of 2010, Borders’ CEO Ron Marshall resigned and Mike Edwards, a 49 years old executive vice president and chief merchandising office, became the interim CEO for Borders Group, being the third Borders Group CEO in 12 months.<sup>109</sup> Mr. Edwards assumed its role as the company’s interim CEO until June 3<sup>rd</sup>, when Bennet LeBow was named Borders’ CEO and Mike Edwards became entitled of the Borders Group subsidiaries.<sup>110</sup>

In the same week that Edwards was named interim CEO of the company, Borders’ senior vice president of human resources sent an e-mail to all their corporate and warehouse employees announcing a new layoff. In the e-mail employees could read: “we must announce that we are moving forward with the unfortunate but necessary step of reducing our payroll by eliminating 124 corporate positions and 40 positions in our distribution centers. As you saw in our holiday sales release, we have not succeeded in improving our sales and, as a result, must make further adjustments to our cost structure.” The layoffs started the very same morning they were announced.<sup>111</sup>

Bill Ackman, the founder and CEO of Pershing Square Capital Management was known for taking large positions in a relatively small number of companies and then encouraging strategic changes, to maximize value.<sup>112</sup> Owing 17.7% of Borders, Mr. Ackman said: “We don’t see this as a likely bankruptcy. It may become part of an industry consolidation at some point, or it may survive as a standalone company.” In fact, what Ackman was suggesting was that Borders could eventually merge with its competitor Barnes & Noble. However, some investors and experts were not so confident and some of the concerns were related with a \$42.5 million senior secured loan Borders would have to repay to Pershing by April 1.<sup>113</sup> In fact, in December 2010, Ackman already owned 37% of Borders and formally proposed the company a bid to acquire Barnes & Noble, saying that he would help the company to found the acquisition.<sup>114</sup> The Ackman’s desire never became a reality.

In March 31, Borders announced the company just had paid its loan to Pershing, and also renegotiated a revolving credit line. The afternoon announcement pushed up the stock price 33% to \$2.27 a share. That very same day, Borders’ CEO, Mike Edwards said “We have made significant operational and financial improvements and will maintain those disciplines as we shift our focus now to growing market share by acquiring, engaging and retaining customers through a transformation of the Borders brand,”, preparing the press for next day announcement of a series of turnaround actions that were intended to transform Borders’ brand.<sup>115</sup> Actions presented by the interim CEO were the improvement of in-store experience, the reinvention of border rewards program, the leverage of education and social media forums and the growth of borders.com online sales through the development of strategic business partnerships.<sup>116</sup>

In May 2010, a Tobacco executive and activist investor, named Bennet LeBow, invested \$25 million in Borders, being nominated chairman of the company. The investment gave LeBow roughly 15% of Borders shares. Mike Edwards, interim CEO of Borders said that “Ben’s investment will improve the company’s capital position, and provide greater stability as we execute strategies to transform the brand”.<sup>117</sup> In June, LeBow is named CEO of Borders.

In July 2010, Borders launched its e-book store that was developed by Kobo Inc., exactly one year after Barnes & Noble<sup>118</sup>, and the company hoped to achieve 17% market share within one year. To reach that goal Borders would have to acquire around 1,200 of the 7,000 or so new e-book consumers that enter the market each day, plus siphon even more from the existing base of consumers.<sup>119</sup> However, Amazon.com was already selling e-books in its online store since 2004. Borders focused on selling Kobo e-reader and the sales of the device effectively started to increase. Borders e-book store had more than 1.5 million titles and apps had been introduced so customers could access Bordes e-book store from their iPhone, iPod, iPad, BlackBerry phones or even phones that used Android system.<sup>120</sup>

In August the layoffs continued<sup>121</sup> and in November the company launched its redesigned website in an attempt to increase online sales at the critical holiday season. Easier to use and with more competitive price offerings, Borders expected that customers would be excited with the new changes and offers.<sup>122</sup>

### **Borders new Chapter?**

However, Borders' situation did not improve and in December 2010, the company posted \$74.4 million losses on the third quarter and confirmed that it was delaying payments to some publishers, hoping to rework vendor's financing arrangements. These announcements lowered the stock price to an unimagined level of \$0.90 a share.

In January 2011, experts said bankruptcy could come within weeks. Borders continued the layoffs trying to cut its cost wherever it was possible. In fact, that same month the company announced its decision to delay payments to more partners and on February 11, Ackman acknowledges a \$125 million loss in its Borders investments.<sup>123</sup>

February 16, 2011, Borders filed for Chapter 11 bankruptcy protection (**see Exhibit 11**), giving the chain a chance to reorganize by slashing expensive leases and reducing its debt load, actions that could return the company to

profitability. “We are confident that, with the protection afforded under Chapter 11 and with the support of employees, publishers, suppliers and creditors, and the reading public, a successful reorganization can be achieved enabling Borders to emerge from the process as a stronger and more vibrant book seller,” said Mike Edwards, CEO of Borders Group subsidiary Borders Inc..<sup>124</sup> However, Borders was not able to recover and on July 18, shortly after 4:10 pm, the company announced its liquidation.

## Exhibits

### Exhibit 1

Number of Borders' bookstores

	Borders (superstores) <sup>2</sup>	Waldenbooks (mall stores)	Singapore	UK	Puerto Rico	Australia	New Zealand	Paper -chase	Books etc
<b>1992</b>	21								
<b>1993</b>	62	1109							
<b>1994</b>	75	1049							
<b>1995</b>	124	976							
<b>1996</b>	158	936							
<b>1997</b>	163	930	1						22
<b>1998</b>	238	896	1	2		1			25
<b>1999</b>	288	894	1	5		1	1		26
<b>2000</b>	337	890	1	9		2	1		31
<b>2001</b>	374	856	1	11	1	5	1		34
<b>2002</b>	420	809	1	17	2	8	1		37
<b>2003</b>	473	778	1	24	2	9	1		36
<b>2004</b>	445 <sup>3</sup>	733						733	
<b>2005</b>									
<b>2006</b>	473 <sup>3</sup>	678	1	35	3	14	2	45	33
<b>2007</b>	499 <sup>3</sup>	564	1	42 <sup>4</sup>	3	20	2	52	
<b>2008</b>	509 <sup>3</sup>	490			3			112	
<b>2009</b>	515 <sup>3</sup>	386			3			117	
<b>2010</b>	508 <sup>3</sup>	175			3			85	
<b>2011</b>	639 <sup>3</sup>				3				

Source: Writers' research

<sup>2</sup> Borders superstores include international Borders superstores that are specified in other columns

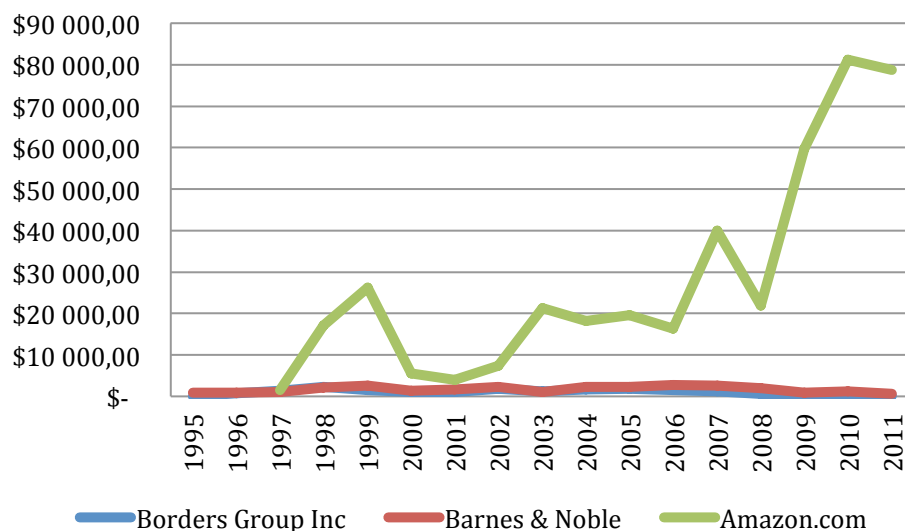
<sup>3</sup> Only domestic locations of Borders superstores

