

Research Paper: Big Six Publishers' Response to eBook Evolution

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Introduction

The recent price-fixing allegations brought by the Department of Justice against the Big Six publishers as well as Apple, Inc. represent a challenge to the historical management procedures of mainstream publishing. It is merely the latest round of changes the publishing world is facing since the founding of Amazon.com July 16, 1995. “Despite the economic recession, online retail in the U.S. grew 11% in 2009, according to a March 2010 report from Forrester Research. More than 150 million people — about two-thirds of all Internet users in the U.S. — bought something online last year.” (Webley, 2010) This shift in the buying public's purchase patterns — from in-person purchases at brick-and-mortar stores to online buys from retailers that were able to cater to the broadest range of interests — caught the Big Six off-guard.

In the early years of Amazon.com, publishers completely discounted the need to pay attention to an upstart company. “Eventually, a revolutionary change in culture and groupthink took place. Buying things online was all about price and selection, says Ellen Davis, a vice president with the National Retail Federation. If you lived in a small town with just one bookstore and they didn't stock the novel you wanted, the Internet was a solution.” (Webley, 2010) To catch up to a race the traditional publishers had ignored, then, executives were more than open to Apple Inc.'s offer to develop a new business practice of offering an “Agency Rate,” that would counter-act the deep discount, loss-leader offers Amazon had pioneered to end up with 90% of the eBook market. (Haq, 9/7/2012) Rather than innovate, traditional publishers decided to do stick with their past procedures.

Historical Perspective

The recent, rapid evolution in book reading away from just paper-based consumption to include eBook options has posed a challenge to an industry that has changed very little in 500 years. EBooks started out in the early 1970s with the establishment of Project Gutenberg, and the storage, retrieval, and searching of libraries' content. Libraries joined the fray in 1998 with NetLibrary, purchased in 2002 by OCLC, by expanding their offerings to include eBook options. It wasn't until 2001 that the major publishing companies finally took notice: "The publishers, at first frightened of the capabilities of the new medium in much the same way as the music industry was against the MP3, are now following the music industry's example in trying to better understand, and ultimately take advantage of, the new e-book formats. They have established online stores and partnered with e-reader manufacturers to establish themselves in the e-book market. Concurrently, electronics hardware manufacturers are working on dedicated e-book readers, also hoping to capitalize on the e-book movement." (ebookweek.com, 2012)

Even so, legacy publishers were reluctant to leave behind the monopolistic roots of their own business practices. "We can also look to the results of the legacy model: high book prices, most recently enforced via the so-called 'agency' model; 'windowing', whereby consumers who want cheaper paperback or digital versions are forced to wait until long after the release of the high-margin hardback; digital rights management regimes that annoy consumers and do little to inhibit piracy; increasingly draconian rights lock-ups in publishing contracts; lockstep digital royalties of only 17.5% for authors." (Eisler, 2012) The founder of Smashwords, an eBook self-publishing and distribution platform founded by Mark Coker in 2008, offers a harsher indictment

against traditional publishers, pointing out that traditionally published authors have historically earned as little as a 5% royalty on their hard work, giving them a very strong financial motivation to pursue an alternate path. (Coker, 3/4/2011)

Since non-mainstream publishers and manufacturers interested in expanding offerings to the digital cutting edge have focused on developing ever-more-flexible ways for consumers to access digital versions of the books available, use of eBook readers to consume the written word has increased. “The share of adults in the United States who own an e-book reader doubled to 12% in May 2011 from 6% in November 2010. E-readers, such as a Kindle or Nook, are portable devices designed to allow readers to download and read books and periodicals. This is the first time since the Pew Internet Project began measuring e-reader use in April 2009 that ownership of this device has reached double digits among U.S. adults.” (Purcell, 2011)

In the past year, eBooks have begun to assume primacy in a market filled with price-conscious consumers. “The eBook phenomenon continued in 2011 with eBooks ranking, for the first time, as the year’s #1 individual format for Adult Fiction; Children’s/Young Adult titles showed the strongest performance among categories; brick-and-mortar stores remain the biggest sales channel; and direct-to-consumer saw strong growth according to BookStats 2012, the most comprehensive annual survey of the size and scope of the US publishing industry.” (Sporkin, 2012)

