The Challenge to Consumer Book Discovery

United States

2010 to 2012

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I. U.S. Book Consumer Context

Among the U.S. adult (18+) population, 54% read at least one book in the last 12 months, while 46% read no books. Book reading in the United States is highly concentrated among 19% of adults, who read 12 more books a year, accounting for 79% of the books read, according the U.S. government's ongoing Survey of Public Participation in the Arts (2008; 2012 update scheduled for July 2013 release). In part due to this imbalance in book reading behavior, the U.S. ranked 12th among OECD countries in combined Reading Literacy, behind countries like Canada, Finland and Norway, based on Program for International Student Assessment (PISA) 2009 results. Based on extensive research and benchmarking work, Codex-Group believes this core group of 19% is also the foundation of the U.S. consumer book market. As a result the firm focuses all its primary research on those who have purchased at least 1 book in the past month to best capture current book consumer behavior. Demographically, this group of core book buyers is significantly higher educated, and more affluent than the average American, earning 40% more in annual pre-tax household income ($94.7K (May 2012) vs. $67.5K U.S average (2011)), making this group an extremely attractive business target.

II. New Book Discovery Background

Codex-Group's ongoing research into consumer book sales dynamics has statistically validated, through the firm's Triad Book Sales Forecasting Model, that new consumer book sales are the direct output of three factors—a new book's level of Discovery, Conversion and Availability performance. The absence of any one of the three factors in a book's publication dooms it to a minimal audience and minimal sales. As a result Book Discovery has become a high priority focus in U.S. book publishing, forced by the book retail trends of the last three years.

As recently as 2010, when Codex estimates that physical stores accounted for over 65% of book units sold—by far the leading engine of new book Discovery was physical stores, delivering a 31% share of discovery of books bought last by past month book buyers. This leading discovery source was of tremendous business value to book publishers because it was obtained at minimal added cost or effort simply through strong Availability performance (new book retail distribution and physical merchandising) in physical stores—no additional marketing or Discovery investment required!

Other major sources of new book discovery were Personal Recommendations (14%), Author Marketing (12%) and Analog Publicity (10%) (publicity through traditional media outlet news, reviews, interviews—in print, broadcast and online). At that time, with a 35% share of book unit sales, Internet Book Sellers contributed only a 6% share of Discovery.

III. New Digital Technology Impact

The book industry's historical dependence on print format books was first challenged in the early 2000's with the introduction of back-lit LCD screen book reading devices. Due to poor battery life, low resolution/high glare screens, and the limited access and range of new titles, none of these early digital book innovations were consumer accepted.

Next, the breakthrough of Electronic Paper Display (EPD) screen technology, delivered long battery life and easy to read reflective, high contrast screens, delivering a very consumer acceptable digital book reading interface for the first time. Initially introduced nationally by Sony in partnership with the now bankrupt Borders book store chain in 2006, Amazon followed 12 months later in late 2007 with the Kindle eReader. After 2 years EPD eReaders had captured 4.5% of past month book buyer households, with Amazon holding a dominant 70% market share of those households. eReader users both read and bought more books in total, and for every book buyer converted to buying a Kindle, Amazon's share of that consumer's book buying wallet more than tripled from an average of 12% to over 40% of that book buyers book unit purchases through Amazon. eBooks delivered 60% of those units, fostering tremendous Amazon brand loyalty in the process. Other branded eReader devices had similar, but far less dramatic brand loyalty and market share impact on

their owners' reading, buying and format preferences. EPD eReaders remained the dominant form of digital reading device through 2011. Without the eReader device the U.S. digital book revolution would not and could not have happened.

The third wave of digital book reading first introduced nationally in the U.S. in April 2010—the multi-purpose 'entertainment' tablet—Apple's iPad. With this massive global success from the world's biggest market cap. company, using DRM-protected content (music, book, app, video) as an essential purchase attraction for affluent consumers (iPad owner household income: $121K (May 2012))—the world's largest technology companies soon followed into this new digital book reading market (Google, Samsung, Microsoft, Amazon, Motorola, et al). From only 17% book buyer household penetration at the end of 2011, entertainment tablets will more than triple their book buyer household penetration in less than 18 months to as much as 60% penetration—by early 2013. As multi-purpose entertainment devices, book consumption on tablets is not only significantly lower in digital book hours read per week (2 hours on iPad vs. 5 hours on Kindle eReader), as a result not only is the % of digital books bought lower (32% tablet only owners, vs. 47% eReader only owners), the total number of overall book units bought is below average for these new digital book buyers (only 3.6 units bought vs. 4. 1 average),

