THE ASSOCIATION FOR CHRISTIAN RETAIL
SINCE 1950

9240 Explorer Drive, Suite 200, Colorado Springs, CO 80920 USA
toll free – 800.252.1950 direct – 719.265.9895 fax – 719.272.3510
www.cbaonline.org / www.christianstores.org

White Paper

Christian Retail Channel e-Book Status

An exploration into the rise of e-books

By Curtis Riskey, CBA Executive Director
Michael Regennitter, CBA Director of Membership
Eric Grimm, CBA Manager of Strategic Partnerships

July 2011

Contents

Executive Summary

A yearlong exploration into e-books and Christian retail stores began with a CBA-hosted "Digital Summit" and helped drive industry dialog on a critical marketplace challenge.

Problem Statement

Consumer acceptance of e-books is increasing and shifting book sales away from brick-and-mortar stores.

Continuing Challenges

Multiple retailer and publisher challenges affect development of a cooperative digital-delivery solution.

Summary and Conclusion

Presently, no viable cooperative solutions have been identified. Key challenges are high start-up costs, limited foreseeable return on investment, perceived high risks in a cooperative program, and the inability of technology providers to broadly meet critical requirements. Additionally, there have been recent introductions of small-scale technology solutions within the industry. Therefore, the retailer group concluded a broad-based, cooperative industry e-book platform is not feasible at this time. However, retailers should pursue individual solutions through available technologies.

Executive Summary

Christian stores need a way to sustain established relationships with their customers and build new relationships that meet changing customer expectations in a new business environment that includes marketing, selling, and delivering e-book content. Rapid development of multiple e-reader device technologies, the mobile revolution, changes in the publishing business model including more author control over content, emerging self-publishing options, and other factors may disintermediate brick-and-mortar stores threatening business viability.

It is difficult for independent retailers to fund and support digital-content distribution because of high up-front technology costs, pricing pressures from Internet-only retailers, limited economic return, and other financial and marketing factors.

CBA opened industry dialog on the concerns last year and hosted a "Digital Summit" with leading retailer and publisher representatives to discuss the challenges. CBA was asked to explore whether a cooperative industry platform could be developed that would enable Christian stores to deliver e-books to customers. CBA developed a work plan and organized a retailer task force to review and assess the issue.

A needs analysis and review of possible technology platforms identified critical areas that would enable such a cooperative initiative:

1. The individual Christian-store brand must be maintained through any online e-book transaction.
2. Each store must "own" its customers, meaning the platform provider could not market to or compete for the retailer's customers.
3. A Christian community built around the platform would enable online social interaction and would serve to differentiate Christian stores and content from competing Internet-only or other competitors.
4. A significant investment in marketing the digital capability would be needed to drive traffic and sales.

Presently, no viable cooperative solutions have been identified. Key challenges are high start-up costs, limited foreseeable return on investment, perceived high risks in a cooperative program, and the inability of technology providers to broadly meet critical requirements. Additionally, there have been recent introductions of small-scale technology solutions within the industry. Therefore, the retailer group concluded a broad-based, cooperative industry e-book platform is not feasible at this time. Retailers should pursue individual solutions through available technologies.

Problem Statement

Product Challenges

Consumer acceptance of e-books and e-readers increasingly will challenge brick-and-mortar book sales unless stores have a way to sell and distribute digital content as part of their value proposition to customers or offset the challenge with in-store service and experience. The transition to e-books will be progressive over time. However, e-books likely will not be the only content format, as the printed-book format will continue to enjoy consumer acceptance and demand for many years. The challenge is balancing sales and profitability as digital formats become more widely accepted and represent a greater proportion of overall publishing sales.

Current estimates reported by publishing-industry media show e-book sales ranging from 4.4% of publisher sales to as high as 22% of publisher sales. The range is driven by publisher type, with fiction publishers reporting higher e-book sales rates than other genres.

The Association of American Publishers reported for the year ended April 30 that U.S. e-book sales were up 163% to $313 million, while adult hard-cover book sales declined 19% to $300 million. The statistics represent only 16 New York publishing houses that report sales and sell-in statistics to AAP.

Total e-book sales currently are estimated to be less than 10% of all book sales.