<sup>4</sup> Includes one Borders store in Ireland

## Exhibit 2

Market Value (in Millions)

	Borders Group Inc	Barnes & Noble	Amazon.com
<b>1995</b>	-	\$887,45	-
<b>1996</b>	\$748,47	\$910,49	-
<b>1997</b>	\$1 417,60	\$1 032,98	\$1 455,16
<b>1998</b>	\$2 365,55	\$2 156,52	\$17 054,84
<b>1999</b>	\$1 451,93	\$2 574,17	\$26 274,92
<b>2000</b>	\$1 131,33	\$1 376,09	\$5 557,99
<b>2001</b>	\$978,20	\$1 672,94	\$4 038,22
<b>2002</b>	\$1 895,28	\$2 251,48	\$7 327,54
<b>2003</b>	\$1 242,39	\$1 124,18	\$21 224,49
<b>2004</b>	\$1 678,96	\$2 303,39	\$18 146,10
<b>2005</b>	\$1 889,00	\$2 227,50	\$19 614,40
<b>2006</b>	\$1 557,55	\$2 770,55	\$16 336,44
<b>2007</b>	\$1 248,47	\$2 631,51	\$39 927,84
<b>2008</b>	\$656,73	\$2 051,77	\$21 947,84
<b>2009</b>	\$26,36	\$896,78	\$59 726,88
<b>2010</b>	\$51,49	\$1 227,80	\$81 180,00
<b>2011</b>	\$61,17	\$627,03	\$78 760,50



Source: Bloomberg

### Exhibit 3

Borders' Balance Sheet from 1995 to 2011 (in Millions)

	1995	1996	1997	1998	1999	2000	2001	2002
<b>Operating Revenue</b>	\$1 511,0	\$1 749,0	\$1 958,8	\$2 266,0	\$2 595,0	\$2 968,4	\$3 297,1	\$3 413,9
<b>Sales</b>	\$1 511,0	\$1 749,0	\$1 958,8	\$2 266,0	\$2 595,0	\$2 968,4	\$3 271,2	\$3 387,9
<b>Costs of Goods Sold</b>	-\$1 127,1	-\$1 302,3	-\$1 437,8	-\$1 634,3	-\$1 859,4	-\$2 127,6	-\$2 380,4	-\$2 438,1
<b>Gross Profit</b>	\$383,9	\$446,7	\$521,0	\$631,7	\$735,6	\$840,8	\$916,7	\$975,8
<b>Other Operating Items</b>	-\$332,7	-\$378,5	-\$416,8	-\$492,1	-\$565,4	-\$667,0	-\$742,6	-\$790,7
<b>Depreciation/Amort.</b>	-\$7,4	-\$268,6	-\$1,1	-\$1,6	-\$2,9	-\$2,8	-\$39,0	-\$28,1
<b>Operating P/L</b>	\$43,8	-\$200,4	\$103,1	\$138,0	\$167,3	\$171,0	\$135,1	\$157,0
<b>Financial Revenue</b>								
<b>Financial Expenses</b>	-\$1,0	-\$4,6	-\$7,0	-\$7,2	-\$16,2	-\$16,6	-\$13,1	-\$14,4
<b>Financial P/L</b>	-\$1,0	-\$4,6	-\$7,0	-\$7,2	-\$16,2	-\$16,6	-\$13,1	-\$14,4
<b>P/L before Tax</b>	\$42,8	-\$205,0	\$96,1	\$130,8	\$151,1	\$154,4	\$122,0	\$142,6
<b>Taxation</b>	-\$21,9	-\$6,1	-\$38,2	-\$50,6	-\$59,0	-\$60,4	-\$48,2	-\$55,2
<b>P/L after Tax</b>	\$20,9	-\$211,1	\$57,9	\$80,2	\$92,1	\$94,0	\$73,8	\$87,4
<b>Extraord. &amp; Oth. Items</b>						-\$3,7	-\$30,2	
<b>P/L for Period</b>	<b>\$20,9</b>	<b>-\$211,1</b>	<b>\$57,9</b>	<b>\$80,2</b>	<b>\$92,1</b>	<b>\$90,3</b>	<b>\$43,6</b>	<b>\$87,4</b>
<b>Cash Flow</b>	\$28,3	\$57,5	\$59,0	\$81,8	\$95,0	\$93,1	\$82,6	\$115,5
<b>EBIT</b>	\$43,8	-\$200,4	\$103,1	\$138,0	\$167,3	\$171,0	\$135,1	\$157,0
<b>EBITDA</b>	\$51,2	\$68,2	\$104,2	\$139,6	\$170,2	\$173,8	\$174,1	\$185,1

	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Operating Revenue</b>	\$3 514,7	\$3 764,2	\$3 931,4	\$3 717,1	\$3 569,4	\$3 597,4	\$3 165,5	\$2 711,0	\$2 274,9
<b>Sales</b>	\$3 486,1	\$3 698,6	\$3 879,5	\$3 675,7	\$3 532,3	\$3 555,1	\$3 133,6	\$2 679,9	\$2 252,8
<b>Costs of Goods Sold</b>	-\$2 411,5	-\$2 587,3	-\$2 699,5	-\$2 540,8	-\$2 504,5	-\$2 564,6	-\$2 312,9	-\$2 021,8	-\$1 823,1
<b>Gross Profit</b>	\$1 103,2	\$1 176,9	\$1 231,9	\$1 176,3	\$1 064,9	\$1 032,8	\$852,6	\$689,2	\$451,8
<b>Other Operating Items</b>	-\$793,2	-\$855,5	-\$895,1	-\$891,4	-\$887,9	-\$912,0	-\$812,1	-\$678,9	-\$580,7
<b>Depreciation/Amort.</b>	-\$122,4	-\$123,3	-\$120,1	-\$114,5	-\$171,8	-\$116,7	-\$199,3	-\$109,3	-\$167,5
<b>Operating P/L</b>	\$187,6	\$198,1	\$216,7	\$170,4	\$5,2	\$4,1	-\$158,8	-\$99,0	-\$296,4
<b>Financial Revenue</b>							\$40,1	-\$20,7	\$30,8
<b>Financial Expenses</b>	-\$12,6	-\$8,7	-\$9,1	-\$13,6	-\$29,9	-\$43,1	-\$45,4	-\$24,1	-\$33,4
<b>Financial P/L</b>	-\$12,6	-\$8,7	-\$9,1	-\$13,6	-\$29,9	-\$43,1	-\$5,3	-\$44,8	-\$2,6
<b>P/L before Tax</b>	\$175,0	\$189,4	\$207,6	\$156,8	-\$24,7	-\$39,0	-\$164,1	-\$143,8	-\$299,0
<b>Taxation</b>	-\$67,4	-\$72,1	-\$75,7	-\$60,3	\$2,8	\$19,1	-\$28,0	\$31,3	-\$1,3
<b>P/L after Tax</b>	\$107,6	\$117,3	\$131,9	\$96,5	-\$21,9	-\$19,9	-\$192,1	-\$112,5	-\$300,3
<b>Extraord. &amp; Oth. Items</b>	\$0,0	-\$2,1		\$4,5	-\$129,4	-\$137,5	\$5,4	\$3,1	\$1,3
<b>P/L for Period</b>	<b>\$107,6</b>	<b>\$115,2</b>	<b>\$131,9</b>	<b>\$101,0</b>	<b>-\$151,3</b>	<b>-\$157,4</b>	<b>-\$186,7</b>	<b>-\$109,4</b>	<b>-\$299,0</b>
<b>Cash Flow</b>	\$230,0	\$238,5	\$252,0	\$215,5	\$20,5	-\$40,7	\$12,6	-\$0,1	-\$131,5
<b>EBIT</b>	\$187,6	\$198,1	\$216,7	\$170,4	\$5,2	\$4,1	-\$158,8	-\$99,0	-\$296,4
<b>EBITDA</b>	\$310,0	\$321,4	\$336,8	\$284,9	\$177,0	\$120,8	\$40,5	\$10,3	-\$128,9