Driven directly by these multiple waves of digital book technology, 59% of past month book buyers now read at least some digital books—but in contrast to music consumption, 97% of all past month book buyers still read analog (print) books. The reason behind this ongoing parallel format usage is that the hybrid format users do not see digital as a full replacement for print format, but view the two formats as complementary, with different, distinct uses for each. eBooks are for light, one-time, leisure reading—print books are for serious reading, sharing, repeat reading, and for learning. That format differentiation in combination with the transition from eReader to Tablet based eBook consumption, appears to have currently stalled the growth of the U.S. digital book market—the % of book buyers reading books digitally has not increased since May 2012, nor has the % of books bought in digital format increased since September. Digital book reading rates are also over 10 points lower among U.S. children age 3 to 12 than for their parents.

eBooks are available in three primary formats: 1) plain text eBooks—a direct monochrome copy of the print book, including black & white maps, photos, illustrations, design, etc., often from the same digital production file, readable on all digital devices, with the current majority having Digital Rights Management protection, ensuring device/platform brand loyalty; 2)"enhanced' eBooks—digital books with added color illustration, video, voice narration, games, word pronunciation, reading performance tracking, music, dynamic graphics, web links, or any other conceivable digital enrichments, not playable on eReaders; 3) digital book Apps—self-contained downloadable reading interface programs for mobile operating systems (Android, iOS, Windows 8, etc.) in either standalone book format or reading platform format (Kindle for Android, Storia for iPad, etc.) through which an entire digital book library can be accessed and 'played' on an open platform tablet, smartphone or other mobile device, through cloud stored and synched files, not operable on eReader devices.

As of December 2012, the unit share of digital books bought, based on retailer type purchased was 91% eBook, within that "illustrated or multimedia" eBooks were 19% of the total, with "enhanced eBooks" representing a minority of that amount due to their high production costs and very inconsistent consumer demand, and eBook's very heavy skew to fiction. The remaining 9% was digital "multimedia App" books. On a device consumption share basis 41% were bought for tablet, 38% for eReader, 13% for smartphone/mobile device, and 8% for computer consumption.

Forecast: The long anticipated transition to an all-digital book market appears to be stalling. Book consumers will continue to insist on books in both print and digital formats for the foreseeable future—with eBooks tending to entertainment (genre) fiction, and print books to more challenging literary fiction and nonfiction. However, due to intense competition from the global tech company elite, physical book stores will continue to lose market share to deep discounting online sellers even as demand for print books stabilizes, resulting in the further loss of book selling space, title diversity and discovery of serious new books—unless public policy is enacted to ensure an ongoing balance in the

retail book market. If major physical bookstores are economically forced to leave the market, new stores are highly unlikely to ever replace them given the high capital requirements of this business model.

IV. Impact of Digital Technology Competitors on Book Retailing

The strong brand/device/online bookseller loyalty created by ownership of a branded tablet or eReader, can result in significant ongoing additional content and retail sales if done effectively, with low switching rates (the razor and blade business model). Under this assumption of ongoing future revenue streams and a high return on investment, the major technology companies have invested billions in device, platform and content development with frequent upgrades and relaunches, supported by over $1.4 billion in measured advertising from 2010 through 2012. To acquire and hopefully own each household's device and future content sales loyalty, an important part of that investment has also funded deep discounts in eBook pricing, and also in print book pricing in Amazon's case.

To support the iPad's launch against both technology competitors and physical retail competitors, Codex understands that Apple issued an "eBook Agency Distribution Agreement", which had several notable features:
1) Publisher as Retailer Seller/Digital Merchant as Publisher's Agent—digital books sold via the Apple iBookstore and ALL other digital merchants would technically be retailed by the issuing publisher, with the merchant legally acting in the role of publisher's transfer agent, earning a 30% agent commission on each book sold, while the 'seller' retained 70% of the revenue.
2) Maximum Customer Pricing Formula—the selling price of all new release digital books was set based on a fixed print format price-to-maximum eBook format price schedule, comparable to a new book priced at $25.99 in hardcover having a maximum customer price of $12.99 in its eBook format, and had to sold at the very same consumer price through all selling 'agents'. While generating less revenue per book for publishers than the standard "wholesale pricing" model (which lets the retailer set the customer price), Agency Pricing protected the anchor price of what a new book was worth, to hopefully avoid the economic value erosion experienced by newspaper and magazine publishers through their aggressive (or lack of) digital pricing strategies, while standardizing retail pricing across all sellers.
3) Same Day Release—the eBook (low price format) edition of a new book was required to be released the same day as the print (premium format) edition. This action forced publishers to break a proven, 80+ year old, publishing revenue driver called "windowing", in which the low price edition is released many months after the premium edition, maximizing audience reach, unit sales and revenue. (The proven windowed release strategy remains a cornerstone of the film industry's revenue model, earning them record box office sales in 2 of the last 3 years). Same day release of both low price and premium price book formats dramatically reduced the need for book buyers to visit a bookstore or to buy a print edition to obtain the latest, hot bestseller—this has been devastating to physical sellers.