Strategic Retail Challenges

Christian-store retailers generally have two strategic options, and they were divided into two operational camps: independents and large chains.

Large Chains: These companies generally have the wherewithal to develop e-book delivery capability on their own and declined to participate in an industry cooperative initiative.

Independents and small chains: These retailers are most vulnerable to e-book challenges and threats to business viability because of lost sales. However, there was general uncertainty among them about the potential success of a cooperative platform because of little margin to appropriately market and support such capability. These retailers were divided primarily by two strategic options:

1. Do nothing
   - These retailers seek to create or continue strong in-store experiences and customer and church relationships that don't require digital-product delivery. Investment in digital-delivery technology may be futile, was a concern, and they believe printed books will always remain an option for many consumers. A number of large, successful bookstores do not have an Internet presence or online multichannel strategies.
2. Do something
   - These retailers believe the ability to serve existing customers with e-book capability is needed for continued growth and are looking for a solution. However, the

technology investment and operational requirements without a viable margin or eventual ROI makes deploying such a solution unlikely because of great uncertainty and financial risk.

Market Structure Challenges

The e-book market transition is highly volatile, especially in the technology necessary to deliver digital content. It is apparent, through, that a "both/and" strategy is needed to sustain a viable marketplace transition — meaning both digital- and printed-format.

Since consumers drive marketplace transitions, it must be considered that a segment of them will only read digital content, a segment will read both digital and printed content, and a segment will never read digital content.

The music industry's digital transition demonstrated that stores do matter in adding value to content and serving those consumer segments that will continue to purchase physical products. Stores add value both from the perspective of customer discovery and from the ability to curate product to specific customer taste and preference through the in-store experience. The in-store experience supported by multichannel customer engagement is the ideal transitional model. It serves many customers how they want to be served. The in-store experience is about how customers are reflected in the store and how they reflect the store. The online experience is mostly about research, convenience, and quick access. Many Christian-store retailers have reported customers asking to purchase e-books through the Christian store because they want to support the store.

According to Pubtrack Consumer, active Christians, those who regularly attend church and are active in church activities, buy books – especially print books. These core Christian-store customers represent a significant purchasing block. While these customers likely also will buy or are buying e-books, most will continue to want printed books, too, purchased for personal reading or as gifts.

The reality of the e-book marketplace transition is that despite new ways of delivering content, many consumers continue to like and shop in stores, especially those stores that reflect personal lifestyles, values, or felt need for transformation (knowledge, expertise, or personal growth). Consumer research reveals product awareness and recommendations that lead to purchasing decisions occur in stores at a high level, particularly among core Christian-store consumers (Active and Professing Christians). Printed-product formats will continue to have longevity because of consumer demand and preference, even if at a reduced rate.

Predatory pricing strategies by Internet-only retailers and free content or very-low-cost content have driven much e-book growth. Additionally, authors experimenting with self-publishing and Internet distribution are disintermediating publishers and retailers. Authors are capturing margin without traditional publisher editorial and marketing support or a retail distribution network.

While e-book sales are rapidly growing, a strong network of retail outlets is required to capture consumer segments that don't want to purchase e-books, purchase them at less frequency, or purchase both e-books and printed books. This store network is also a powerful component to discover and launch new voices. Ironically, its reduction or demise may actually contribute to declining overall publishing sales or profitability because customers who shop in stores can't find titles they want or can't learn about new titles they likely would purchase.

This store network also helps offset the dominance of technology providers, as devices become commoditized rather than the content. For example, *The Wall Street Journal* reported June 22, 2011[1], that Barnes & Noble now controls about 27% of the e-book market – taking share from Amazon.com and Apple – after opening its e-book store in June 2009. E-books are reportedly outselling print books on the retailer's website three to one, and the company attributed e-book sales as contributing to its 0.7% growth for the year. Gross profit for the e-commerce business (which includes digital content) increased nearly 8%, though, and gross margins were reported at 8.8%. However, the cost of technology development and launching of its e-book device, The Nook, along with operations costs still plague Barnes & Noble, which reported a $59.4 million lost for the quarter ended April 30, 2011.