Source: Company Report

## Exhibit 4

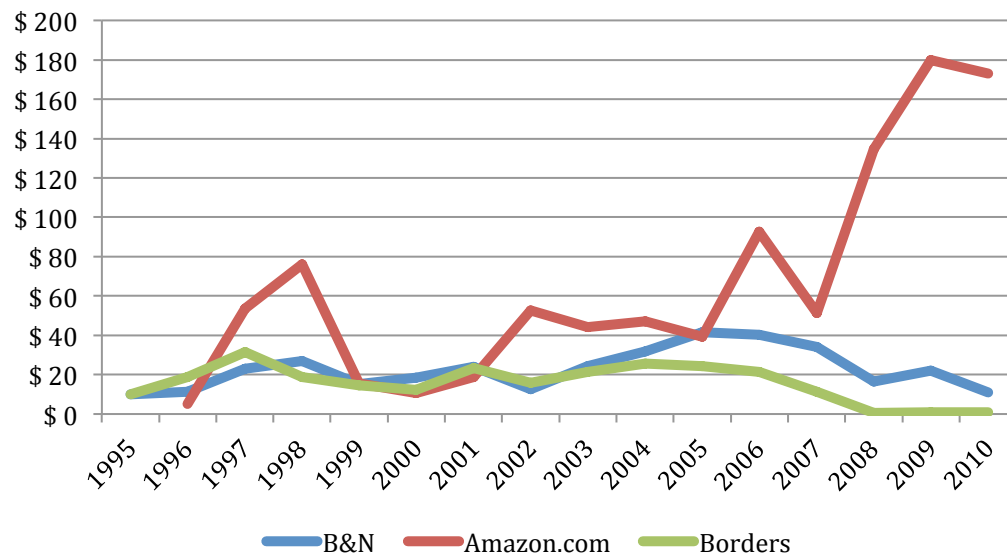
### Borders' Share Price Evolution



Source: Bloomberg

### Exhibit 5

#### Share Price Evolution



Source: Bloomberg

### Exhibit 6

#### Borders Employees

	Number of Employees	Employees 1 Yr Growth	Sales Per Employee	Net Income per Employee	Assets per Employee	Cash Flow per Employee
<b>1996</b>	12500		\$156 704	\$4 632	\$96 880	\$8 080
<b>1997</b>	14100	12,80%	\$160 709	\$5 688	\$108 858	\$10 426
<b>1998</b>	15600	10,64%	\$166 346	\$5 904	\$113 244	\$10 654
<b>1999</b>	30000	92,31%	\$99 973	\$3 010	\$63 827	\$5 767
<b>2000</b>	17000	-43,33%	\$192 424	\$2 565	\$120 418	\$8 153
<b>2001</b>	15000	-11,76%	\$225 860	\$5 827	\$145 287	\$17 613
<b>2002</b>	32700	118%	\$107 483	\$3 291	\$69 364	\$6 159
<b>2003</b>	15000	-54,13%	\$248 733	\$7 680	\$172 307	\$15 887
<b>2004</b>	14800	-1,33%	\$263 716	\$8 912	\$177 622	\$15 162
<b>2005</b>	16400	10,81%	\$248 732	\$6 159	\$156 841	\$10 360
<b>2006</b>	16600	1,22%	\$224 313	-\$9 114	\$157 434	\$2 699
<b>2007</b>	14100	-15,06%	\$255 135	-\$11 163	\$163 312	\$7 397
<b>2008</b>	10500	-25,53%	\$311 943	-\$17 781	\$153 238	\$20 219
<b>2009</b>	8500	-19,05%	\$318 941	-\$12 871	\$166 541	\$5 624
<b>2010</b>	5700	-32,94%	\$399 105	-\$52 456	\$169 246	\$9 842

Source: Bloomberg

### Exhibit 7

Book sales growth

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>B&amp;N Bookstores</b>	3%	4%	7%	8%	2%	2%	2%	-3%	-5%	N/A	
<b>Borders Group</b>	3%	1%	4%	2%	2%	-1%	0%	-9%	-15%	-16%	N/A
<b>Amazon.com (US)</b>	-1%	10%	21%	14%	18%	17%	29%	16%	11%	15%	16%
<b>BN.com</b>	21%	4%	4%	-2%	5%	-1%	9%	-2%	24%	N/A	

Source: <http://www.fonerbooks.com/booksale.htm>

### Exhibit 8

Book sales (in \$Millions)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Jan</b>	1 973	2 056	2 148	2 075	2 225	2 222	2 301	2 214	2 178	2 072
<b>Feb</b>	1 001	992	1 108	1 086	1 101	1 040	1 157	985	962	1 051
<b>Mar</b>	1 009	926	1 073	1 101	1 092	1 029	1 026	961	962	973
<b>Apr</b>	968	976	1 023	997	987	931	1 005	929	871	888
<b>May</b>	1 118	1 109	1 112	1 020	1 176	1 135	1 159	1 071	1 032	1 048
<b>Jun</b>	1 046	1 182	1 206	1 154	1 238	1 162	1 077	1 058	1 040	1 018
<b>Jul</b>	1 038	1 130	1 172	1 214	1 135	1 221	1 124	1 056	1 025	984
<b>Aug</b>	1 799	2 142	2 119	2 219	2 142	2 330	2 435	2 337	2 183	2 440
<b>Sep</b>	1 491	1 574	1 560	1 553	1 555	1 579	1 481	1 548	1 448	1 547
<b>Oct</b>	998	1 047	1 069	1 064	1 055	1 129	1 032	975	949	888
<b>Nov</b>	1 060	1 037	1 088	1 150	1 143	1 227	1 044	979	1 030	949
<b>Dec</b>	1 949	2 065	2 199	2 256	2 134	2 179	2 029	1 938	1 982	1 672
<b>Total (year)</b>	<b>15 450</b>	<b>16 236</b>	<b>16 877</b>	<b>16 889</b>	<b>16 983</b>	<b>17 184</b>	<b>16 870</b>	<b>16 051</b>	<b>15 662</b>	<b>15 530</b>

Source: <http://www.fonerbooks.com/booksale.htm>

Note: Sales from general book stores, specialty book stores and college book stores.

## Exhibit 9

### E-readers comparison

	Ipad 2	Kindle 3	Nook	Sony PRS 350	Kobo Touch
<b>Introduction Year</b>	2011	2010	2009	2010	2011
<b>Screen (Inches)/ Resolution</b>	9.7/ 1024x768 Lcd	6/ 600x800 E Ink	6/800x600 E Ink	5/ 800x600 E Ink	6 E Ink
<b>Color</b>	Yes	16 Shades Gray	16 Shades Gray	16 Shades Gray	16 Shades Gray
<b>Storage</b>	16GB-64GB	4GB	2GB	2GB	1GB
<b>Connectivity</b>	Wi-Fi/3G	Wi-Fi/ 3G	Wi-Fi	3G	Wi-Fi
<b>Connectivity Cost</b>	Optional, Us\$15- \$50/Month	Free	Free	Free	Free
<b>Ebook Format</b>	Epub, Kindle, Pdf	Kindle, Pdf, Mobi	Epub & Pdf/Epub, Pdf, Doc,	Epub, Pdf, Txt, Rtf, Doc, Bbeb Book	Epub, Pdf, Mobi, Txt, Rtf
<b>Web Browser</b>	Yes	Limited	Limited	No	No
<b>Audio/Video?</b>	Yes	Audio	Audio + Images	Audio + Images	No
<b>Games</b>	Yes	No	Yes	No	No
<b>Weight (Lb.)</b>	1.3-1.35	0.54	0.47/ 0.99	0.485-0.798	0.44
<b>Price</b>	Us\$499- \$829	\$139/ \$189	\$139	\$169	\$129

Source: <http://ipod.about.com/od/ipadcomparisons/a/comparing-ipad-kindle-nook.htm>

### Exhibit 10

Amazon.com figures (in Millions)

