Innovating for the Mobile End-User Market:

Amazon's Kindle 2 Strategy as Emerging Business Model

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***Abstract*—Using the example of Amazon's Kindle 2 launch, this exploratory case study research investigates an emerging mobile business model in the eBook market that closely connects an innovative device with access to content. Reflecting on the business model and innovation literature, the paper points to the potential of mobile business model that relies on radical innovations to change industry structures. Based on the case study of Kindle 2, the study reveals the need to align innovative products and services with a company's overall brand strategy to avoid dilution. It suggests that a mobile business model based on a proprietary approach can be successful in the short run; its long run success depends on the ability to react to new market requirements and competitors. The paper concludes with a reflection of how business models need to be dynamically re-adjusted in such a fast moving field.**

"There are about 5m e-readers in circulation world-wide and double that amount will be sold in 2010."
Economist.com, 2009

Keywords-Mobile Business Model Innovation; Exploratory Case Study; Amazon Kindle

I. INTRODUCTION

In the past 20 years digitalization has changed nearly every sector of our everyday life. Although eBooks have existed for more than 20 years, they are still far from substituting traditional books. Only recently have specialized mobile technical devices for reading digitalized books, so called eBook readers or simply eReaders, emerged.

The launch of innovations such as eBooks and eReaders based on software, hardware, and infrastructure resources [1] provides an opportunity to implement new business models [2, 3]. Although crucial for the success of mobile businesses, research on emerging mobile business models concerning the eBook market is still scarce.

Investigating an emerging mobile business model in the eBook market, this paper offers an exploratory case study of Amazon's Kindle 2 launched in February 2009. It depicts a book retailer undertaking first steps to restructure the (e)Book industry by closely connecting an innovative device with access to content.[1]

II. EBOOKS AND EREADERS

The term 'eBook' often stands for two separate products: the actual *eBooks* themselves, i.e., the content, and the *eReaders*, the rather small and portable devices that make electronic reading of books feasible. eReaders are certainly not the only way that eBooks can be displayed. Alternatives include computer displays, laptops, netbooks, smartphones, and almost any other electronic display.

A. Market Overview

After the first eBook euphoria ended at the beginning of the 21st century, eBooks and eReaders caught public attention again when major players such as Sony in 2005 and Amazon in 2007 entered the market with their reading devices, the 'Sony Reader' and the 'Amazon Kindle'. Today, almost 40 different devices are available for purchase worldwide [4] suggesting continuous development of eReaders and a steady growth combined with price decreases (see Figure 1).

1 The case is based on data collection from market reports and the press and on interviews with four Amazon managers in Germany and abroad and six other industry players. Due to the exploratory nature of the case study, we agreed to keep interviewee names confidential, and to only disclose them later upon request

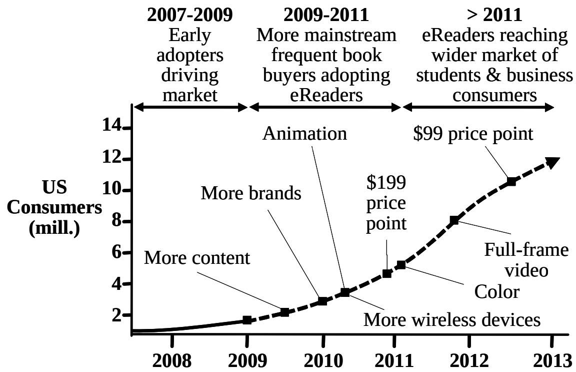

Figure 1. Predicted eBook/eReader Demand Development [5].

An industry survey conducted at the Frankfurt Book Fair in 2009 emphasized the future importance of eBooks. Almost 40% of respondents considered eBooks to be the most important advancement in the publishing sector since the 1950s. They predicted that both, customers and global players including new entrants such as Google, Microsoft, BlackBerry, and Apple, would push the eBook market. They expected that eBooks sales would surpass traditional book sales by 2018, if some global and local issues could be resolved [6].

On a global scale, a standardized eBook format and digital rights management are prerequisites for further market growth. Although most eReaders are technically similar, they still support only a selected number of text formats [7]. A first standardization attempt has been made by the open epub-format [8]. Major local challenges include varying national copyright laws or 'Resale Price Maintenance' regulation. For example, the German "Boersenverein des Deutschen Buchhandels" clings to eBook Resale Price Maintenance, and thus excludes price advantages for eBooks compared to its printed version [9].

