

Beyond the Book[®]



DAVID PAKMAN AT BOOK EXPO AMERICA - 2008

Q: Well, welcome to another up front and unscripted. My name is Chris Kenneally. I'm the Director of Author Relations for the not for profit Copyright Clearance Center, and I want to welcome you to a discussion about how publishers should adapt to new digital channels. We're going to be looking at a specific example of that with David Pakman, who is the CEO of eMusic. Welcome David.

A: Hi, Chris.

Q: It's good to have you here, and David is here to tell us some news and to issue a bit of a challenge to publishers as they look at how they're going to distribute audio books online. eMusic, David's company, has been a pioneer in offering customers digital content in open formats since 1998, and is the world's largest seller of MP3 music and audio books. After testing DRM-free audio books on eMusic, Random House has announced it will cease to use DRM – that's digital rights management – on its digital files, a major reversal, and one with huge implications for the publishing industry. Looking forward to hearing about why they made that decision David, but first you have some news to share with us today.

A: Well, this morning we announced, in addition to the five or six publishers who supported eMusic at our launch of MP3 audio books, and those original five or six were Random House, and Naxos, Hachette, Blackstone, Penguin, and a partnership with McSweeney's, we announced this morning that 11 publishers in addition have joined us and are selling their catalogues through eMusic, their audio book catalogues, MP3, DRM-free. So that was BBC Worldwide, Simon & Schuster, LA Theatre Works, Tantor Media, and 11 additional publishers. So at this point the majority of large and medium sized publishers are moving forward in this way.

Q: Do you think the example of Random House kind of pushed them in from the sidelines?

A: Absolutely. We had met prior to our launch with all the publishers and Random House was the one most interested in doing some testing and learning, and the

testing, as I'm sure we'll talk about today, proved to be successful, so as you can see, they jumped headfirst, and as the world's largest publisher, I think that really opened the doors to the other ones coming along.

Q: Well, the test was something that really did challenge some long-held notions about how audio book files should be distributed online. And when we talk about DRM-free, there's an implication almost of being held hostage by DRM. Tell us about that and what the existing situation was before Random House made this move.

A: Well, maybe it's important first to look at some background. We sort of put ourselves as a retailer in the shoes of the consumer. So what does the landscape look like for a consumer in the purchase of media in the digital world? Well, most consumers approach the purchase of digital media from the same angle as their experience with physical media. When you buy an audio book or a CD or watch a television show on TV, all of those programs, all of that media is available in the clear. There are no restrictions on that content. There's no copy restrictions, there's no usage restrictions. The courts have allowed repeatedly the notion of personal time shifting and space shifting –

Q: That goes back 20 years at least.

A: At least. So that's the consumer experience. Now we get to the digital world where all these physical media are migrating digitally, and starting in music and then in audio books, the publishers and labels said, well, let's restrict usage. In an attempt to put restrictions on content so that piracy won't be a problem, let's enforce – they use software to enforce rules and say you can't copy material and you can only copy a certain number of times or use it on a certain number of devices. So the digital good is inferior in the consumer's mind to the physical one that they've been buying for decades.

Q: And which gives a sense of frustration I think to their experience.

A: And consumers are not really philosophical, they're practical. So they say, well, I'm just not going to buy that. And so a lot of the first generation digital formats for music and for audio books have not been as widely adopted as the publishers and record labels would have hoped. So our point of view was, well, if you want to make a transition from physical to digital, and you want to compete with the kabillions amount of files that are trading everyday illegally, you have to sell a good to a consumer that's at least as good as the free one, as the pirated one, and hopefully better. And the way to do that is not put restrictions on it, but to offer it in formats that play on every device and don't have restrictions like the other goods they're used to.

Q: And that being said, though, eMusic is the number two to the number one, which is of course iTunes, and there they are in a proprietary software environment. But yet from what I understand, Random House felt, again, hostage to that. Is that correct?

A: Yeah, so what happened in music was a single retailer became dominant in the digital world. That's Apple. They have 70% market share in the digital music download market. And there's only one other successful digital music store today, and that's eMusic, and we have about 15% of the market, and we are the largest seller of DRM-free music. And the industry came along, and now DRM is dead in music, and all music now sold digitally will not include DRM.

