

Amazon's next revolution

CEO Jeff Bezos used the web to shake up book retailing. Now he's using the Internet to sell electronic books on his Kindle e-reader. A look at Amazon's latest effort to transform the book business, writ digital.

By [Jeffrey M. O'Brien](#), senior editor

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(Fortune Magazine) -- On a bright May morning Jeffrey Bezos descended from atop Mount Seattle unto the press corps. He appeared casually on stage in a standing-room-only theater in New York City. Like another messenger of long ago, he carried a tablet. And he said unto the people: "Ladies and gentlemen, I'm excited to introduce Kindle DX." Keyboards tapped. Shutters clicked. And as the Amazon founder and CEO turned a 9.7-inch display toward the masses, they saw an inscription: *The New York Times*.

We live in a culture of product lust, in which every new release is hyped and deconstructed, only to be dismissed in favor of the next shiny web-enabled wedge of plastic. But Kindle DX, a large-screen e-reader designed to optimize the presentation of newspapers and textbooks, bears little resemblance to anything else in the gadgeteria. The \$489 tablet technically is portable but slides comfortably into no pocket. With all the sex appeal of a bamboo cutting board, it would look more at home in Sur La Table than Best Buy ([BBY](#), [Fortune 500](#)). It will impressively download any of the 285,000 e-books available at Amazon.com in less than a minute. But it features a black-and-white display with a crippled web browser, no video, and not even a backlight. It's a brash example of a single function trumping broad ambition.

Apparently doing one thing well is enough, at least for now. Amid the malaise of the retail sector, Amazon ([AMZN](#), [Fortune 500](#)) blew past expectations when it reported 24% year-over-year earnings growth in the first quarter. A key driver was Kindle DX's predecessor, Kindle 2, a \$359 device that made its debut in February. As consumers everywhere curtailed spending, Kindle 2 was flying off Amazon's virtual shelves. "Kindle sales have exceeded our most optimistic expectations," Bezos declared at the time.

And now, in rapid-fire succession, the company has unveiled Kindle DX to greater expectations still. While newspapers have always been part of the Kindle playbook, Kindle 2 presents content on a display roughly the size of a paperback. The large-screen DX is designed to favor the type of graphics-heavy presentation found in college textbooks. Thanks to an accelerometer, the display can also be viewed sideways, broadsheet-style. Which means that packed inside the device is a burden so large that one can hardly imagine it fitting within a 10.4-by-7.2-by-0.38-inch frame. It's meant to be a savior.

The device has been called the iPod of reading, but unlike Apple's music player, the new Kindle has been met less with lust and awe than with hope and wonder. Could this rather plain-looking and pricey gadget actually pull off something so monumental as reversing the slide in book publishing and saving newspapers? Um, maybe?

In the comfort of Seattle headquarters a week after the DX event, Bezos is surrounded by handlers who mind his clock, police his conversation, fetch water, and signal to him from the far side of the room. Dressed in jeans and an oxford shirt, he's genial and conversational but religiously on message. Even his famous projectile guffaw seems premeditated, a human laugh track inserted to denote intended levity.

Kindle is sometimes referred to as an e-book reader. But that's a bit of a misnomer, because even the original Kindle (which now looks clunkier than a first-gen iPod) was designed with all types of long-form narrative in mind. Newspaper subscriptions were available at launch (editorial content is delivered every morning by four for a monthly fee of up to \$14.99), and they quickly rose to the top of the bestseller list, where they remain today.

The willingness of Kindle owners to purchase daily content should be an obvious lesson - the business is news, not paper - and further expose the foolishness of giving everything away on the web. "I don't want to oversimplify what's happening in media. It's very complicated," says Bezos. "But I find it hard to believe that the primary way of reading newspapers 10-plus years from now is going to be on printed paper."

What's Amazon's interest in hastening the move to digital? "The math is compelling," he says. "There is a genuine opportunity to make the cost structure of printing and distribution much more attractive."

Amazon is notoriously tight-lipped about details of all sorts, and that reticent culture clearly starts at the top. Far from revealing sales figures or margins on Kindle, Bezos and his charges won't confirm where the device is manufactured, what the revenue-sharing arrangements look like, or whether publishers even know how well their Kindle editions are performing. That leaves the analyst community guessing about, well, everything.

One firm, iSuppli, puts the \$359 Kindle 2's materials and manufacturing costs at \$185. (The biggest expense is the \$60 E-Ink display.) Clearly there's more to selling a device than buying and assembling parts. Beyond overhead and software development, Amazon needs to account for the lifetime of wireless access that comes with each device. But most company watchers think that Bezos is positioned to make a fortune on the device. Barclays Capital predicts Kindle devices will produce \$840 million in profit on \$3.7 billion in sales in 2012. That's roughly 20% of Amazon's total sales and profit today. A recent Citigroup report pegged total Kindle sales at roughly 500,000 units.

