

Do Readers Dream of Electronic Books?

Reshaping the publishing industry amid the e-book revolution



Amazon has the Kindle, Apple the iPad, Sony the Reader and Barnes & Noble the Nook. The race is on as an e-reader phenomenon that began in the United States is ready to spread to Europe and beyond. More players are fighting for more customers in an ever-growing electronic book market, and within 10 years e-books could represent up to 20 percent of the total book market. The question is: What impact will e-books have on the global publishing industry?

The e-book revolution has begun, capturing consumers' imaginations and pocketbooks. More people today are downloading e-books, a trend that will only accelerate in the next decade and undoubtedly change the publishing value chain. Core industry participants—printing companies, distributors and book retailers—will find it difficult to adapt. While some existing players and newcomers to the market—publishers, authors, telecommunications operators and device manufacturers—will find this an ideal time to capitalize on the opportunities.

In this paper, we analyze the evolution of the e-book market, the main factors around its growth, recent trends in the United States and Europe, and the changing structure of the publishing value chain. Our goal is to answer a larger question: What should the publishing industry expect and how should they prepare?

A World of E-Books, Finally

After years of false starts, e-books finally took off in the United States. While the overall publishing

market has constricted slightly, e-book sales in the trade sector have grown five-fold in three years, to \$165 million in 2009, or roughly 1.3 percent of the market, according to the International Digital Publishing Forum. It could reach 20 percent penetration within seven years (*see sidebar: What Took So Long for E-Books? on page 2*).

U.S. e-book penetration differs by segment and target sector. Within the non-trade sector, which includes educational, reference, technical and scientific books, e-book penetration is near 30 percent and rising, thanks to their easy access (from university workstations), search options (dictionaries and research papers) and storage capacity (educational books and technical manuals).

The real revolution, however, is occurring in the trade sector. E-book sales increased 213 percent year-over-year from 2008 to 2009, and while penetration and market value remain low, future growth forecasts are high and growing.

How e-books will affect the overall publishing market is hotly debated. Some believe an overall decrease in market value is logical, since e-books

generally cost about half the price of paper books. Conversely, Amazon has asserted that e-readers such as the Kindle are not cannibalizing hard-copy sales; it says that Kindle owners are reading more than they would otherwise because of the convenience of buying new books, and that

effect is a limited decrease in market size and a significant shift in customer mix.

The supporting devices used for e-books offer relevant insights as well. According to the Association of American Publishers, e-readers account for about 40 percent of total downloads of e-books; iPods, iPhones and mp3 players account for another 20 percent; and personal computers represent the remaining 40 percent. Further analysis suggests that most downloads to PCs are not comparable with e-reader downloads, as they relate mainly to non-trade books (such as technical manuals), or products that are eventually transferred to e-readers or mobile devices.¹

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e-books are in fact increasing overall revenues. We have analyzed recent sales data and believe the reality is somewhere in between: Between 30 and 40 percent of e-book sales represent incremental gains in consumption, while the remainder is a cannibalization of paper books. The compound

Future Scenarios in Europe

Based on the current experience in the U.S. market and taking into account lessons learned from other sectors, we believe the e-reader market in Europe will be shaped by the following factors:

What Took So Long for E-Books?

E-books are not new—they have received considerable attention since the 1990s, when industry observers projected they would replace paper books in a very short time. However, it took a decade for sales to take off. What happened this time around? Why are e-books suddenly popular?

A new generation of e-readers.

New devices have technology that

allows for a more enjoyable, user-friendly experience—such as paper-like reading.

Supporting devices. Digital books can be read on e-readers, but they can also go on laptops and mobile devices that have wider reach.

Consumer attitude. People are more accustomed than they were 10 years ago to purchasing products

and services online, such as music and tickets.

“Digital” environment. Digital books are easier than ever to obtain—both new and old, such as through the digitization of out-of-copyright publications from Google Books.

¹ For further details on the e-reader, see “The E-Reader (R)evolution,” at www.atkearney.com.

Enhanced technology devices. The devices of the future will be colorful and fashionable while also maintaining flexible hardware, animation and competitive prices.

Product availability. Consumers will have increasing choices over pricing and the breadth of the e-book catalog.