	Net Sales	EBITDA	Oper. Inc.
<b>1995</b>	\$0,5	-\$0,3	-\$0,3
<b>1996</b>	\$15,7	-\$5,7	-\$6,0
<b>1997</b>	\$147,8	-\$29,2	-\$32,6
<b>1998</b>	\$609,8	-\$50,2	-\$62,0
<b>1999</b>	\$1 639,8	-\$315,6	-\$597,7
<b>2000</b>	\$2 762,0	-\$257,3	-\$663,6
<b>2001</b>	\$3 122,4	\$35,1	-\$230,7
<b>2002</b>	\$3 932,9	\$193,4	\$105,7
<b>2003</b>	\$5 263,7	\$349,0	\$270,7
<b>2004</b>	\$6 921,1	\$516,1	\$440,4
<b>2005</b>	\$8 490,0	\$553,0	\$432,0
<b>2006</b>	\$10 711,0	\$594,0	\$389,0
<b>2007</b>	\$14 835,0	\$901,0	\$655,0
<b>2008</b>	\$19 166,0	\$1 129,0	\$842,0
<b>2009</b>	\$24 509,0	\$1 507,0	\$1 129,0
<b>2010</b>	\$34 204,0	\$1 974,0	\$1 406,0
<b>2011</b>	\$48 077,0	\$1 945,0	\$862,0

Source: Bloomberg

Exhibit 11

Borders Petition (Chapter 11) – United States Bankruptcy Court

B1 (Official Form 1) (4/10)

UNITED STATES BANKRUPTCY COURT Southern District of New York		VOLUNTARY PETITION
Name of Debtor (if individual, enter Last, First, Middle): <b>Borders Group, Inc.</b>		Name of Joint Debtor (Spouse) (Last, First, Middle): N/A
All Other Names used by the Debtor in the last 8 years (include married, maiden, and trade names): None		All Other Names used by the Joint Debtor in the last 8 years (include married, maiden, and trade names): N/A
Last four digits of Soc. Sec. or Individual-Taxpayer I.D. (ITIN)/Complete EIN (if more than one, state all): 4588		Last four digits of Soc. Sec. or Individual-Taxpayer I.D. (ITIN)/Complete EIN (if more than one, state all): N/A
Street Address of Debtor (No. and Street, City, and State): 100 Phoenix Drive Ann Arbor, Michigan		Street Address of Joint Debtor (No. and Street, City, and State): N/A
County of Residence or of the Principal Place of Business: Washtenaw		County of Residence or of the Principal Place of Business: N/A
Mailing Address of Debtor (if different from street address): N/A		Mailing Address of Joint Debtor (if different from street address): N/A
Location of Principal Assets of Business Debtor (if different from street address above): N/A		
<b>Type of Debtor</b> (Form of Organization) (Check one box.)  <input type="checkbox"/> Individual (includes Joint Debtors) See Exhibit D on page 2 of this form. <input checked="" type="checkbox"/> Corporation (includes LLC and LLP) <input type="checkbox"/> Partnership <input type="checkbox"/> Other (If debtor is not one of the above entities, check this box and state type of entity below.)	<b>Nature of Business</b> (Check one box.)  <input type="checkbox"/> Health Care Business <input type="checkbox"/> Single Asset Real Estate as defined in 11 U.S.C. § 101(51B) <input type="checkbox"/> Railroad <input type="checkbox"/> Stockbroker <input type="checkbox"/> Commodity Broker <input type="checkbox"/> Clearing Bank <input checked="" type="checkbox"/> Other Retail  <input type="checkbox"/> Tax-Exempt Entity (Check box, if applicable.)  <input type="checkbox"/> Debtor is a tax-exempt organization under Title 26 of the United States Code (the Internal Revenue Code).	<b>Chapter of Bankruptcy Code Under Which the Petition is Filed</b> (Check one box.)  <input type="checkbox"/> Chapter 7 <input type="checkbox"/> Chapter 9 <input checked="" type="checkbox"/> Chapter 11 <input type="checkbox"/> Chapter 12 <input type="checkbox"/> Chapter 13  <input type="checkbox"/> Chapter 15 Petition for Recognition of a Foreign Main Proceeding <input type="checkbox"/> Chapter 15 Petition for Recognition of a Foreign Nonmain Proceeding  <b>Nature of Debts</b> (Check one box.)  <input type="checkbox"/> Debts are primarily consumer debts, defined in 11 U.S.C. § 101(8) as "incurred by an individual primarily for a personal, family, or household purpose." <input checked="" type="checkbox"/> Debts are primarily business debts.
<b>Filing Fee</b> (Check one box.) <input checked="" type="checkbox"/> Full Filing Fee attached. <input type="checkbox"/> Filing Fee to be paid in installments (applicable to individuals only). Must attach signed application for the court's consideration certifying that the debtor is unable to pay fee except in installments. Rule 1006(b). See Official Form 3A. <input type="checkbox"/> Filing Fee waiver requested (applicable to chapter 7 individuals only). Must attach signed application for the court's consideration. See Official Form 3B.		<b>Chapter 11 Debtors</b> <b>Check one box:</b> <input type="checkbox"/> Debtor is a small business debtor as defined in 11 U.S.C. § 101(51D). <input checked="" type="checkbox"/> Debtor is not a small business debtor as defined in 11 U.S.C. § 101(51D).  <b>Check if:</b> <input type="checkbox"/> Debtor's aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than \$2,343,300 (amount subject to adjustment on 4/01/13 and every three years thereafter).  <b>Check all applicable boxes:</b> <input type="checkbox"/> A plan is being filed with this petition. <input type="checkbox"/> Acceptances of the plan were solicited prepetition from one or more classes of creditors, in accordance with 11 U.S.C. § 1126(b).
<b>Statistical/Administrative Information</b> <input checked="" type="checkbox"/> Debtor estimates that funds will be available for distribution to unsecured creditors. <input type="checkbox"/> Debtor estimates that, after any exempt property is excluded and administrative expenses paid, there will be no funds available for distribution to unsecured creditors.		THIS SPACE IS FOR COURT USE ONLY
<b>Estimated Number of Creditors</b> <input checked="" type="checkbox"/> 1-49 <input type="checkbox"/> 50-99 <input type="checkbox"/> 100-199 <input type="checkbox"/> 200-999 <input type="checkbox"/> 1,000-5,000 <input type="checkbox"/> 5,001-10,000 <input type="checkbox"/> 10,001-25,000 <input type="checkbox"/> 25,001-50,000 <input type="checkbox"/> 50,001-100,000 <input type="checkbox"/> Over 100,000		
<b>Estimated Assets</b> <input type="checkbox"/> \$0 to \$50,000 <input type="checkbox"/> \$50,001 to \$100,000 <input type="checkbox"/> \$100,001 to \$500,000 <input type="checkbox"/> \$500,001 to \$1 million <input type="checkbox"/> \$1,000,001 to \$10 million <input type="checkbox"/> \$10,000,001 to \$50 million <input type="checkbox"/> \$50,000,001 to \$100 million <input checked="" type="checkbox"/> \$100,000,001 to \$500 million <input type="checkbox"/> \$500,000,001 to \$1 billion <input type="checkbox"/> More than \$1 billion		
<b>Estimated Liabilities</b> <input type="checkbox"/> \$0 to \$50,000 <input type="checkbox"/> \$50,001 to \$100,000 <input type="checkbox"/> \$100,001 to \$500,000 <input type="checkbox"/> \$500,001 to \$1 million <input type="checkbox"/> \$1,000,001 to \$10 million <input type="checkbox"/> \$10,000,001 to \$50 million <input type="checkbox"/> \$50,000,001 to \$100 million <input checked="" type="checkbox"/> \$100,000,001 to \$500 million <input type="checkbox"/> \$500,000,001 to \$1 billion <input type="checkbox"/> More than \$1 billion		