Aided first by Agency Pricing and now by deep online discount pricing, and further fueled by the transaction mobility of broadband and WiFi enabled eReader, tablet and smartphone devices—book buyers began to aggressively "showroom" books—discovering and browsing new books in physical stores, then buying them online at deep discounted prices. In September 2012 alone 29% of past month book buyers showroomed an average of 2.4 book units bought, with an average price savings of 20%—further decimating physical book seller revenue and business viability.

The combined effects of multi-billion dollar competitive technology investment, advertising, deep discount pricing, simultaneous co-release of eBook with Hardcover, and "showrooming" has resulted in major market share shifts to online (print and digital) sellers, including the 2011 closure of #2 bookstore chain, Borders, significant physical store selling space reallocation to non-book merchandise (toys, gifts, stationary, etc.) in chains, mass merchant and independent retailers, with as much as a 30% book unit share decline in stores from 2010 through December 2012.

The result —fewer new titles are now available to discover and buy in physical stores, fewer stores are selling books, and there is less book access for the less affluent book buyer (Kindle eBook buyers have 1/3rd higher household income that

Walmart book buyers, May 2012) who either can't afford a digital reader, or who don't buy books often enough to justify the purchase.

V. Digital Competitor Impact on Book Discovery

Because of the skew of eBook reader preference to light, single read, entertainment book categories (Genre Fiction: Romance, Thriller, etc.) fully 50% of eBookseller unit sales in December 2012 were in "Genre" fiction, while only 21% were in Nonfiction. By contrast, and consistent with print book buyers preference for more serious, challenge, educational book categories (Literary Fiction, History, Biography, etc.), only 31% of physical store unit sales were in Genre Fiction, while 42% were in nonfiction. As a result, the more eBook store market share increases and the more physical store market share declines—the fewer new titles book buyers are exposed to, able to discover, and purchase—the less support there is for serious published works, which require the greatest amount of author research, investigation, time, effort and cost to deliver.

On a book category trend basis, in June 2010 33% of Literary Fiction titles bought last were discovered in a physical store, but only 5% from internet book sellers. By December 2012 that physical store discovery share had dropped by nearly half to only 18%, but the internet book sellers only contributed 6% of Literary Fiction discovery. The trend is the same for Narrative Nonfiction (History, Biography) where physical store discovery share dropped from 35% to 18%, while internet bookseller discovery also declined, from 7% to 6%. Surprisingly those same, skewed discovery trends also occurred for Genre Fiction categories. While Codex estimates that combined online book seller unit share (print and eBook) has risen to as much as 60%, the online bookseller channel still only delivers7% of the discovery of books bought last. In short physical stores are subsidizing the sales of online sellers because of the very strong pricing incentive to 'showroom', delivering far more than their share of discovery, without an equal return in revenue.

By default more and more books are now simply discovered through random, face-to-face word of mouth. The issue here is that 95% of personally recommended titles were older titles—published a minimum of 6 months ago, further reducing the opportunity for newly published works of new ideas and new thinking to find a buying audience. This default trend will continue as long as physical book retailing is not actively protected to ensure the business model's viability in the face of unprecedented competition from the largest, best funded, most competitive, global technology companies, who see books largely as a lure to affluent consumers, providing added "stickiness" and ongoing content revenue for their branded device platforms, thereby maximizing "long term customer value".

VI. Conclusion

For a country like the United States, already at a lower reading literacy level than many of its first world competitors (South Korea, Shanghai, Singapore, Japan, Australia, Finland, Canada, Norway, et al)—or for any country competing in the global knowledge-based economy—a decline in both new book discovery and book availability channels like physical retail, particularly among less affluent, less educated adults and children—can only result in further reduced literacy—and thus a diminished long term economic, and cultural, future.

METHODOLOGY

Codex-Group is a book audience research firm based in New York City, exclusively focused on measuring and tracking trends in consumer book consumption behavior. Founded in 2004, the firm has interviewed over ¼ million past month consumer book buyers since the dawn of the current U.S. digital book market in 2006. In addition to ongoing custom research in both the U.S. and U.K., the firm tracks book buying behavior on a regular quarterly cycle, and through the Book Preview online book buyer survey, interviews a minimum of 5,000 book buying adults each cycle. The firm also provides ongoing tracking research on the U.S. children's (3 to 12) book market.

Data from this report are primarily from the June 2010 (n=), and December 2012 (n=), further informed by firm's overall Book Preview tracking study database and findings, and work with leading U.S. book retailers and trade publishers.