B. *Players along the Value Chain*

Apart from device manufacturers, major constituencies along the eBook value chain are authors, publishers, distributors, and consumers. Their respective adoption of eBooks is influenced by the relative advantage gained from the new technology compared to the traditional way of publishing books.

Authors are willing to adopt eBooks and the possibilities of self-publishing when they benefit from increasing revenue shares and audience sizes [10]. However, successful self-publishing requires that authors already enjoy popularity; they would not be found otherwise.

Traditional *publishers* receive economic benefits from ePublishing, as manufacturing costs decrease due to the digital delivery and elimination of the printing process. They enjoy higher profitability when inventory, back order, or 'out-of-stock' costs are eliminated. Their flexibility increases with the ability to publish niche books and to update versions faster and more easily. However, they can only realize those benefits when the issues of copyright and content control are resolved.

Many traditional *distributors* are likely to resist mass adoption of eBooks when they experience eBooks as a significant threat to their traditional business model: Especially wholesalers may lose their importance in the value chain, as eBooks require neither inventory nor transportation. Retail distributors, on the other hand, may have to introduce eBooks as an additional product in their assortment to avoid being 'overtaken' by 'alternative' book distribution channels.

Consumers can enjoy a recognizable look and feel as reading an eBook has become almost as comfortable as reading a traditional book. They usually appreciate that eBooks are lighter than a stack of books and have roughly the same dimensions as traditional books. Consumers like text search capabilities, links to electronic dictionaries, sound and multimedia playback, and adjustable font sizes. However, consumers not only face the initial purchasing cost for the eReader, they may also be hesitant to abandon familiar habits related to books, such as turning pages or putting books into shelves.

III. Conceptual Foundations

As a background to analyzing Amazon's launch of Kindle 2, this section focuses on the literature of the following three conceptual foundations.

A. *Mobile Business Model Components*

Business model research has moved from business model definition via exploration to description approaches [11], typically validated on the basis of case analyses along critical design characteristics [12]. Common components of mobile business models refer to (1) service – value proposition and the market segment at which the offering is aimed, (2) technology – technical prerequisites of service offers, (3) organization – value-chain structure, and (4) finance – money-making strategy and sharing arrangements [3].

In the context of mobile offerings, the business model literature has yet to specify the critical design characteristics for creating value through innovative service offerings [3].

B. *Innovation Categories*

Emerging business models are driven by innovations, for which the degree of innovation is vital [13]. Approach and degree towards innovation differ among organizations [14]. Not every organization has the capabilities required for innovation, and radical redefinition of existing technologies is not always beneficial [15; 16].

Henderson and Clark [17] suggest four categories of innovation in order to measure the impact that an innovation is likely to have on an existing firm (see Figure 2). On the x-axis, they capture the impact of innovations on the linkage of components and competencies – whether they are changed or unchanged; on the y-axis, they cover the impact on core concepts – whether they are reinforced or overturned. The four innovating categories are: (1)

incremental innovation, (2) modular innovation, (3) architectural innovation, and (4) radical innovation.

		Reinformced	Overturned
Linkage between Core Concepts and Components	Incremental	Incremental Innovation	Modular Innovation
	Radical	Architectural Innovation	Radical Innovation

Core Concepts

Figure 2. Innovation Categories [17].

C. *Innovation-Brand Typology*

Companies frequently apply branding strategies to support their product and business model innovations. Beverland, Napoli, and Farrelly [18] name four branding strategies considering the frequent distinction of incremental and radical innovations (approach to innovation) and market driven or market driving brands (relationships to market place). The four types are: (1) follower brands – focusing on satisfying customer needs through incremental improvements to existing products, (2) craft designer driven brands – seeking to maintain traditional brand status through small incremental innovations to existing product lines, (3) category leader brands – undertaking radical innovations, and (4) product leader brands – seeking to become industry leaders through the development of radical innovations.

		Market Driven	Driving Markets
Approach to Innovation	Incremental	Follower Brands	Craft-Designer Led Brands
	Radical	Category Leader Brands	Product Leader Brands

Relationship to the Marketplace

Figure 3. Innovation-Brand Typology [18].