Page 2

<b>B1 (Official Form 1) (4/10)</b>		Page 2	
<b>Voluntary Petition</b> <i>(This page must be completed and filed in every case.)</i>		Name of Debtor(s): <b>Borders Group, Inc.</b>	
<b>All Prior Bankruptcy Cases Filed Within Last 8 Years (If more than two, attach additional sheet.)</b>			
Location Where Filed: <b>NONE</b>	Case Number: <b>N/A</b>	Date Filed:	
Location Where Filed: <b>N/A</b>	Case Number: <b>N/A</b>	Date Filed:	
<b>Pending Bankruptcy Case Filed by any Spouse, Partner, or Affiliate of this Debtor (If more than one, attach additional sheet.)</b>			
Name of Debtor: <b>SEE ANNEX 1</b>	Case Number: <b>PENDING</b>	Date Filed:	
District: <b>Southern District of New York</b>	Relationship: <b>SEE ANNEX 1</b>	Judge: <b>PENDING</b>	
<b>Exhibit A</b>		<b>Exhibit B</b>	
(To be completed if debtor is required to file periodic reports (e.g., forms 10K and 10Q) with the Securities and Exchange Commission pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 and is requesting relief under chapter 11.)		(To be completed if debtor is an individual whose debts are primarily consumer debts.)	
<input checked="" type="checkbox"/> Exhibit A is attached and made a part of this petition.		I, the attorney for the petitioner named in the foregoing petition, declare that I have informed the petitioner that [he or she] may proceed under chapter 7, 11, 12, or 13 of title 11, United States Code, and have explained the relief available under each such chapter. I further certify that I have delivered to the debtor the notice required by 11 U.S.C. § 342(b).	
		X Signature of Attorney for Debtor(s) (Date)	
<b>Exhibit C</b>			
Does the debtor own or have possession of any property that poses or is alleged to pose a threat of imminent and identifiable harm to public health or safety?			
<input type="checkbox"/> Yes, and Exhibit C is attached and made a part of this petition.			
<input checked="" type="checkbox"/> No.			
<b>Exhibit D</b>			
(To be completed by every individual debtor. If a joint petition is filed, each spouse must complete and attach a separate Exhibit D.)			
<input type="checkbox"/> Exhibit D completed and signed by the debtor is attached and made a part of this petition.			
If this is a joint petition:			
<input type="checkbox"/> Exhibit D also completed and signed by the joint debtor is attached and made a part of this petition.			
<b>Information Regarding the Debtor - Venue</b> (Check any applicable box.)			
<input checked="" type="checkbox"/> Debtor has been domiciled or has had a residence, principal place of business, or principal assets in this District for 180 days immediately preceding the date of this petition or for a longer part of such 180 days than in any other District.			
<input type="checkbox"/> There is a bankruptcy case concerning debtor's affiliate, general partner, or partnership pending in this District.			
<input type="checkbox"/> Debtor is a debtor in a foreign proceeding and has its principal place of business or principal assets in the United States in this District, or has no principal place of business or assets in the United States but is a defendant in an action or proceeding (in a federal or state court) in this District, or the interests of the parties will be served in regard to the relief sought in this District.			
<b>Certification by a Debtor Who Resides as a Tenant of Residential Property</b> (Check all applicable boxes.)			
<input type="checkbox"/> Landlord has a judgment against the debtor for possession of debtor's residence. (If box checked, complete the following.)			
_____			
(Name of landlord that obtained judgment)			
_____			
(Address of landlord)			
<input type="checkbox"/> Debtor claims that under applicable nonbankruptcy law, there are circumstances under which the debtor would be permitted to cure the entire monetary default that gave rise to the judgment for possession, after the judgment for possession was entered, and			
<input type="checkbox"/> Debtor has included with this petition the deposit with the court of any rent that would become due during the 30-day period after the filing of the petition.			
<input type="checkbox"/> Debtor certifies that he/she has served the Landlord with this certification. (11 U.S.C. § 362(f)).			

B1 (Official Form) 1 (4/10) Page 3

<b>Voluntary Petition</b> <i>(This page must be completed and filed in every case.)</i>		Name of Debtor(s) <b>Borders Group, Inc.</b>	
<b>Signatures</b>			
<p style="text-align: center;">Signature(s) of Debtor(s) (Individual/Joint)</p> <p>I declare under penalty of perjury that the information provided in this petition is true and correct. [If petitioner is an individual whose debts are primarily consumer debts and has chosen to file under chapter 7] I am aware that I may proceed under chapter 7, 11, 12 or 13 of title 11, United States Code, understand the relief available under each such chapter, and choose to proceed under chapter 7. [If no attorney represents me and no bankruptcy petition preparer signs the petition] I have obtained and read the notice required by 11 U.S.C. § 342(b).</p> <p>I request relief in accordance with the chapter of title 11, United States Code, specified in this petition.</p> <p>X _____ Signature of Debtor</p> <p>X _____ Signature of Joint Debtor</p> <p>_____ Telephone Number (if not represented by attorney)</p> <p>_____ Date</p>	<p style="text-align: center;">Signature of a Foreign Representative</p> <p>I declare under penalty of perjury that the information provided in this petition is true and correct, that I am the foreign representative of a debtor in a foreign proceeding, and that I am authorized to file this petition.</p> <p>(Check only one box.)</p> <p><input type="checkbox"/> I request relief in accordance with chapter 15 of title 11, United States Code. Certified copies of the documents required by 11 U.S.C. § 1515 are attached.</p> <p><input type="checkbox"/> Pursuant to 11 U.S.C. § 1511, I request relief in accordance with the chapter of title 11 specified in this petition. A certified copy of the order granting recognition of the foreign main proceeding is attached.</p> <p>X _____ (Signature of Foreign Representative)</p> <p>_____ (Printed Name of Foreign Representative)</p> <p>_____ Date</p>		
<p style="text-align: center;">Signature of Attorney*</p> <p>X _____ Signature of Attorney for Debtor(s) <b>David M. Friedman</b></p> <p>Printed Name of Attorney for Debtor(s) <b>Kasowitz, Benson, Torres &amp; Friedman LLP</b></p> <p>Firm Name <b>1633 Broadway</b></p> <p><b>New York, New York 10019</b></p> <p>Address <b>212-506-1700</b></p> <p>Telephone Number <b>2/16/2011</b></p> <p>_____ Date</p> <p><small>*In a case in which § 707(b)(4)(D) applies, this signature also constitutes a certification that the attorney has no knowledge after an inquiry that the information in the schedules is incorrect.</small></p>	<p style="text-align: center;">Signature of Non-Attorney Bankruptcy Petition Preparer</p> <p>I declare under penalty of perjury that: (1) I am a bankruptcy petition preparer as defined in 11 U.S.C. § 110; (2) I prepared this document for compensation and have provided the debtor with a copy of this document and the notices and information required under 11 U.S.C. §§ 110(b), 110(h), and 342(b); and, (3) if rules or guidelines have been promulgated pursuant to 11 U.S.C. § 110(h) setting a maximum fee for services chargeable by bankruptcy petition preparers, I have given the debtor notice of the maximum amount before preparing any document for filing for a debtor or accepting any fee from the debtor, as required in that section. Official Form 19 is attached.</p> <p>_____ Printed Name and title, if any, of Bankruptcy Petition Preparer</p> <p>_____ Social-Security number (If the bankruptcy petition preparer is not an individual, state the Social-Security number of the officer, principal, responsible person or partner of the bankruptcy petition preparer.) (Required by 11 U.S.C. § 110.)</p> <p>_____ Address</p> <p>X _____ Date</p> <p>Signature of bankruptcy petition preparer or officer, principal, responsible person, or partner whose Social-Security number is provided above.</p> <p>Names and Social-Security numbers of all other individuals who prepared or assisted in preparing this document unless the bankruptcy petition preparer is not an individual.</p> <p>If more than one person prepared this document, attach additional sheets conforming to the appropriate official form for each person.</p> <p><small>A bankruptcy petition preparer's failure to comply with the provisions of title 11 and the Federal Rules of Bankruptcy Procedure may result in fines or imprisonment or both. 11 U.S.C. § 110; 18 U.S.C. § 156.</small></p>		
<p style="text-align: center;">Signature of Debtor (Corporation/Partnership)</p> <p>I declare under penalty of perjury that the information provided in this petition is true and correct, and that I have been authorized to file this petition on behalf of the debtor.</p> <p>The debtor requests the relief in accordance with the chapter of title 11, United States Code, specified in this petition.</p> <p>X _____ Signature of Authorized Individual <b>Scott Henry</b></p> <p>Printed Name of Authorized Individual <b>Chief Financial Officer</b></p> <p>Title of Authorized Individual <b>2/16/2011</b></p> <p>_____ Date</p>			

**ANNEX 1**

Pending Bankruptcy Cases Filed By Any  
Affiliate Of The Debtor

1. Each of the affiliated entities listed below has also filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Southern District of New York. Such entities shortly will file a motion requesting that their chapter 11 cases be consolidated for procedural purposes only and jointly administered.