Such numbers don't exactly translate to a white-earbud phenomenon (Apple ([AAPL](#), [Fortune 500](#)) has shipped more than 200 million iPods), but anecdotal evidence shows that Kindle has infiltrated one circle in particular. Next time you fly (or just pass through) business class, notice how many professional travelers have Kindles. And if you're carrying one, prepare to answer

questions: How do you like it? Is it worth it? "They're not gadget people," Bezos says of the early adopters. "I think of a gadget as something that you buy, play with awhile, and stick in a desk drawer. Nobody calls their microwave oven a gadget. It's too useful."

Amazon has sold all sorts of electronics over the years, but bridging the gap between retailing and manufacturing a highly complex device would seem a perilous venture. Apple's success notwithstanding, the two aspects of business require distinct skill sets. It's not surprising that Bezos would try. By now Amazon has a long history of expanding into areas where it didn't obviously belong - and altering entire industries in the process.

In the oft-repeated legend, Bezos gave up a comfortable finance career in New York City to travel across the country and begin selling books online at a time when it seemed somewhat ridiculous to do so. While in the middle of conquering one industry, the retailer shrugged off the limiting association of "Earth's biggest bookstore" and plowed into everything from music and movies to toilet seats and treadmills. Each time the company would approach profitability, it seemed, it expanded in a new direction. Amazon has even broadened the definition of retail by providing a platform for third-party sales, offering fulfillment services, and selling "cloud" computing services to the enterprise.

Of course there have been brushes with failure - most notably with A9, a foray into the search business, and with an attempt at taking on eBay ([EBAY](#), [Fortune 500](#)) with auctions. One person who has worked closely with the company says digital music and movie downloads have been a disaster: "Unbox has been a complete and utter failure," the source says. (The company counters, "We are very pleased with our Amazon Video on Demand business.")

And yet such lapses have done little to squelch an overriding sense of adventure. "The thing that allows for all the teams to come together after a failure is the recognition that this is just a first failure [for the project]. We may have to work through a couple more," says Bezos. "After every failure, we ask ourselves, 'Do we still believe in the vision?' If we have conviction, that gives us energy to pursue [another] approach."

Most companies pursue linear growth, taking stock of competencies and determining where those skills might also apply. Tangential growth usually comes via acquisition. Doing it organically, the way Amazon favors, requires both vision and discipline. Bezos says it's the difference between doing what you can do and doing what you should do. "You can always do what you should do if you're willing to put in the time and energy to develop a new set of skills," he says. "If you only extend into places where your skill sets serve you, your skills will become outmoded."

Warning: Rubbernecking parallel industries for the next great opportunity does not necessarily make for a stable or universally beloved work environment. Many current and former employees glow about their professional growth at Amazon. But to others it's just grueling. "A lot of people leave burned out," says one former director-level manager. "They're pretty brutal in how they handle human capital. They lay off and hire people like a breeze coming in and out whenever they enter new businesses."

By many accounts the company obsessively analyzes and squeezes suppliers, and Bezos reaches deep into the organizational chart to monitor performance, expertly sizing up quarterly numbers in minutes. "He asks the difficult questions. He's extremely blunt and can make a meeting extremely uncomfortable," says a former Amazonian. "That bellowing laugh? He would look at your spreadsheet and laugh you out of the room."

Ian Freed was lured into this culture to help Amazon think about wireless. Now a vice president running the Kindle division, Freed has been involved in telecommunications for more than 20 years, since his days studying at Harvard Kennedy School of Government. When he was hired, the idea for Kindle was being bandied around the halls at Amazon, but nothing had taken shape. "I was Jeff's TA when we first started talking about it," says Freed, referring to a program where a hand-chosen exec shadows the boss for as long as 18 months. "We discussed making it wireless, and that was the line for me. One of the dilemmas today is that, yes, you can get access to anything you really want - sometimes. But getting quality publications whenever and wherever really isn't easy."

It was a key insight. Kindle's display is truly impressive. It causes none of the eyestrain of an LCD screen and dispels the urge to print out a page. At first it seems strange to read long-form narratives electronically, but, as Bezos likes to say, it doesn't take long for readers to get so immersed in the content that they forget they're holding an electronic device. But the wireless connection makes Kindle superior to a traditional book in an important way.

Running on Sprint Nextel's high-speed data network, Kindle bridges the gap between the perpetual connectivity of a mobile phone and the sporadic connectivity - but superior form factor - of a laptop. There's no need to plug into a computer, the battery will last two weeks, and there are no connection fees. And buying a book is a snap. Freed considered slower connections, like a pager network or 2G, but ultimately determined that 60-second downloads would spur impulse purchases. See an interesting author speak on The Daily Show? You can start reading the book before the interview's over.

The plan has worked like a charm. For titles where a traditional paper and an electronic Kindle version are available, 35% of sales already come from downloads, Amazon says. That suggests not only that Kindle owners love their devices, but also that they're buying impetuously. And the wireless connectivity, which Amazon provides free to Kindle owners, has helped Amazon blaze ahead of its main competitor, Sony's Reader, which requires users to connect to a computer, like the iPod, to download books. (Other competition is coming from publishers such as Hearst and computing companies, including HP ([HPQ](#), [Fortune 500](#)). Apple is rumored to be mulling a reader too. Chances are they will all include some wireless connection.)