In book publishing, I think Random House saw the same sort of issue. Their business was migrating from a physical world to a digital world, and yet 90% of all audio book digital sales were controlled by this single retail partnership between Audible and iTunes. And that's not in their best interest. They want there to be a plethora of successful digital audio book retailers. The more places to sell audio books, the more audio books will be sold. So they believe that pretty strongly and they said how do you offer retailers an incentive to open up audio book stores and sell audio books? Let them sell it in a format that consumers really want, and they totally saw it, and we've been great partners ever since.

Q: And yet they didn't just set their media free. They did a fairly interesting bit of cyber espionage. Tell us about that.

A: Well, I think the point of view was there's so much piracy, we would only go down this route if going down this route wouldn't materially contribute further to piracy. Because if this is going to make piracy worse, we don't want to do it. So they said, we want to go test. And we said, great. We took a bunch of Random House's titles. I think we started with 12, both front line and catalogue titles. And we watermarked them with an eMusic watermark. So a watermark is an inaudible piece of audio sounding –

Q: Meta-data really.

A: Well, not really. It's buried in the audio stream itself, so it's not removable. Your ears don't hear it, but it's a little signal in the audio that says, this book came from eMusic. And then we hired some tracking firms to scour the file sharing networks and look for those titles. An interesting thing happened. They found every one of those titles on the file sharing networks, but none of them came from eMusic. So the point of view was, eMusic can sell a bunch of books, but they're not going to make piracy any worse, and I think the smart money says, if you want to compete with piracy, sell more. So they were pleased with the results and moved forward full speed ahead. And then in fact they went even farther than working with eMusic, they announced that that's their entire future direction and they'd like to –

Q: Whoever the retailer is?

A: Yes, whoever the retailer is. And as I said, they really led the industry now, just about every major publisher and mid-size publisher has moved in the same direction.

Q: And while it sounds surprising that there would be absolutely no files found that were coming from eMusic in any of these P2P sites, it's really not when you understand who the customer is for these kinds of files.

A: Sure, I think in general audio book customers are a slightly older group than the mass digital media consumer, and specifically the eMusic customer is an older customer. Our target customer is 25 and older, average age is 39. So when you look through it with that lens, it's probably not surprising that an adult customer is not spending a lot of time engaged in piracy online. Time is more important to them than money generally, and the time required to get familiar with rogue file sharing networks is really the domain of youth. So in some ways it's not very surprising.

But also I think we understand now enough about piracy both in the music world and the audio book world to know that those who are engaged in the buying of media are often not the people engaged in the stealing of media. So you want to reward your good people by selling them something they want in a format they want, as opposed to punishing them for being the only ones still willing to pay.

Q: It's interesting, I think, there's a certain amount of reconciliation to a degree of piracy and yet an understanding that you can move beyond that. It's not an either or. There will be some of it, and yet if you're working with the right customer in the right way, you can, as you say, grow your business.

A: Yeah, I think we know that piracy will always be part of digital media. We're never going to eradicate it. And certainly the means to diminish it we now have learned are not through law enforcement or through the courts, and we now know it's also not through technology, that we've been unable to thwart meaningfully or reduce piracy in any way by the use of DRM. But the most important weapon we have in piracy is a healthy vibrant legal market.

The music industry first started suffering their decline in 1999. That was the peak year of music sales. And they had a decline of about 25% over the next four years. And during that time, while it was possible to steal any song you wanted from any file sharing network, it was impossible to buy it legally. So if you wanted to consume a song digitally, you had to steal it. That was a lost four years of time where they weren't battling piracy by saying, oh, clearly the consumer wants the download, because they're stealing it. Let's sell it to them that way. So I think we've learned a lot from that lesson.

Q: Another lesson learned was the pricing model. I think to say that iTunes did kind of figure that out is true, with the 99 cents a track, at least in the music world.

You've got an interesting pricing model – a subscription model, for how you deliver the audio books. Tell us about that and why you think that's suited to the circumstances you've described?

A: Well, in the physical audio book world, the cost of the books is somewhat expensive, \$25 to \$40, but largely that's driven by the physical media costs. You need four or five, six CDs in some of these boxes. In the digital world, there's no physical cost of goods, right? The material is marginal. So you can actually afford to price it lower, but the audio book industry hadn't, and so the digital version was selling for only marginally less than the physical version. But our view from consumer standpoint was that they're expecting there to be some cost reduction, some savings since they're not buying a box anymore. So we were aggressive in trying to bring the price to consumers of audio books down. Our pricing model is most books are \$10, and you can subscribe – you subscribe to a monthly plan with us. \$10 a month for one book, or \$20 a month for two. Now, some books are dual credit books, so you need to have some – you need to be in the higher plan to buy them, but the lion's share of the books are sold effectively at \$10.