DEBTOR ENTITY	CASE NO.	DATE FILED
Borders International Services, Inc.	11 -	February 16, 2011
Borders, Inc.	11 -	February 16, 2011
Borders Direct, LLC	11 -	February 16, 2011
Borders Properties, Inc.	11 -	February 16, 2011
Borders Online, Inc.	11 -	February 16, 2011
Borders Online, LLC	11 -	February 16, 2011
BGP (UK), Limited	11 -	February 16, 2011

Source: <http://dealbook.nytimes.com/2011/02/16/borders-files-for-bankruptcy/>

## Endnotes

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## Teaching Note

The teaching note is divided in six parts: the Case Overview describes the main highlights from the teaching case presented previously; the Teaching Purposes that explains the challenges that a student will face when studying the case and the goals and benefits that can be achieved through the usage of the case as teaching material; the Intended Contribution that consists in providing a real-world illustration of how a specific theory applies; the Instructor Preparation that gives the lecturer all the extra information and bibliography that can be helpful for the preparation of the teaching case and for the in-class discussion; the Suggested Assignment Questions that are intended to help students to link the theoretical background with the real-life situation presented in the teaching case; the Teaching Plan that includes suggestions regarding the division of the analysis in a class situation.

### A. Case Overview

Borders' company was founded by Tom and Louis Borders, in 1971, with the opening of the first Borders Book Shop in Ann Arbor. Borders bookstore started to grow, and having in mind the company's expansion, the brothers hired, in 1988, Robert DiRomualdo. At that time, there were two major bookstore chains in the US, B.Dalton and Waldenbooks, both mall based bookstores. In 1984, Kmart acquired Waldenbooks and two years later, Barnes & Noble, a book superstore company acquired B. Dalton. As the book superstore business became more important in the industry, Kmart started making some moves to enter that field and in 1992 the company bought the 21 book superstores' chain, Borders, for a price of \$190 million and Borders' brothers left the company.

In 1994, under the name of Borders Group, Kmart creates a separate company, preparing it for an IPO the following year. In 1995 Borders Group Inc. goes public, one year after the public stock sale of Barnes & Noble. In the same year Jeff Bezos launched Amazon.com, a web based bookstore that promised to revolutionize the book retail industry. With the growth of online retailing, Barnes & Noble also joined the World Wide Web in 1997 with its own website

and Borders entered a year after, a late move that revealed to be costly for the company. Struggling to succeed in the online retailing world, in 2001 Borders decides to handle to Amazon the management of Borders online store, giving to its biggest competitor the ability to build a relationship with Borders' customers. At that time, Robert DiRomualdo had already leaved the company since 1998 and Borders was leaded by Philip Pfeffer. However, Pfeffer didn't stay for a year and its abrupt exit from Borders required DiRomualdo to assume Borders management until November 1999, when Greg Josefowicz assumed the management of Borders Group. In 2004, Borders expanded its partnership with Amazon to some of its international subsidiaries. In January 2006, Borders launched its Borders Loyalty Program, named Borders Rewards, six years after B&N and almost one year after Amazon. However, Borders made it free, contrary to what its competitors were doing.

In July 2006, when George Jones was named Borders' CEO, major changes started to take place in Borders. Mr. Jones started preparing the company for the end of the partnership with Amazon, creating a team to develop the Borders website that was launched only on May, 2008. The entrance of George Jones in the company also marked the end of Borders Group international expansion with the company selling the majority of its international subsidiaries while Waldenbooks stores also suffered a significant decrease. When Borders recovered Borders.com, other changes had already happened in the industry and electronic books were growing in the book market. In fact, Borders was already selling in its stores a Sony e-reader device since 2006, but the entrance of Amazon Kindle in 2007, B&N nook in 2009 and the appearance of iPad and other tablets in 2010 jointly with the easy connection of those devices with e-book stores was one of the factors that determined the failure of Sony e-reader.

The sequential failures of Borders, forced the company to several lay offs as part of a cost-cutting plan that was announced in 2008. In 2009, George Jones was fired and Ron Marshall took his place. In January 2010, Ron Marshall resigned and Mike Edwards assumed the management of the company as an interim CEO, being replaced by Bennet LeBow in June that year. Borders launched an e-book store developed by Kobo Inc. and started selling Kobo e-

reader in its stores, in 2010. Despite the efforts to find the right person and the right strategies that could take the company from the black hole, Borders situation did not improve and in February 2011, Borders filed for Chapter 11 bankruptcy protection and in July the company announced that its liquidation.

## **B. Teaching Purposes**

The Borders case gives a clear portrait of how a major player in an industry can overcome serious challenges due to surrounding changes and the internal misunderstanding of those changes. Described in a chronological sequence, this teaching case enables students to understand the path of strategic decisions (or the lack of them) made in the company and the impact of such choices in the company's outcome.

Requiring some background on the strategic management field and some critical thinking, the Borders case was conceived to be lectured in Master classes as part of courses as Strategic Management, Advanced Strategic Management, Managing in a Global Context or Business Strategy. The case is especially useful as a practical example to be used when explaining the dynamic capabilities' theory. In fact, there are two main dimensions of the dynamic capabilities concept that are particularly relevant in this case and it is expected that students will have the capacity to recall that topics.

### **1) Exogenous Shock**

The case presents the problems faced by the second largest American bookseller due to its inability to see and act upon the changes that were occurring in the American book industry. The role of the Internet in the retail world and the importance of e-books for the book industry changes were not clear to Borders and the company didn't take the needed steps to overcome the obstacles it was facing.

Students must be able to identify the exogenous shocks, analyze the evolution on the environmental situation surrounding the company and discuss the role of the technology progressions in the case. They should be able to approach the need to keep up with industry developments whether they are

related with technological changes or competitors' strategies, even if it implies sometimes the change of the company's resource base.

## 2) Timely decisions

With a clear lack of a strategic plan that would fit the environmental changes that could be felt in the industry, the Borders case is a perfect example of the implications of not taking the right decisions at the right time.

The importance of timely decisions and the role of the CEO as a decision maker in the company are the topics that students are expected to analyze. Students should be able to determine the right and wrong decisions taken by the company and the timing of those choices.

## C. Intended Contribution

The presentation of Borders case as a possible teaching material is intended to illustrate a real world business situation of the dynamic capabilities concept. Enabling the lecturer to show how the dynamic capabilities theory applies and how important it is in today's world, the Borders case is especially relevant when approaching the different dimensions of dynamic capabilities' concept and the role of the exogenous shocks in the company's decisions and consequent performance.

## D. Instructor Preparation

When preparing to discuss the Borders case in class, there are some interesting sites that the lecturer can visit either to better understand the case or to present in class and stimulate the students' rationale about the issue.

Book-buying behavior reports:

- <http://www.versoadvertising.com/DBWsurvey2012/>
- <http://www.versoadvertising.com/dbwsurvey/>

George Jones video interview about Borders strategy:

- <http://www.youtube.com/watch?v=IMM22VQIK7M>
- <http://www.youtube.com/watch?v=CiD1RT2B2z8&feature=relmfu>

Articles about Borders' end:

- <http://www.annarbor.com/business-review/borders-rapid-rise-accelerated-its-fall/>
- <http://www.annarbor.com/business-review/exclusive-interview-with-borders-ceo-mike-edwards-we-are-here-fighting-to-the-end-1/> (Interview with Mike Edwards)

## E. Suggested Assignment Questions

In order to make the class discussion more focused on the main topics approached in the case and to easily direct the students to the key situations that require major attention, three assignment questions are suggested below with the answer requirements for each one.

### **1. Identify the exogenous shocks presented in the Borders case and discuss the role of technology advancements in those external changes.**

A detailed analysis of the Borders case gives students a clear understanding that the middle 1990's were critical years for the book industry. The Amazon.com entrance in the market led to major changes and that was the time when Borders lost its edge. Students must be able to identify Internet as the first and major exogenous shock present in the case and the booster of online retailing. The opportunity seen by Amazon.com to create an online bookseller led to the launch of its website in 1995, making Amazon one of the fiercest competitors in the book industry. Just years after the boost of Internet on the retail business, Borders realized the importance of being present in that channel. "As someone once said, the Internet is the comet that killed the dinosaur. I'm afraid Borders is one of those dinosaurs."<sup>1</sup> Among its biggest competitors (Barnes & Noble and Amazon.com), Borders was the last one to enter the online retail business.