Barnes & Noble now controls about 27% of the e-book market – taking share from Amazon.com and Apple – after opening its e-book store in June 2009.

In the Christian channel, technology providers are attempting to enter the marketplace on a retailer level, such as Innovative (Signature Websites) and Integra Interactive. These solutions have not been endorsed by CBA or specifically recommended by the retailer task force at this time.

CBA and the retailer task force reviewed approximately 16 e-book delivery solutions and nine proposals. Through a series of webinar presentations, the candidates were narrowed to a few.

Among solutions reviewed were OverDrive, Ingram Digital Content Group, Copia, Google Editions, the Nook, Kobo, Novo Ink, Libre Digital, and several existing and start-up platforms or delivery mechanisms. Challenges for most of these solutions involve co-ownership of customers, lack of appropriate customer service or experience, technical complexity, or development investment.

Continuing Challenges

Retailers

Consumers are experimenting with many technology options, and options are changing rapidly as new devices come to market. Developing a cooperative approach to a common platform must balance the extraordinary investment necessary to enable content delivery

---

[1] Barnes Digital Plan Pays Off, But Its Cost Broadens Loss, WSJonline.com
http://online.wsj.com/article/SB10001424052702303936704576399480605532442.html?KEYWORDS=e-book

without knowing what consumers will ultimately prefer. New devices are constantly being introduced and upgraded that could change how content is delivered, including e-readers (Nook, Kindle, etc.), tablets (iPads and multiple competitors coming on the market), and mobile devices (iPhones, Android devices, etc.).

The complexity of offerings is resulting in consumer experimentation with devices, driven by convenience, access and cost, while fanatical loyalty to specific brands (e.g., Apple, Amazon) also drives early adopters. Consumers have expressed a need to access content wherever they are with as few devices as possible – using a reader device, but also being able to access and synch content through a mobile device to read on demand. Today, nearly half of readers read on their home computers, not reading devices. That is changing as new devices come to market. However, understanding which devices or how readers actually will access content is still developing and is not totally understood primarily because readers continue experimenting with new options.

Relatively few titles are formatted for e-book delivery. No solid numbers are available, but an estimated 10,000 Christian titles are available in digital format. This makes it difficult to analyze demand and sales projections that would support investment alternatives. Most publishers are releasing or plan to release new titles in digital format. Some titles may release only in digital format as a market test, some may be bundled in print/digital packages.

Two strategies emerged in the task-force investigation, a Web-driven strategy based on developing a common platform, and a device-driven strategy, based on selling devices and earning commissions on purchases made through them.

The cost of developing a website solution is prohibitive, requiring extensive programing development to build individually branded retailer access to a content library, e-commerce services, and e-reader software. None of the options explored offered a cohesive social or community capability along with a powerful content-delivery capability.

The device-driven strategy is based on a "perpetual customer" concept. Retailers would sell devices (by individual retailers, groups, or the industry) and all digital content sold through the device would earn selling retailers sales commissions.

This solution is built on having a central digital-delivery engine that could be updated technologically and with new content that would be distributed through the device, avoiding the complexity of hosting and maintaining individualized storefronts.

Primary costs would be device purchase for resale and transaction costs. Margins in this era of device-driven customer acquisition strategies (as practiced by Amazon, Apple, Kobo, and major big-box retailers) would be minimal. Low-price strategies are designed to get technology into the readers' hands to begin the content-purchase cycle (like buying cheap razors and expensive razor blades).

Key strategic concerns were aggregating enough volume for device purchase, device fatigue (waning consumer interest in specific technologies), devices would need to be upgraded regularly creating competition on features, the continual consumer cost of upgrades and new devices, and inventory costs for retailers.

Publishers

Publishers also are squeezed by technology-development costs in a highly competitive environment against also trying to maintain sales for traditionally delivered content to pay for it all. Digital transitions have not been as valuable for content providers as for technology providers because of consumer expectations that anything online should be free, low cost, or cheaper. Publishers face similar ROI challenges in digital delivery as retailers, with many seeing technology development as a long-term investment. While the agency model attempts to help publishers set pricing and protect margins, this doesn't answer all concerns or cover all costs, and it leaves no or little retailer margin or profitability. Additionally, the U.S. Justice Department is reviewing the practice as possibly unfriendly to consumers, and class-action litigation has been filed challenging publisher retail-price setting.