Q: And just like a book club model, which is what that sounds like, you do things to help inform the customer about various options, where they might go if they like this particular book, you have things online that complement the actual delivery of the work itself. And a whole team of writers working on that. Again, describe that for us.

A: Well, I think we've learned a lot from the independent bookstore and the independent music store of days gone by, where there was lots of content expertise in the minds of those who operated or staffed the store and that the consumer would go to the store not just for access to the material but for recommendations, for filter, for context. And a lot of that's lost online. I think with very successful e-commerce retailers like Amazon and iTunes, they've become largely sort of search engines for media. Find it, buy it. And there is some context – I don't mean to belittle that. But it's not like the context of the independent book store or independent record store. We said let's build that. Let's try to recreate the digital version of the independent book store, independent record store. So we hired lots of experts. We have more than 250 writers from around the world that are either literary or music experts, and they are writing sophisticated reviews that are informative. Not just like, I think you'll like this. But we just returned from a trip from the African rain forest where we found this singer that sounds a little bit like Natalie Cole, and we think you'll like it based on this stuff. So placing some context.

We did the same for audio books. And with audio books, the reviews, as you know, are not just about the book itself, but about the performance of the book, the narrator as well. And then we used the community – we have more than 400,000 subscribers – who are also reviewing and putting in context and helping add some additional information to the experience. So that helps I think in the filtering.

Q: And it seems to me that that context is critical because what the Internet does that's different than an independent bookstore, the independent bookstore had a limited square footage where they could choose a limited number of books. Here you have the opportunity to deliver thousands of titles, and Amazon, millions of titles, and that always does seem overwhelming, and yet it's what you're trying to do. You want to deliver that kind of very broad choice, that long tale, but still so with these editors and reviewers, you've got an opportunity to have the best of both worlds, the long tale and that sense of context, that sense of community.

A: Right. I think there's a certain romantic notion about the Internet democratizing selection. With shelf space being unlimited, the consumer doesn't have to select just the stuff that's on the shelf space in the retailer in the physical world. But our experience is that just by stocking that stuff, it doesn't automatically sell. Because – well, why is that? Because the popular media is already educating many buyers about the head. So you actually have to work on selling the tale. You have to be a retailer who cares about selling the tale. Most don't. Most stock it, but they're not invested in trying to sell the tale.

Why do we want to sell the tale? Because it's a high point of differentiation for us. If people subscribe to our service and say, you know, I'm discovering so many great books or songs that I never knew existed, they're likely to stay with us longer. So we have invested in building out this long tale discovery process. And I'll share with you two stats I think that tell that it's successful.

In the music world, we have a catalogue of 3.6 million tracks, and it's mostly the long tale – we don't stock a lot of the head. Of that catalogue, two-thirds of it sells at least once every six months. And this is a remarkable statistic because we have a highly diverse catalogue of music from African subcontinent and China and India, and yet we're selling two-thirds of the catalogue. In the audio book space, now we have a much smaller catalogue, we only have about 2500 hundred titles so far, but to date, 96% of those have sold at least once.

Q: And you've only been up for six, eight, months.

A: Yes. So the mission is being painted and worked and it's sort of working. We want to maintain that as the catalogue grows.

Q: With the growth of the catalogue, you're going to see perhaps new forms of audio book emerge. One of the signees recently was McSweeney's, which is a kind of very leading edge, almost bleeding edge, literary journal. How are they approaching audio books? What are they contributing to this forum that might be new and interesting?

A: Well, when we approached McSweeney's, they had never done an audio book before and they were intrigued by the idea. So we really wanted their creativity to

come through. And they've kind of created a field journal. It's very rough, and very raw, and it's self-recorded. It's not done in some high fidelity studio. So –

Q: That's what's appealing to me. I think there's a certain – to my taste at least – kind of turn off, in the over-produced audio book, where it sounds like it's audio stripped off of a film. You know, it tells me too much. If I'm listening to an audio book or some drama just in the audio form, I want to feel it in myself, I want to use my imagination, I want to create the scene in the same way that I create the scene as I'm reading.