E-books, although related with the exogenous shock that initiated the major changes that the book industry suffered, the internet appearance, was a clear second shock that Borders struggled to overcome. In fact, there are citations in the case that enable students to clearly recall that information. Mike

Edwards, one of Borders CEOs, said in an interview that “Pricing has put pressure on the industry, (but) the e-book effect is far more destructive than pricing, which has been out there for years”<sup>2</sup>. The fact that Borders started selling e-readers before the company owned a e-book store was also a negative differentiator point from its competitors. Borders was not exploiting the opportunity of selling e-books through the sale of e-readers. Although Borders had launched an e-book store, developed by Kobo Inc., and started selling Kobo e-reader, in 2010, customers were already used to buy electronic books at other e-book stores. The need to keep up with technological changes was a key issue in the failure of Borders and the success of its competitors.

**2. Barreto identifies, in his definition of dynamic capabilities, four different dimensions. Please analyze the case and assess how Borders performed in each dimension, and how such performance contributed to its final outcome.**

Propensity to sense opportunities and threats:

The ability to look at the external or internal environment and track possible opportunities and/or threats, identify the market trends and seize the industry direction was not a characteristic of Borders Group. In fact, there are several strategic decisions that corroborate this point of view. The emergence in the middle 1990’s of the Internet and then, the online retail business was somehow ignored by Borders that stuck with its expansion plans, growing national and internationally. David Dykhouse, a manager of Borders’ Arborland store from 2002 to 2007 stated, talking about the company, “They never really harnessed the power of the Internet,” said him. Even when Borders entered the online retailing business they were not able to succeed and handled the management of its online store to Amazon.com, not realizing the danger of that move. Even years later, and despite all the criticism around the partnership, some people in the company still believed that at that time, the company made the right choice as the vice-president for e-business at Borders said, in 2008, when the company recovered its website from Amazon.com. “The decision to partner with Amazon, at the time it was made, was made I think for very good

reasons,” said him. “Now the world has changed significantly. It’s right for us now to own our own e-commerce experience and to tie into stores and really connect with our customers in a way we could not do in a partnership with another company.” Even when the sales of physical books declined, and although other companies were already selling electronic books since 2004, the company never took it too seriously and only in 2010 opened its e-book store. The Borders disability to see and understand the opportunities in the market, transformed them in threats for the company.

Propensity to make timely decisions:

The timing of decisions is undoubtedly a critical issue in today’s world, even more when we are talking about technologies that evolve constantly. In the Borders case, it is very clear that the company was always late in its decisions. The following table shows the differences between Borders and its competitors when it comes to the timing of their strategic choices.

	Borders	B&N	Amazon
<b>Online Store</b>	1998/2008	1997	1995
<b>Customer Loyalty Program</b>	2006	2000	2005
<b>E-book store</b>	2010	2009	2004
<b>E-reader device</b>	2006/2010	2009	2007

Borders was not sensitive to the changes that were occurring in the book industry, not enabling the company to undertake the needed efforts and resources to overcome those external changes. This is probably the most important propensity in the Borders’ case. Closely related with the previous propensity to sense opportunities and threats, it was the lack of that propensity that made it impossible for Borders to evolve and change in the right time frame. When Borders entered the online retailing world, in 1998, Amazon was already valued more than seven times the value of Borders and its competitor Barnes & Noble was already playing the game for one year. The late enter could be justified by the changes that the company would have to undertake to be able to compete in a completely new and different field. However, this was not the case.

In fact, it could be said that Borders only entered the online world in 2008, when the company recovered its website from the hands of its fiercest competitor, Amazon.com. If we look to the problem from this perspective, it can be said that Borders really entered the field and realized of its importance more than a decade after its competitors, delaying all the other technological changes that the company would have to suffer in order to keep up with the advancements and modifications that were happening in the industry.

Even when Borders started selling e-readers in its stores in 2006, being the first one to do so, and although Amazon only launched Kindle in 2007, the complete control of the device, its good features and the fact that the company was already selling e-books since 2004, were major factors for Kindle's success. B&N also introduced its own e-reader device, Nook, in 2009, at the same time that it launched its e-book store. As it happened for the first situation, explained in the previous paragraph, Borders tried a second chance, and in 2010 the company launched its e-book store, developed by Kobo Inc., and started selling Kobo e-reader in its stores. However, the timing of Borders' strategic decisions was not able to avoid the company to become again a distant third competitor in the field.

Propensity to make market oriented decisions:

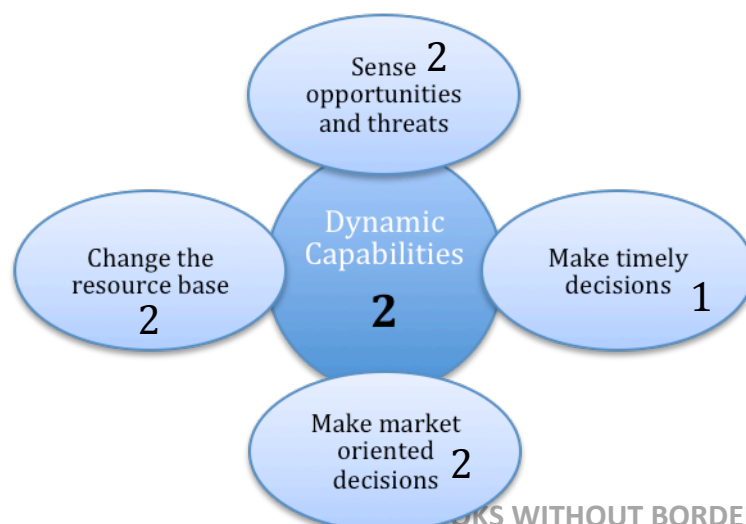
Although the timing of decision-making plays a very important role in the strategic field, the content of such decisions is not less relevant. In order to make market oriented decisions, the company should be able to analyze customers' wants and needs, competitors' actions and the company goals and objectives. Borders was not consistent in this field. Even when the overall book sales in the bookstores trade was clearly achieving its decline phase, Borders was still expanding national and internationally. Even with the sales of Amazon.com increasing more than 10% every year since 2002, Borders didn't realize the trend in the industry. At the same time customers were already saying, "I'll go to Borders to find a book, and then I'll go to Amazon to buy it".

When e-books became a trend in the market, Borders started selling the Sony e-reader, a device with very poor features. However, the main issue was not the characteristics of the device but the fact that Borders didn't notice that they should be selling the e-books needed for the device usage. This was something that Amazon didn't fail in understanding, being able to success in Kindle's sale also due to its presence in the e-book trade since 2004.

Propensity to change the company's resource base:

A lot of what happened in the Borders case is related with the company's propensity to change its resource base. Although it was mainly due to the lack of the propensities previously explained, the Borders failure in the online retailing in the first years had a big part of its cause in the company's disability to change its capabilities, competences and resources. Borders chose to stick with the physical world and didn't take the needed efforts and resources to be able to change or diversify its approach to the market. The same happened with e-books and e-readers. While Borders' competitors developed and produced their own e-reader devices and e-book stores, not letting the customers deviate their attention to other players in the field, Borders teamed with other companies that could fulfill the company's lack of resources.

Summing up all the four dimensions suggested in Barreto's definition of dynamic capabilities, students are expected to make a conclusion, assessing the strenght of each of the four dimensions and arriving to a final conclusion about Borders' dynamic capabilities. The valuation that I propose is the following (in a scale from 1 to 5, where 1 corresponds to the lowest level):



## F. Teaching Plan

### Main Parts

When studying the case in class, and in order to facilitate the analysis, Borders case, should be divided in three main parts:

#### Until 1998

- Borders' rise
- Entrance of other players in the industry (Amazon.com) with different book store concepts
- Borders national and international expansion
- DiRomualdo resigns
- Philip Pfeffer named CEO, expected to help Borders in its online efforts

#### From 1998 to 2006

- 1999 Philip Pfeffer leave Borders
- 1999 Greg Josefowicz named Borders CEO
- The growth of e-books market
- Borders expansion despite the company's decline
- Borders deal with Amazon to run Borders.com

#### From 2006 on

- Borders Loyalty Program
- 2006, Borders start selling Sony e-reader in its stores
- 2007, Kindle enters the market of e-readers
- 2009, B&N lanches Nook e-reader
- Several shake-ups in Borders management
- Borders files Chapter 11
- Borders liquidations

### Topics

The Borders case should be presented in a 80 minute and below I propose a division of the analysis of the case in order to make it easier for the lecturer to structure the class and assure all the topics are covered and the objectives of the usage of the case as a practical illustration of a theory, achieved.