IV. Amazon's Kindle 2

A. *Launch*

Amazon, incorporated in 1994, is the largest online retailer in the United States with established websites in six other countries. Since its foundation, Amazon has steadily expanded its product spectrum, which today spans from tennis rackets to diamond jewellery to a wide range of service offerings such as private marketplaces. Nevertheless, its original core business – the sale of books and media products – is still a major pillar of Amazon's activities. Although Amazon's market share in the overall book market is unpublished and hard to quantify, a significant market power worldwide can be assumed.

Beyond complementing its existing product lines with eBooks, in 2004 Amazon made its first move to take advantage of the eBook technology. Amazon initiated a project to develop the Amazon Kindle (or just 'Kindle'), both an eReader and software for PCs. As Jeff Bezos, Amazon CEO, suggests, *"The vision is that you should be able to get any book – not just any book in print, but any book that's ever been in print – on this device in less than a minute"* [19; p 2]. The first version of Kindle was released in the United States in November 2007.

The successor, Kindle 2, was introduced in February 2009, and the expanded version, Kindle DX, was brought to market in June 2009 [4]. While the Kindle design resembles paperback books, it is able to store up to 3,500 eBooks depending on the model. Displays with higher resolution and color have been announced for the next few years.

Compared to competitors' products such as the Sony Reader, Amazon's differentiation in Kindle 2 lies in the new business model, implying a *direct connection between hardware sales (eReader)* and *eBook content delivery*. Access to Kindle Shop with its more than 400,000 eBooks is free of charge via the integrated Whispernet mobile data connection. The mobile connection is the reason that Kindle 2 users are likely to make impulse purchases, whereas users of other devices have to plan in advance and connect via USB or wireless LAN.

As Amazon did not have in-house knowledge for conceptualizing and building a mobile device, it hired hardware engineers to develop and design Kindle and founded Lab 126. The manufacturing was outsourced to the Taiwanese firm Foxconn Technology Group, which has experience in producing high quality technical devices.

The development of Kindle marked a new level of Amazon's continuous expansion philosophy. For the first time, Amazon not only extended its product spectrum, but it also entered a completely new business area by developing a technical device. This step is not only an expansion into a promising market, but also a necessity to achieve a sustainable and strong position in the eBook market. Facing potential cannibalization by traditional book sales, Amazon aims at sustaining its dominant market position by developing a business model that builds on the direct link between selling a new generation reading device and globally branded eBook content. Amazon has a big customer base, a strong reputation for book selling, and a worldwide known brand. It also has intangible assets such as the patented one-click purchase button and its widely recognized customer relationship management. As these resources have been accumulated over time, short-term imitation by competitors seems unlikely [20].

B. *Strategic Moves*

This section discusses Amazon's strategic moves when introducing Kindle 2 with regard to vertical integration, first mover advantage, marketing, and pricing.

Vertical Integration. In contrast to its competitor Sony, which relies on cooperation with experienced book sellers, Amazon forces Kindle 2 users to purchase eBooks exclusively via the Kindle store. It thus fosters its vertically integrated, proprietary system via its eBook format AZW, which is only usable with the Kindle hard- and software. Due to the initial cost and the proprietary format, switching to a competitor device is expensive and implies losing one's entire eBook library purchased via the Amazon store. In other words, once users have bought Kindle 2, they experience a lock-in. This creates a constant flow of revenue for Amazon.

At the same time, the business model of directly connecting hardware sales with content delivery and supporting a proprietary eBook format is an obstacle for quickly achieving a critical mass of users [21]. Amazon has opted to exploit the lock-in effect to achieve continuous growth, even at a slower rate, accepting a rather slow extension of its customer base in a still uncertain eBook and eReader market. The strategy is to keep the eBook market – or at least Amazon's slice of the cake – as a blue ocean, i.e., a nearly uncontested market where competition is essentially irrelevant [22].

First Mover Advantage. Amazon's move around Kindle 2, establishing a business model that connects the eReader device with the storefront and thus the content, clearly makes Amazon a first mover in the eBook market. Not only is Amazon first to introduce the business model, it also tries to secure its time advantage by making a good part of its business model proprietary (e.g., the eBook format, the exclusive access to the Kindle store, and the direct, free of charge wireless connection). Another form of first mover strategy is visible in offering exclusive content: By purchasing exclusive publishing rights for new book releases and making them accessible only via the Kindle platform [23], Amazon seeks to benefit from creating additional incentives for potential customers.