In addition to the challenges brought by facing the realities of a new distribution option,

traditional publishers face issues in sustainability. “Arguably there are few industries more vulnerable in sustainable business terms than in book publishing. Here is an industry beset by rising costs, unrelenting competition (including that from non-industry sources), disrupted supply chains, value chains and business models and the inexorable double-sided presence of accelerating technological change.” (Tian and Martin, 2012)

Compounding their own problems, the Big Six also spend time pursuing authors in breach of the contracts they've signed. By way of such lawsuits, these agreements, including details about advances and potential earnings are coming to light. In a recent suit brought by Penguin Group against Ana Marie Cox, the publisher is seeking repayment of a debt of \$81,250.00 plus interest of not less than \$50,000.00, and attorney fees and whatever further relief the court may deem proper. (Penguin v. Cox, 2012) Other prominent writers are also being targeted, including Elizabeth Wurtzel, who signed a \$100,000 deal; Rebecca Mead, who signed a \$50,000 deal; Herman Rosenblat, who signed a \$40,000 deal, and Conrad Tillard, who signed an \$85,000 deal. (*The Smoking Gun*, 2012)

Commentary on this story points out that publishers build in clauses in their contracts that allow them to reject manuscripts for reasons other than purely editorial reasons, at which point the author is out the time and effort and stuck with a breach of contract lawsuit. Publishing law and copyright counsel Samuel Levine addresses the issue this way, “Both Federal and state courts have interpreted the unsatisfactory manuscript clause to allow publishers wide discretion to terminate contracts provided that the termination is made in good faith. Determination of the

publisher's good or bad faith is tricky. In a federal lawsuit for return of a \$350,000. advance paid by Random House the judge noted that "evaluations of editorial acceptability are based on the subjective judgment of the publisher" and "[what] in good faith may be acceptable to one publisher may be, in equal good faith, not acceptable to a different publisher." (By paying a large advance Random House had taken a calculated risk that the author's next work would be as commercially successful as his earlier books.). At the same time, to properly reject a manuscript the publisher must demonstrate that it did not "arbitrarily change its mind." There must be good reason other than a change of market conditions for the publisher's decision to terminate the contract." (Levine, 2012)

From the perspective of best-selling author Dean Wesley Smith, who has decided to eschew traditional publishing after having started his career in that venue, advances are loans. In response to his blog post on the topic, lawyer Marc Cabot replies with additional clarification regarding the nature of advances as loans, pointing out that loans are forgivable, and the publishers have the right to determine whether they forgive an advance or just hold it in abeyance. By accepting a forgiven loan, the author then faces the possibility of a tax issue, as having received either a payment or a gift. (Wesley Smith, 9/26/2012)

Additional "gotcha" clauses standard in publishing contracts include cross-collateralization, indemnification, out of print clauses, option clauses, missing date-of-print clauses, subsidiary rights clauses, and royalty clauses that can result in everything from missing payments to missing print date and broader use of the artist's work than originally intended. In

particular, the use of cross-collateralization to draw down advance payments for future works or royalty payments for past works is an accounting trick that has tripped up many an author. Royalty clauses are particularly sticky, as they are broken into performance in hardcover versus paperback versus deep discounted edition rates. Some even offer break points as more copies of the books are sold. In the end, in the clauses these lawyers have seen, the author's earnings range between 6% and 15% — neither end of which range allows for significant income at any timely manner. (Steven, 2006)

This system all but guarantees the need for legal representation as well as artistic representation (in the form of a literary agent) on the part of authors interested in pursuing an old-school style contract with one of the Big Six. These many representatives — including the search for them — have been a perennial source of trouble for authors. Authors are required to build trust with a team that is intended to watch out for their rights and best interests, but really only serve at their foundation as legal cover when dealing with overly large organizations who operate from a position of strength vis a vis a singular artist.