Class Section	Objective	Exercise	Time
<b>Review on Dynamic Capabilities Theory</b>	Recall the theoretical basis of dynamic capabilities in orders to introduce the illustration given by the case and prepare the students for an interesting discussion of the case in the lights of the studied theory.	Give students the opportunity to show what they remember from previous lectures about the topic of dynamic capabilities. (This will enable the professor to understand the doubts of students and the topics that need further explanation.)	15'
<b>Case Overview</b>	Ensure all the students understand and identify the main topics of the case and the linkage between it and the dynamic capabilities theory.	Ask for a group of 2 or 3 students to previously prepare a power point presentation of the case and ask them to bring updated information about the company.	10'
<b>Assignment Question 1</b>	Identify the two exogenous shocks presented in the case and understand the importance of being attentive to changes in the market, sensing opportunities and threats.	Encourage students to participate individually and give their own point of view. Write on the board the students' insights about the identification of external shocks	15'
<b>Assignment Question 2</b>	Assure students understood the four dimensions of the dynamic capabilities concept and its applicability in real life business situations.	Discuss, in groups, the practical examples of the four dimensions of the DC's concept. This will help students to clarify doubts that may exist.	10' – group 15' - discussion
<b>Conclusions</b>	Guarantee the clear understanding of the dynamic capabilities theory and how they can be applied in real world situations	Summarize the wrong and right decisions taken by Borders and let students state what the company could have done differently.	15'

### Update

#### B&N buys Borders IP assets:

'Barnes & Noble, based in New York, won a Sept. 14 (2011) auction to buy most of the trademarks and intellectual property of Borders for \$13.9 million. In addition to Borders' trade names and the database, Barnes & Noble bought the Waldenbooks and Brentano's marks. Including other asset sales, the auction brought in \$15.8 million to Borders' creditors.'<sup>3</sup>

<sup>1</sup> Bomey, Nathan, 2011. Borders plans to liquidate, ending 40-year-old bookstore chain. AnnArbor.com, [online] 18 Jul. Available at: <http://www.annarbor.com/business-review/borders-liquidation-chapter-11-ann-arbor-bookstore-chain-borders-group-e-books/> [Accessed on 10 April 2012]

<sup>2</sup> Bomey, Nathan, 2011. Q&A: Exclusive interview with Borders CEO Mike Edwards: 'We are here fighting to the end'. AnnArbor.com, [online] 5 May. Available at: <http://www.annarbor.com/business-review/exclusive-interview-with-borders-ceo-mike-edwards-we-are-here-fighting-to-the-end-1/> [Accessed on 10 April 2012]

<sup>3</sup> Kary, Tiffany, 2011. Borders to Sell Intellectual Property to Barnes & Noble. Business Week [online], 26 September. Available at: <http://www.businessweek.com/news/2011-09-26/borders-to-sell-intellectual-property-to-barnes-noble.html> [Accessed on 20 May 2012]

## Discussion

The topic of dynamic capabilities has been explored and studied by researchers in recent years, and the increasing interest in the field and its close connection to the world that we live in, have led to an impressive number of academic works around the topic. My teaching case about Borders aims to facilitate the understanding and diffusion of the dynamic capabilities theory and show their applicability in real world business situations.

In the literature review of this dissertation, I exposed some of the main topics analyzed by the principal researchers in the field. Despite all the definitions given by different researchers on the concept of dynamic capabilities, to be able to conduct the analysis presented in this dissertation, I chose to use the definition provided by Barreto (2010). This definition seems clear, precise and organized, enabling the concept to be tested and avoiding the mistakes and criticism of previous definitions.

The literature review previously presented, explains the main topics behind the concept of dynamic capabilities enabling the reader to understand the case from the dynamic capabilities perspective. In fact, the Borders case is an illustration of the four dimensions introduced by Barreto (2010). Borders case can help students to understand not just the importance of each one of the dimensions separately but also the influence of one dimension in the others. In this section of the dissertation I will link the dynamic capabilities theory with the practical case of Borders, showing the applicability of this concept and its utility in real world situations.

Before analyzing each of the dimensions presented by Barreto (2010) in the lights of Borders case, it is important to recall his definition of the dynamic capabilities 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.*

One crucial component of this definition is its clarification of the nature

of DCs: the potential of a company to systematically solve problems. The definition makes it very clear that this is about problem solving and that this is not an ability to exercise once in a while, but something firms need to perform well in a systematic way.

The first propensity is related with the sense of opportunities and threats. Teece (2007) had already used this approach stating the companies' need to continuously examine, pursue and explore across markets and technologies to identify and shape opportunities. Analyzing the Borders case, it can be seen that Borders did not do that continuous search. In fact, Borders did sometimes see the opportunity and/or threat but very late. When Internet started to develop and the Amazon online retailer entered the book industry, Borders was able to identify the threat and opportunity but very late.. Although the propensity to sense opportunities and threats is usually linked to the entrepreneurial approach, Zahra et. al. (2006) put it differently saying that the relevance of entrepreneurial activities is not just critical for the conception, development and maintenance of dynamic capabilities in new ventures, but also in established companies, as it happened in the Borders case.

The second dimension is presented as the propensity to make timely decisions. In the rapid changing environment where companies live in, timing reveals to be key in strategy (Eisenhardt & Martin, 2000). In Borders case this is one of the dimensions that play a major role. The right and wrong decisions of when to change can determine the path of a company. As it was already exposed in the teaching note, almost all major Borders Group strategic decisions after the Internet shock were made not at the right time, seriously compromising the following decisions that the company had to make. Eisenhardt and Martin (2000) stated that the potential for competitive advantage also lies in using dynamic capabilities sooner than the competition.

Related with the second dimension due to its link to the decision making process, the third dimension is the companies' propensity to make market oriented decisions. While the previous dimension proposes the question of when to change, the third one asks the question of how to change. Borders strategic

choices revealed some distance to the market, ignoring competitors moves and customers needs and wants. The firm ignored that customers wanted online purchases, first, and e-books, later on. This is also illustrated by the previous dimensions, revealing that Borders acted only when it was already too obvious the opportunity and/or threat.

The dynamic capabilities definition also highlights the propensity of a firm to change its resource base. A lot of Borders' failures can be explained by its lack of propensity to change its resource base. Borders was not able to succeed in its first attempt as an online retailer because the company did not have the resources and capabilities needed alterations to overcome the industry changes. Eisenhardt and Martin (2000) state that the role of dynamic capabilities, in the form of strategic routines, is also the alteration, acquisition, integration and recombination of resources as a way to generate value-creating strategies. Borders was not able to do it.

In sum, Borders case is a practical illustration of how the dynamic capabilities concept can be seen and tested in real world situations. Although the four dimensions have different levels of relevance in the specific case of Borders, with the propensity to make timely decisions being the most important and the propensity to sense opportunities and threats also playing an important role, in the Borders case the reader can find illustrations of each dimension of the dynamic capabilities concept. This dissertation enables the students' clear understanding of the dynamic capabilities theory using a real life situation.

Completing this dissertation I was able to understand the importance and applicability of dynamic capabilities theory. Using the Borders case as a practical illustration of the theory I wanted to test, made me realize the crucial importance of each one of the four dimensions of the dynamic capabilities concept. The relevance of being attentive to changes in a company's surrounding environment, identifying opportunities and/or threats, and even more important, understanding those changes; the role of the decision-making process in a firm's path regarding the time of its strategic choices and the content of those decisions; and the propensity to undertake the required resource changes

in order to guarantee that the perceived opportunity and/or threat is appropriately addresses by the firm.

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