As a first mover, Amazon benefits from its well-established distribution channels, its in-house knowledge concerning storefront and the related processes, and its international scope. However, it also faces the typical first mover challenges [24]. A standardized eBook format has not yet been established, and thus Amazon's proprietary eBook format could mean 'betting on the wrong horse'. Competitors such as Google or Apple, new to the book market, may exploit some typical late-mover-advantages and eventually enter a heavily standardized market with only a short delay. They may then benefit from economies of scale and network effects arising from investments in a generally growing customer base, combined with known customer demands, customer education, and better customer information [25; 26].

Marketing. Amazon markets its innovative product with an advertisement campaign via mass media, and through viral marketing efforts, thus actively stimulating positive word-of-mouth.

To encourage early adopters to share their experiences with prospective users, Amazon initiated the 'See a Kindle in your Area' program [27]. Via the Amazon website, prospective and current customers have the opportunity to contact each other and arrange a meeting for a private demonstration. This saves Amazon costly presentations and also increases its credibility [28]. To intensify public discussions on Kindle, one of the most influential women in the United States media scene, Oprah Winfrey, has publicly recommended Kindle in her TV show [29]. At the same time, Amazon keeps information about eBook sales rather secret, presumably to foster continuous speculations. In 2009 on its website, Amazon announced only that Kindle was the best selling technical product in Amazon's portfolio [30].

Pricing. The initial price for Kindle 2 was set at US$399 [31]. Considered expensive, Kindle 2 attracted only less price sensitive early adopters, who possibly triggered the rather critical word-of-mouth 'campaigns'. In spite of high margins, the small number of early adopters barely allowed Amazon to recoup its initial investments. After two price decreases, in early 2010 Kindle 2 was available for US$259. By abandoning the skimming strategy, but pursuing economies of scale and acquisitions along the supply chain, Amazon reduced manufacturing costs and could thus lower sales prices. Nevertheless, on the device side, Amazon has overall been committed to a high price strategy.

On the content side, Amazon has applied an aggressive pricing strategy. For instance, it offers all New York Times Bestsellers for US$9.99 [32]. Depending on the book, users save up to 75% per book, compared to the paperback [33].

V. DISCUSSION OF AMAZON'S KINDLE 2

A. Identification of Mobile Business Model Components

Amazon defines its *service* and the corresponding value proposition through a closed system, linking Kindle 2 to exclusive content. With making it impossible for individuals to share eBooks across different eBook readers, Amazon limits customer value. It remains to be seen how long Amazon's approach will be sustainable. Clearly, in markets with network effects, limited exchange among users seems questionable. But even in less network-driven market segments, such as music sales and movie downloads, closed systems have proven to have short 'shelf lives' [34].

Regarding the *technological* prerequisites, Amazon's Kindle 2 business model concentrates on the provision of a distribution platform for eBooks connected to eReaders. The offering implies only limited personalization and usability capabilities beyond features such as full text search and immediate newspaper download. The individualized choice of specific eBook content does not contribute to the mobile client per se. Amazon's eBook system is only available via Whispernet or Kindle software and does not support any other mobile network technology. It is thus only of limited usefulness [35].

Concerning the *value-chain structure*, cooperation among players along the value chain is needed, since "[n]o single organization (…) possesses all the resources needed for a typical mobile service offering" [3, p. 5]. However, with Kindle 2 and the related vertical integration, Amazon seems to close the doors. Upstream, Amazon handles the development of the Kindle in-house through its subsidiary Lab 126 and employs Foxconn for commissioned production. This is typical for players established in one market (book sales), that enter a new market (eReaders) [36]. Downstream, Amazon tries to exploit its strength in different value chain activities (book selection, store front, mobile client) and builds on selected partnerships with publishers.

With regard to *finance,* Amazon has explicit revenue sharing arrangements with publishers, and maintains commissioned production with Foxconn. Thus, Amazon pursues a costly, high supply certainty strategy that guarantees a procurement approach typical for large firms [37].

B. Positioning in the Innovation Categories

Since its foundation, Amazon has continuously presented itself as an innovative company [38]. However, during its corporate history, Amazon mostly engaged in *incremental innovations* [17], i.e., individual components were improved, while the fundamental core design concepts remained the same. Only already established designs were extended and refined, thus reinforcing Amazon's competitive position. When Amazon expanded its product portfolio, the core design of its online store essentially remained the same – only new products were added.