Another perspective on the topic of advances is offered by Fiona Inglis, managing director of literary agency Curtis Brown. “Advances were previously too high and weren’t earning out for publishers. Inglis thinks the lowering of advances may have corrected this balance. She estimates literary fiction — the type only sold in book stores, and likely to win critical praise but not commercial success — usually earn around \$10,000 in an advance, although sometimes it can be \$5000. ‘We’d like to think \$10,000 would be the minimum for our

authors,' said Inglis. Commercial fiction — the type sold in Big W and other discount department stores — would earn an even bigger advance for authors.” (Jamieson, 2012)

Price-Fixing

In response to consumer moves toward new and cheap offerings, the Big Six have responded by colluding among themselves to set an “Agency Rate,” (Brown, 2012). The evidence seems clear that the Big Six were keen on maximizing profits that were disappearing under Amazon's sales of eBooks as loss-leaders to generate additional interest in its line of Kindles. “One publisher’s CEO said, 'Our goal is to force Amazon to return to acceptable sales prices through the establishment of agency contracts in the USA. ... To succeed, our colleagues must know that we entered the fray and follow us.' The publishers also agreed with Apple to pay Apple a 30 percent commission for each e-book purchased through Apple’s iBookstore and promised, through a retail price-matching most favored nation (MFN) provision, that no other e-book retailer would sell an e-book title at a lower price than Apple.” (Guglielmo, 2012)

Not everyone sees the value in the anti-trust suit brought by the Department of Justice. “It’s devastating to bookstores,' executive director of the Authors Guild Paul Aiken told the *Wall Street Journal*. 'For two years the settling publishers must allow vendors to discount e-books at any price they want. The court acknowledges that this restores the status quo conditions before 2010, when Amazon was able to capture 90 percent of the e-book market. The Justice Department is reshaping the literary marketplace without submitting a single economic study to the court to justify its actions.’” (Haq, 9/7/2012) The irony of this position is that the Big Six

themselves represent a past monopoly that allowed for the development of author contracts and procedures that kept the majority of authors at what amounted to slave wages, unable to make a living off of their writing. In fact, it was acknowledged practice to be stingy with advances and royalties for non-celebrity authors to counter-act the reality that only very few books would eventually prove themselves in the marketplace and allow the publisher to not only recoup its investment but support the vast number of less-successful authors.

In fact, in approving the settlement agreement Simon & Schuster, Hachette, Penguin, Macmillan, and HarperCollins proposed in recognition of their collective actions geared toward forcing Amazon to stop offering discount prices on their books, federal judge Denise Cote noted, “Many complaints, she said, referred to Amazon's pricing of ebooks at \$9.99 as 'predatory', but she ruled that 'even if Amazon was engaged in predatory pricing, this is no excuse for unlawful price-fixing', and said that 'the familiar mantra regarding 'two wrongs' would seem to offer guidance in these circumstances!'.” (Flood, 2012)

The Big Six's insistence on standard contracts favoring their old models reflects an entrenched attitude against innovation. “It's a sad day for the Big Six — but not because they're in a bitter race to the bottom. It's sad because of their thinking. It reflects their pathetic victim mentality of 'cannot do.' These big publishers would rather close the doors and slash their staff than innovate in a changing market.” (Aizenstat, 2012)

Movement Toward Indie Publishing

At the intersection of a device and accessibility explosion and an economic crunch, eBooks have answered consumer demand for cost-effective entertainment. “Here in the U.S., most consumers already think twice before shelling out \$7.50, \$15.00 or \$30.00 for a good read. If a book at the current prices represents a big purchase for citizens of the world's most affluent economy, imagine the cost burden for the vast majority of the world's literate people. ... The publishing industry has successfully responded to the price issue in the past by releasing lower cost formats such as the mid-sized trade paperback and the small purse-sized mass market paperback. Each lower cost format dropped the price 30-50 percent.” (Coker, 10/7/2009)

Because of the market disruption the new eReaders offer, as well as the new distribution avenue available through programs such as those available at Smashwords, authors are in the new position of being able to decide whether to pursue traditional publishing or strike out on their own. “Self-published authors, aka 'indie authors,' now have the power to produce, publish, price and promote books that are as good or better than those put out by Big Publishing. Indie eBook authors earn royalties of 60-70% of the list price.” (Coker, 3/4/2011)