A: Sure, and I think the McSweeney's material does a great job of stretching the boundaries of what audio books have been, and it's very exciting and we've been rewarded with it. It's consistently in our top 10. And as you point out, this is somewhat bleeding edge material. It's not being discussed on Oprah's show. It's not in her Book Club, yet it's the top 10 seller. It's done very well with us.

Q: And you also have a group called the Caravan Project, which is a consortium of university presses, and there you're delivering non-fiction, so again in the audio book world, we tend to think of it as being primarily driven by the fiction titles and yet here you're finding ways to offer listeners non-fiction work, and not even traditional non-fiction. It's not Bill Clinton's memoirs, it's something coming out of an academic environment.

A: And I think that's consistent with the audio book consumer's thought process as they're getting into audio books. Typically, they have some downtime, like a commute, and they want to fill that with something that's different than just consuming written word or something more casual, video game or watching a TV show on a portable device. So they have some commitment to some form of self-betterment or education, so it's not a surprise that non-fiction can do well in that scenario, and by that, not just a historical biography or something like that.

Q: It's still early days, but have the publishers learned that the audio books sales are helping to drive the printed book sales at all?

A: I don't know the answer to that question, because we're very new to the audio book world, it's only been six, seven, eight months, as you point out. In the music world, there is evidence that particularly among our customer, this older customer, that they use the digital world as a sampling mechanism to help decide what physical products they'll buy. But I don't know, I don't have enough information to know if whether an audio book drives the sale of the printed work, physical work. I don't know yet. The publisher would.

Q: It would certainly seem that at least it might help to drive the catalogue for major publishers like this to sort of take the leap onto and go DRM-free and really be out there in a very obvious way, is calling attention to their other media. Because so

much of what we see now, we'll see this throughout the next few days at Book Expo, it's a book show but it's a book show and more.

A: Yeah, and I think to look broadly at the audio book industry, our view is it's too small. It should be a much larger industry. The book industry is an enormous industry, but audio book industry is minute compared to that. There are a couple reasons for that. One is the selection's paltry. There's only about 15,000 total audio books. Whereas there are how many million for sale at Amazon, and about 400,000 new titles come out a year of books. So 15,000 is not large enough. Now, why is that? Well, if you ask the publishers, it's because there's a cost associated with making it that's not justified because not enough sell. Well, why don't enough sell? Because there aren't enough retailers. And why aren't there enough retailers? Because there's this one proprietary one that's had the monopoly.

So our view is the DRM-free move is a great move to encourage more retailers to enter the space and some have already – more have entered, including us, and you'll have more people selling audio books, so you'll have more demand for them, and there will be more that will come on the scene.

I think one interesting development is as blogging has allowed sort of the self-publishing crowd to publish their thoughts or information, I think podcasting might be viewed as the primitive version of an audio book. And there's no reason why the gabillions of amateur or even pro or semi-pro podcasts can't be sold as – right now the notion is podcasts are free, but why couldn't it be a self-published author reading his or her work and upload it to eMusic and sell that as an audio book? So there's this longer tale, if you will, of audio book content I think that can emerge over time.

Q: Can they do that? I mean, can one individual author approach you with their work and –

A: Today if they've made their own, yes, we'll do a deal with them of course. But we haven't made any sort of broad tools available to let the masses begin to upload, but that seems interesting to us and we're studying that.

Q: And in the same way, too, you can imagine that certain bloggers have found that the blogging experience has built the reputation for them and gotten them a book deal. I could see the same thing happening with the podcasting, free or in some small charge to help introduce characters or certainly writing ability that then get noticed by the book publishers themselves.

A: And maybe that's not even the goal. Maybe the goal is just to build an audience which you could do online without the participation of a major book publisher. If you've got enough people downloading your podcast/audio books through sites like eMusic, and you can build that audience large enough, they can come direct to your

site and download pdfs or ebooks. So there might be a vibrant, probably selective, but vibrant sort of self-published industry of material.

Q: Any chance that, just the same way that iTunes kind of deconstructed the CD and began to sell things by the track, are we going to see or are we seeing already audio books in shorter forms? Is that perhaps what McSweeney's is doing, so they're not full-length, full-blown, ten-hour listens, but really short bursts?

A: I can foresee it certainly. I can't predict it, it would depend on consumer behavior, but I would look at blogs as an interesting example. At this point, I think it's fair to say that the blog is a form. You may not call it an art form, but it's certainly a form. Writing the right type of blog entry is different than writing an essay or a magazine article or a book or a journalistic piece. So similarly, a podcast has become a form. And the audio book has been a form. So will we start seeing shorter versions of – there's a trend right now among audio books to go to the unabridged route, which could mean 23-hour commitment to getting through a work. But why – there certainly could be 30 minute, one hour, one and a half – so it's possible, we just have to watch consumer behavior and see if it goes through.