With the introduction of Kindle 2, Amazon introduced a *radical innovation* [17] by changing the core design concept. Kindle 2 and the linked provision of content contain new components and embody a new set of knowledge, compared to traditional books and other eReaders. For the first time in the book market; hardware sales are being combined with content delivery – a business model that has been proven to be successful in other major content markets such as music and software [39]. However, it is not clear whether Amazon can comprehensively benefit from its existing resources based on the radical innovation approach [17]; Amazon may be stimulated to put more emphasis on the development and expansion of its eBook offer [40]. At the same time, publishers – losing bargaining power – may build their own sales offers. Overall, Amazon's success will be dependent on the complexity of competition and more incremental innovative offers [16].

C. Locating in the Innovation-Brand Typology

With the introduction of Kindle 2 – if sustainable in its proprietary design – Amazon may fundamentally change the nature of consumption, behavior, and demand. If succcessful, Amazon would enjoy the position of having a *market driving product leader brand* [18]. With such a brand, Amazon could exploit first mover advantages, gain higher margins, and recoup R&D costs [18; 41]. However, with new players entering the market, the unique features of Kindle 2 and the sustainability of the respective business model based on the direct link to the content distributed on the Kindle shop may be at risk. Amazon may face the challenge that customers are risk averse and hence hesitant to buy into proprietary offerings [42]. In such a situation, Kindle 2 would rather be a market driven device. Amazon would count on the brand image of its store front together with an established and settled brand image for the Kindle 2 device; it would position itself as a *category leader brand* [18].

However, it is questionable whether Amazon will be able to sustain its brand position and act as a pioneer in the long run. Due to Amazon's primary focus on the retail business and its history of incremental innovations, the current eReader strategy can worsen its future brand image and value. By not meeting established brand promises and retail customers' expectations, Amazon's overall mobile business model may dilute Amazon's overall brand equity [18].

VI. SUMMARY, OUTLOOK, AND FUTURE RESEARCH

The eBook market has become an increasingly important sector of fast growing mobile services. Its development poses new challenges and opportunities for eBook vendors and eBook Reader providers. New business models emerge based on the adaptation or radical change of existing models and the creation of unprecidented business models.

Amazon's incremental convergence of hardware sales and content delivery using a proprietary system may be a precursor of innovative, emerging business models. In the case of Amazon, the business model made the company the leading eBook seller in the United States with similar achievements being possible worldwide.

With the future growth of the eBook market, Kindle 2 is likely to become a promising investment and an important part of Amazon's retail portfolio. For some time, the proprietary offerings may enhance customer loyalty. Whereas Amazon's experience in selling books should help to avoid systemic failures, the company needs to continuously adapt its strategy and perhaps even its mobile business model. Including eBooks content in foreign languages may help to grow the non-English markets.

The question remains as to from where future competition is likely to come. For instance, advertisers may enter the eBook market: They could initially place advertisements in eBooks or completely sponsor them [43]. Other device producers, possibly new to the industry, may enter the eBook market. They benefit from late entry, as customers are already educated and technological developments are on the verge of settlement.

Although eBook specific theoretical insights are scarce, the basic economic logic seems to be replicable. One may expect tough fights for each slice of the 'eBook cake' among big players (e.g., book eRetailer Amazon) and new entrants to the (e)Book market (e.g., Google, Apple, or Sony). One may also expect the traditional book empire to strike back – why should large publishers and large traditional book sellers not have learnt from other 'digital content' industries? Economic success will arise if values are created that somebody is willing to pay for – via whatever emerging business model, and based on whatever new 'core' competence.

Future research will be needed to investigate the scene: It may focus on upcoming technological developments such as color display or eBook provision in the cloud; it may stress the broad spectrum of human computer interaction related issues in the context of eBooks; or it may dig deeper into economic and industry structure issues. Assuming that books are just another sort of goods that 'go digital' in a rather short period, how will the book publishing industry change? What kind of player will win the game – the content producer, the aggregator (publisher), the retailer, the device manufacturer, or the infrastructure provider? Under what circumstances will one company or one kind of company dominate the various value chain activities?

We do not claim to know the outcome to any of these research endeavors. We only find it difficult to see why the book industry should be different from the music industry, where currently the biggest player is neither a singer, a producer, nor a publisher.

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