Improved content. Multimedia convergence and the use of “apps” is destined to grow, rendering the e-reading experience closer to that of printed books.

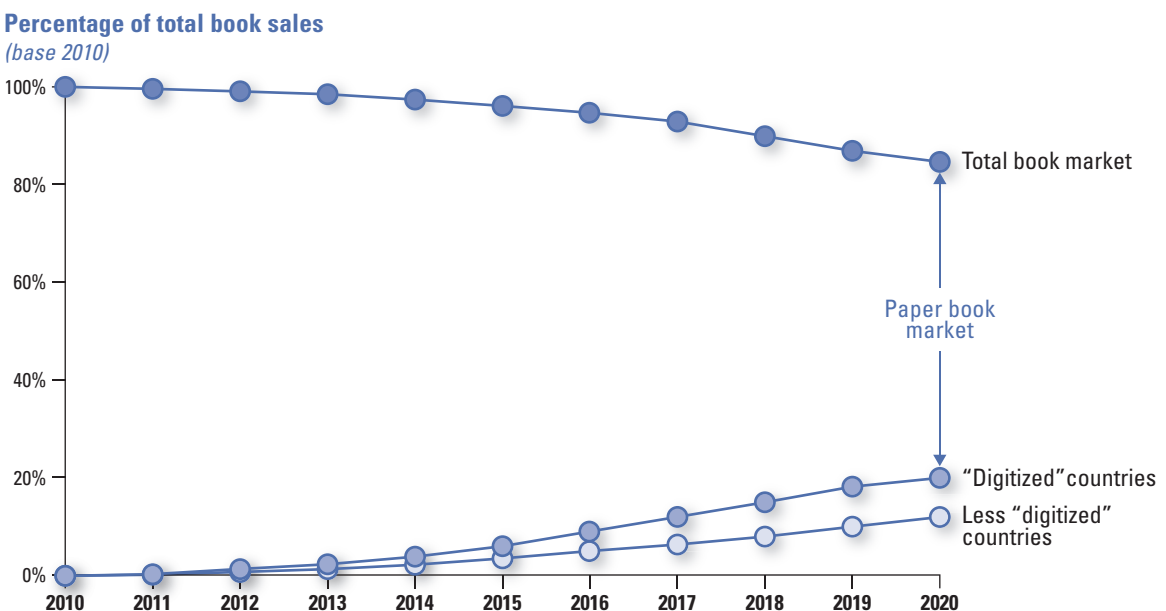
Editors’ attitude or resistance. Particularly in non-English speaking countries, some within the industry are resisting the move to new media.

Presence and power of major international players. Amazon and Apple’s popular designs and early presence in the market will give them the early advantage.

Technical proficiency. A cultural “digitization” will increase the number of people using e-readers, and those who can adopt them for personal use easily.

We see two different patterns for how these factors will increase the penetration of e-books, based on the country. On one side, more “digitized” countries, similar to the United States in terms of digital friendliness with a direct presence of Web portals such as Amazon, will adopt the new technologies early. These countries include the United Kingdom, Germany and those in Scandinavia—places where we expect digital books to reach 20 percent share in 10 years. On the other side, less digitized countries such as Italy, Spain, Greece and those in Eastern Europe have gaps in one or more of the main factors, and will likely reach only 10 percent penetration by 2020 (see figure 1).