If the success of Apple's iTunes Store offers any guidance to Amazon's grand plan, it's that consumers will pay for content when the bar is set low enough. Sure, there's still plenty of piracy, but for many of us the ease of buying digital music has rendered file sharing a quaint anachronism, a past transgression stored away next to memories of that drug-fueled summer following sophomore year. Music and literature make good analogs because they're both consumed over long periods, and so it's no surprise that with a good enough reading experience, people would shift from paper to digital. But newspapers are consumed more fleetingly.

Skimmed. Recycled. Forgotten. What's more, the alternative to paying for newspaper content is to get it free, legally, on the web. And yet, as Freed and Bezos note, newspapers are selling well on Kindle, in no small part because of Amazon.com's seamless back-end billing and stealthy delivery. So there are signs of hope.

At the DX unveiling, the *Times* and the *Washington Post* both announced test programs in which they'll subsidize the cost of the device in exchange for long-term subscription commitments in parts of the country where delivery is not available. Arthur Sulzberger, chairman of the New York Times Co. ([NYT](#)), was on hand as part of the spectacle. "We've known for a decade that an e-reader product would offer the same satisfying experience as printed newspaper," he said. With "each new generation of Kindle, that dream continues to get closer to realization."

But Kindle subscriptions alone, no matter how long the term, will never save newspapers. The business is built on advertising, and as of yet there are no ads in Kindle editions. Look for that to change. "We want it to be a great customer experience if and when we introduce ads," says Freed. "If the ads were annoying, we'd take a step back."

That makes Amazon sound like a gatekeeper to the digital future - precisely the way Apple is in music. Newspapers may not be making enough from their websites to stave off disaster, but at least they have the control to try various models. "We have to be able to own our customers and deliver on our advertising promise," gripes a senior executive of one newspaper with a Kindle edition. "Amazon doesn't have the business model right yet."

Freed plays down the suggestion that he's in control. "It's much more collaborative than that," he says. "Our role is to listen and learn together. We have shown that consumers love the experience and they're willing to pay for it. Ultimately that's got to be good."

Advertisers are of course itching to infiltrate the space between Kindles and their devotee owners. "Our brands are meeting with e-readers. We're definitely excited to test models," says Kelly Twohig, executive vice president of Starcom, which works with Kellogg, Allstate, and Nintendo, among many others. "Anytime we're able to follow consumers, it's very promising."

Advertisers and publishers, especially magazine producers like Fortune's parent, Time Inc., are salivating over the prospect of a color-screen Kindle. (Fortune is available on Kindle and is in talks with Amazon to offer unique content on the device.) Display makers such as Plastic Logic say color is only a couple of years away. But Bezos says the technology is nowhere near ready. So what's next? The only hint he gives about his "10-year road map" comes in reaction to an observation that the wireless connectivity could foster interaction (think virtual book clubs) among Kindle owners. He calls the suggestion "very perceptive."

Wherever Kindle is headed, Bezos certainly seems excited about his renewed focus on bringing long-form narrative to the people. The strong-willed dotcom hero turned bona fide titan speaks about his un-gadget the way a President might hint at a legacy. "Humans record our history through writing," he says. "The Kindle team knows they're working on something really important. It's a team of missionaries."

Missionaries preaching to an industry that's dying to be saved.

REPORTER ASSOCIATE Jessica Shambora contributed to this article. ■

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PHOTO: ROBYN TWOMEY



COURTESY: AMAZON

Amazon's journey

Since its inception Amazon has consistently tried to enter new businesses. Here are its greatest hits (and misses).

1995: Amazon launches

Jeff Bezos ditches his finance gig to start a new company via the nascent web. The first office (above) is in Seattle. HIT

1997: Offers recommendations

Amazon analyzes purchases to make personalized suggestions to customers. HIT

1998: Adds music and video

DVDs and CDs are natural extensions of books; electronics and other fare soon follow. HIT

1999: Bids for auctions

Amazon Auctions, an effort to take on eBay, never gains traction. MISS

2001: Unveils Marketplace

Creates a venue for third parties to sell used books and CDs next to Amazon's new offerings.

HIT

2006: Opens Unbox

Bezos tries to get into the video-download business. He'll later try to develop a music-download business to rival Apple's iTunes Store. JURY OUT

2006: Gets on the cloud

Amazon announces Ec2, a "cloud" computing system that lets customers rent space on Amazon's servers. JURY OUT

2007: Releases Kindle

The first version of the lightweight e-reader is embraced by geeks and technophobes alike. HIT (SO FAR)



PHOTO: ROBYN TWOMEY

Ian Freed, Amazon's VP for Kindle, insisted on the wireless connectivity that enables impulse e-book buys.



COURTESY: AMAZON

Bezos with a teletype machine: He was wired even as a school-age boy.



PHOTO: YUNGHI KIM

Struggling publishing companies hope Bezos, shown at a media event announcing Kindle DX, can revive their industry by creating a new platform for news - and advertising.