Several publishers have stated publicly they are in trial-and-error mode when it comes to finding workable e-book models. While some are developing strong direct-to-consumer strategies, many also recognize the value of store networks to reach all customers. Without intentional channel-management strategies, direct-to-consumer strategies bypass stores. An e-book-only strategy might constrain overall publishing sales because customers who still want to buy printed books will have fewer places to buy from, and selling to a consumer segment that only buys digital and online content would become saturated with non-profitable sales. This could mean eventually higher prices for digital content and monopolistic dominance and price control by technology providers at the expense of traditional content creators and producers.

Publishers are very concerned about Digital Rights Management and piracy, which also were major issues in the digital-music transition. Cloud computing might avoid DRM issues. Content would be stored securely on the Internet and readers would access content via password-protected access and devices. This also would simplify synchronizing content across multiple consumer-owned devices.

Publishers also must contend with competition from authors themselves who self-publish and disintermediate retailers and publishers. The technology is reshaping royalty and digital rights negotiations for publishers and authors, as some top-selling authors with resources and time are moving to take all margins.

The highly publicized June 2011 launch of J.K. Rowling's Pottermore website to sell Harry Potter e-books directly to fans is a high-profile example. Observers say the development won't have great impact on publishing because it's driven by the power of the author's brand, and that it is unusual she owned digital rights on the mega-selling series published before digital rights were part of author/publisher negotiations. However, many new self-published authors are finding their own reader base and selling direct to readers via their own websites, Amazon.com, or other retail sites. There are reported cases of authors selling 99-cent titles and generating volumes of 15,000 units.

Digital content is envisioned as becoming very robust with integrated video, audio, graphics, etc. Publishers, though, recognize reading is an "immersive" experience, and in some cases enhanced media may distract readers. However, enhanced media could create new markets as authors and artists develop content especially for this experience.

Retailers are asking publishers to assess current practices and determine if there might be new ways to innovate publishing business models essentially unchanged from a century ago. New business models might include scan-based trading (consignment), non-returnable product, and closer retailer-publisher relations that lead to new strategies or systems for co-op, marketing, digital and in-store merchandising, content development, minimum retail pricing, and other strategic and systems development.

Summary and Conclusion

In a rapidly changing marketplace, the "either/or" hysteria that forecasts the disappearance of printed books in a short period of time is unrealistic. The human relationships, personal engagement, customer service, reader discovery, and passionate curating that retail stores provide add value to the marketplace. Some customers will never want to read an e-book, some will want both formats, and some will want only e-books.

Presently, no viable cooperative solutions have been identified. Key challenges are high start-up costs, limited foreseeable return on investment, perceived high risks in a cooperative program, and inability of technology providers to broadly meet critical requirements. Additionally, there have been recent introductions of small-scale technology solutions within the industry. Therefore, the retailer group concluded a broad-based, cooperative industry e-book platform is not feasible at this time. However, retailers should pursue individual solutions through available technologies.

Key e-book delivery concerns identified by the task force for retailers to consider include:

- *Business sustainability:* Does the solution provide enough margins to operate, promote, and service customers?
- *Customer relationship:* Who owns the customers, the retailer or the technology provider? How will retailers grow sales and the customer base using technology?
- *Strategic commitment:* The value of providing e-book distribution is the continuing engagement with customers and the extension of the customer relationship via the individual retailer brand. Is the retailer commitment strong enough to begin such a service, invest marketing and promotion to establish the retailer as a source for Christian digital content, and to engage customers in a way that digital content is part of the customer relationship?
- *Multichannel Commitment:* Increasingly consumers expect to connect with favorite retailers online, in person, and through social media and mobile technology. Does the retailer have an active, integrated Internet-and-store strategy? Is there a plan to engage customers where they are in ways that create relationship and experience over time as consumer preferences change?
- *Technical capability:* Some systems, such those by Ingram Digital Group, may integrate into a retailer's website. However, the retailer needs to have technical capability to set up and operate such systems, provide e-commerce transactions

and send notifications to providers for e-book fulfillment, and provide customer service.