Figure 1
As total book sales dip, e-book sales will rise

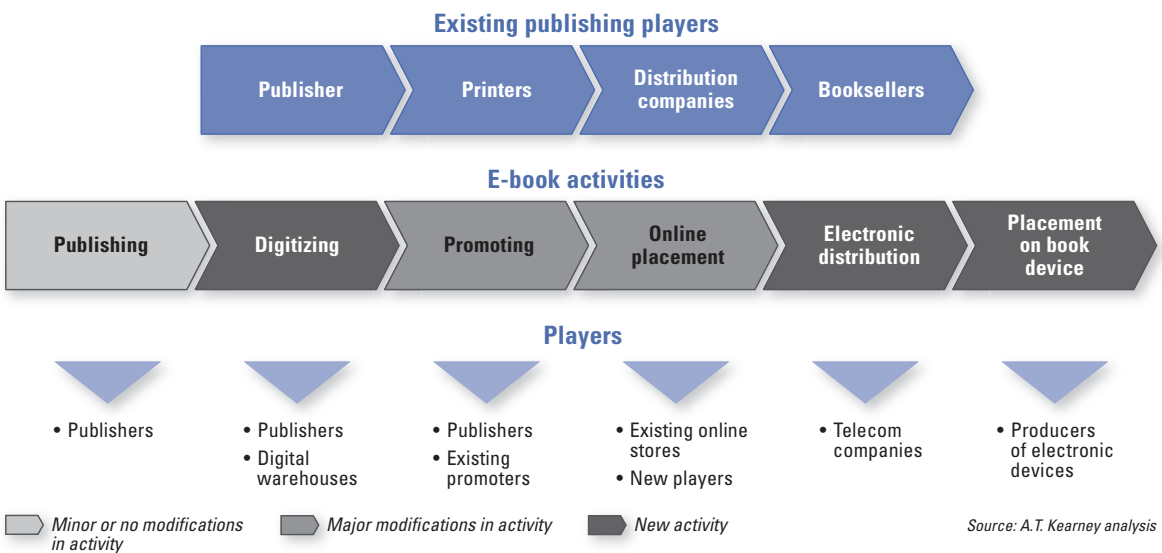


Note: Excludes non-trade books

Source: A.T. Kearney analysis

Figure 2

E-books will usher in new activities and players in the publishing value chain



Overall, we expect the value of the publishing market to decrease by 10 to 15 percent in the next 10 years. Price cuts (in terms of e-books versus hardcover) and illegal downloads will have limited impact, as we assume the main players—particularly Amazon and Apple—successfully battle piracy, adopt the lessons from the online music market, and create the right thresholds for pricing (see sidebar: *Lessons Learned from Other Digital Revolutions*).

Implications for the Old-Timers

The introduction of e-books is reshaping the publishing value chain for the publishers, printing companies, distributors and book retailers that have anchored the industry for years. How is the balance of power shifting for these existing players (see figure 2)?

Publishers. E-book publishers receive about \$4 to \$5 per e-book, according to recent pricing

structures from Apple and Amazon—quite similar to what they receive for a hard copy. While competition may eventually drive prices down, there is still a significant opportunity to increase revenues and margins through a clear multimedia strategy that can succeed in many different channels, new and old. In light of the uncertainty and the strength of new players, publishers might want to take an asset-light approach, avoiding big investments in IT systems to focus instead on content development and generating additional demand.

Perhaps the most relevant threat to publishers is if new technology allows authors to sell digital rights directly to online stores. The most likely areas where this will happen are on opposite ends of the spectrum. Newcomers that are usually filtered out by traditional publishers could find greater ease of publishing. Meanwhile, big-name, blockbuster authors could go out on their own—

Stephen R. Covey and Stephen King have already done this with exclusive Kindle arrangements.

Printers. Clearly, e-book growth brings more threats than opportunities for printing companies. E-book growth will drive down volume sales, essential for countering the costs of large, expensive printing machines. In the short run, these

players will need to focus on the sub-segments that are still not typically digital, such as illustrated books, or on countries where digitization is coming slowly.

Long term, they must prepare for a future in which digital books become more widespread. In particular, printing companies should

Lessons Learned from Other Digital Revolutions

E-books arrived late to the digitization party—after music, photography and video had already gone through massive changes (*see figure*). Let's examine the lessons these markets can teach us.

Music. Digital music entered the mainstream in 1999 with Napster, whose peer-to-peer technology allowed users to share mp3 files. Although Napster was eventually forced to shut down, many other operators have offered similar services to online customers, both illegally using peer-to-peer technology

and legally by charging for downloads. In the United States, digital music accounted for more than 40 percent of the music market, thanks largely to Apple's explosively popular iPod. However, because of piracy, falling prices and competition from other entertainment, the overall music market is nowhere near what it used to be.

Photography. Digital cameras gained mass-market steam in the mid-1990s and eventually ushered in a radical change in photography. Usage increased steeply in the

mid-2000s as prices and quality improved. By 2006, digital pictures accounted for 60 percent of photos; in 2010 penetration is expected to be more than 90 percent.