The opportunity to regain creative control, such that authors have final say over elements including the titles, covers, and final editorial review of their books represents the other side of the argument toward Indie publishing. “The power center in publishing will shift from publisher to author, and the traditional line between the two will continue to blur. Authors will become their own publishers. Commercial publishers will become service providers.” (Coker,

10/26/2009) These positive arguments supporting artistic choice don't even take into account the great legal difficulties they can avoid by not tying up time, money, and effort in gaining access to and then dealing with the complexities inherent in becoming a signed author of a large publishing house. The lost opportunity cost of those efforts alone offer additional income opportunities for the industrious author.

In fact, Coker's argument could point the way forward for Big Six publishers to get creative with their business model. These corporations have the history and experience of producing well-received books; if they could offer their editorial, distribution, and marketing expertise to authors in such a way that both sides could profit, the market would benefit from having well-produced creative products available at reasonable prices. Unfortunately, the very weight of these companies' historical practices argues against the possibility of a successful transition, “an environment that stimulates innovation includes three variables: the organization's structure, culture, and human resource practices.” (Robbins & Coulter, 2009, p271) By refusing to adjust their structures and cultures, Big Six publishers are trying to avoid the inevitable impact of the market-disrupting action brought on by the eBook evolution.

In the meantime, indie authors are back to the perennial question of how much to charge for their work to maintain their competitive edge against the Big Six as a cheap, good alternative for entertainment. “With all the big-world stuff going on, and readers being pushed to pay more, and constantly reading how \$9.99 is cheap for an eBook, what should indie publishers be pricing their electronic books at? Just slightly under that, of course. But not way under.” (Wesley Smith,

9/14/2012)

Indie authors face their own management challenges, as they are forced to address issues far outside the purview of a traditional artist: pricing decisions, marketing decisions, and financial management of their creative business. Few authors boast the breadth of skills necessary to manage the full scope of these responsibilities, so are being forced to create their own alliances and develop new processes to deal with the financial and legal issues that arise from operating as independent publishers.

Conclusion

The book-as-entertainment industry is in the middle of a revolution. EBooks offer authors an option to get their work in front of the public without having to jump through the traditional hoops of finding an agent, signing with a publisher, receiving an advance, and hoping their sales earn out their advances. However, as with any industry change, while there are great opportunities for indies to establish themselves as a viable alternative, they need to watch market trends and position themselves appropriately to maintain their credibility vis-a-vis their traditionally published counterparts. Both sides will need to continue to monitor market response to their offerings to support ongoing sales of books in any format as a cost-effective entertainment option.

The Department of Justice has now settled with three of the defendants in the anti-trust suit: Hachette Book Group (USA), HarperCollins Publishers L.L.C. and Simon & Schuster Inc.

The judge has approved the settlement, and, as Good E-Reader pointed out, “It is a savvy business move by HarperCollins to be the first company to reach a new agreement with many retailers. It may see increased sales in the time it takes other companies to iron out their own plans of action.” (Haq, 9/11/2012) However, this is only the first step in responding to the shifts in the marketplace. If the Big Six publishers fail to incorporate innovation in their future plans, they will be further backing themselves into an untenable corner.

Consumers, in the meantime, are stuck between two extremes: continue to purchase high-price books produced by traditional publishers, or take a chance on the very cheap options offered by indie publishers. In the first case, they are more likely to find well-edited and -produced materials, while in the latter case, they save their pocketbooks the pain of prices that are outsized against the cost of production.

The ultimate source of the work whose value is under debate, the authors, are also stuck between options. Either they continue to pursue traditional representation and publication, with all the known pitfalls those options represent, or they pursue indie publication, with the additional, unknown pitfalls in that path. By approaching the issue as a management problem, in which strategy underpins decisions, though, authors are in the position of being moved away from the purely artistic side of their fiction creations toward a more left-brained, bounded rationality. The more they are able to inform themselves regarding the pluses and minuses of each perspective, the more they are able to protect their own interests. It remains to be seen whether this business focus has a negative impact on the books eventually produced.

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