Q: Well, certainly (inaudible) it makes so many things possible. If we wait long enough it will happen, I believe. David, it's been a fascinating chat. I appreciate having you join us for *Upfront & Unscripted* here at Book Expo 2008. Thank you very much indeed. David Pakman is the CEO of eMusic. My name is Chris Kenneally, and I appreciate your joining us. If anyone has questions from the audience, we'll be happy to entertain them.

A: Thanks, Chris.

Q: Anybody at all, Michael?

M: Just wondering how quickly you expect (inaudible) publishers and sort of talk about how this is all going to go, this DRM-free and yet (inaudible) doing it more enthusiastically than others, and I'm wondering if you have projections or a sense of how quickly the momentum's going to go and what kind of title ramp up you see happening.

A: Well, among Random House and some others, it's full speed ahead. They're limited only by the participation of artists and authors. So if an artist or author is not there yet, Random House is going to abide by their wishes, which I think is the right thing to do. But within a few more weeks, we'll have the majority – almost the entire Random House audio book catalogue, with the exception of the few holdbacks from respecting artist/author wishes. And the same is true of most of the publishers I mentioned. Some of the larger ones who have recently come in, are just maybe six or eight months behind where Random House was in our view, because the sales data I think is what proves it. You would do this just for the heck of it, but in a very short amount of time, we're converted 7% of our 400,000 music

subscribers to become audio book subscribers. And that was very quick in our minds.

In fact 10% of all of our new subscribers who come in on a daily basis are electing to join an audio book plan, too, in addition to the music plan. So I think if you're an audio book publisher overnight to have a number two come in and deliver the royalty checks the size of the ones we're delivering I think is a pretty exciting development, and it's just growing the industry, it's all incremental sales.

So our view is we want to get as close as possible to the 15,000 audio books that are currently in print, but more importantly we want to encourage them and give them an economic reason to produce more. And if we're successful at growing the market, then that will be easy to do, instead of the hurdle rate being whatever it was, number of units sold, now they'll have more than one retailer to expect some sales from.

M: And do you think – I mean, do you perceive to getting to the point soon where your business is significant enough that that alone will provide an incentive for all these audio recordings that are in fact not digital and therefore not available, downloadable in any format. Will your business justify the digitization of some of the audio that hasn't been (inaudible) or online yet, or is it still a while before we get to that kind of scale?

A: Well, I think the answer's yes, and I've met with many of the heads of the audio book publishing divisions, and I think we understand what the hurdle rate is. We understand the number of units they need to sell in order to justify the cost of creating one. But remember, the cost of creating an audio book is coming down and should come down. The number one thing that governs that is the price of the talent, certainly not the studio time, which is a commodity and small. There is also some justification, if they know they have more outlets to sell it, to produce less expensive audio books. Maybe using different talent at a different price scale and get more of them out there. And I think, so that's at the high end.

At the low end, I think you'll see more and more of these self-published folks create their own works. So our goal is to grow the number of titles. The market cannot grow significantly without growth in the catalogue, and that's what's been holding it back.

Q: Another question from the audience.

M: (inaudible) international?

A: Well, right now our audio book product is available in 29 countries. So we're available in the United States, in Canada, and in all 27 EU member nations. And that's true of our music product as well. And we will continue that growth. We add at least several countries a year.

M: (inaudible)?

A: The question is are there any licensing issues, and there are. We respect the licensing restraints or requirements on a book title by title basis. So if the publishers says, hey, you can sell this in Canada and the U.S., but we don't have the rights for Germany, it won't be available to our German customers.

Q: If I could as a follow-up to that, it's a good question, what about the audio book listening habits? Are they different in Europe than here in North America?

A: You know, I don't know. We're still new to the space, and I don't know if the listening habits are different.

Q: I'm just curious whether certain kinds of titles, it's something to look at. Good question. Anyone else from the audience? Well, it's been a great discussion, I appreciate your sharing your news about Simon & Schuster and the others with us today. Again, thank you very much, David, for joining us.

A: Thanks for having me here.

Q: And thank you all for coming.

(applause)

Q: Thank you very much, I appreciate it.

A: Absolutely.

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