Video. File downloading remains limited in this sector, which includes DVDs and VHS, with market share only reaching 10 percent. Technological constraints influencing download time and quality have slowed this market, but the recent growth of online rentals through Netflix means this may be changing.

Figure: What can e-books learn from other digital revolutions?

	Key lessons learned	Possible implications for e-books
Music	<ul style="list-style-type: none"> • 10 years after Napster, the music market lost marketshare mainly due to piracy and falling prices • Digital music rose, fostered by online stores and the iPod as a fashion item 	<ul style="list-style-type: none"> • Increases piracy and further reduces prices • Improves e-book sales as online stores, e-readers and multipurpose devices gain steam
Photography	<ul style="list-style-type: none"> • Digital photo penetration rose as camera prices fell and quality of pictures improved • Switch is almost complete, but many still prefer to print their pictures 	<ul style="list-style-type: none"> • Boosts e-book market growth as e-reader prices fall and device quality improves • Considers offering print-on-demand services (after analyzing customer reasoning behind printing of digital photos)
Video	<ul style="list-style-type: none"> • Digital penetration in the video sector is limited due to technology constraints and poor quality of streaming 	<ul style="list-style-type: none"> • Damages e-book sales due to current technology constraints (for example, backlit screen, trouble reading in sunlight)

Source: A.T. Kearney analysis

focus on making their businesses more sustainable by expanding their offerings to include next-generation, cost-effective digital printing. This is already taking place in some countries, where some printers have become digital warehouses for small publishers—one-stop shops for printing, digitizing, distributing and promoting books for publishers not large enough to do it on their own.

Distribution companies. E-book proliferation will affect distributors more than printers, yet even in the most aggressive scenarios, there remain significant opportunities to consolidate the market

Retail booksellers can mitigate the impact of e-books with a multi-channel strategy that includes e-books in their online sales portfolio.

profitably by restructuring operations, rethinking service offerings, reducing costs and managing the customer base better. The leaders can succeed while broadening their services and offerings through efficiency improvements, including optimized logistics networks and redesigned internal processes. New services could include new digital printing, digital warehouses, promotion and advertising on the e-market, and distributing other product categories.

Booksellers. Traditional booksellers will be most affected by e-book growth. Even if we estimate that about 30 to 40 percent of e-book sales will lead to new revenues, the remaining amount

will likely cannibalize existing sales. Lower prices may force book retailers to provide more discounts and promotions, which would affect all book shops from independent dealers to major chains. The larger chains can mitigate the impact by adopting a multi-channel strategy that includes e-books in their online selling portfolio.

What About the Newcomers?

While facing incredible growth opportunities, the newer players in this e-book market face some threats. Let's look at their prospects.

Telecommunications companies.

Telecom companies face some impact on their revenues from increased data flow over their networks. Major revenue changes could come from offering more services to existing customers, and by assuming the role of technology and data provider. A market flush with small publishers coupled with the complexity of managing and updating large product databases could make these firms excellent partners for large book retailers.

Media companies.

Convergence is the name of the game for media companies. E-book devices' expansion into different areas along the value chain could result in downward integration, such as bundled offers that combine devices, content and platforms.

Device manufacturers. Amazon and Apple dominate the market for now, leaving limited opportunities for other manufacturers in some markets. The top opportunity may be in partnering with local book retailers to accelerate market entry. We expect the market to split in two ways: branded devices that continually launch innovative and multi-purpose products, and cheaper products that use open formats that can be easily

personalized by major e-retailers. There is little space in between for positioning, so the leaders will be those that define and pursue a clear and profitable strategy.

Rock, Paper, Scissors

Two major imperatives await current industry players. First, they must pursue industry development, exploring innovation and new business paradigms without a defensive approach. New players will arrive and easily adopt innovative concepts to take the lead. Second, they must

strive for operational excellence, with a radical approach to improving efficiencies and offering more tailored services.

While e-books grow in prominence and profitability, paper books will likely continue to dominate. As the two formats coexist, leading companies will develop, distribute and sell new multimedia content and formats that account for the value that hard copies can still generate.

In the years ahead, continuous improvement will not be enough as this industry prepares for a step-change transformation.

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