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Interview with James McQuivey
Vice President & Principal Analyst, Forrester Research
author of *eBook Buying Is About to Spiral Upward*

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Q: A year that began with the debut of the iPad is about to end with the arrival under holiday trees of all manner of eReaders. The publication of a research paper that foresees many more eBooks and many more eReaders in our future is an opportunity to look into what the next 12 months may bring for the publishing industry.

Hello, and welcome to *Beyond the Book*, this is Christopher Kenneally. Joining me today is James McQuivey, Vice President and Principal Analyst for Forrester Research, and author of *eBook Buying Is About to Spiral Upward* based on a survey this past summer of more than 4,000 US adults. James, welcome to Beyond the Books.

A: Thank you, Chris, I'm glad to be here.

Q: Well, it's a pleasure to have you join us today. And really it has been a year for the history books, at least as far as the publishing industry is concerned. I was thinking about it as I was preparing for the interview and remembering that afternoon when our friend Steve Jobs held up the iPad for the first time at the end of January. And the room I was in was hushed, it was the Digital Book World, the first of its kind and everybody was watching with baited breath. It seems as if the iPad's been with us always, but in fact it really is less than a year. And the Kindle only a few more years than that. And yet so much has happened, and your survey is beginning to give us some sense of the direction we're moving right now.

But before we go into some of the results, maybe you can recap for us what we've witnessed in the last 12 months.

A: Well, it really has been a remarkable year. So much of what happens in any digital media revolution, whether we're looking at music, which happened some years ago, or books which is just happening now, is that you first you need to have a base of devices that makes it easy for people to consume their favorite content.

In the music business that meant MP3 players, and it meant having PCs that you could play music back on while you were at work, or at home checking your email.



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And so those devices changed the music business. And really this last year, even though as you say the Kindle has been out, and was in more than three million homes coming into 2010, it's really 2010 in which we now exploded the number of devices people had access to from very reliable brand names.

So not only did we have the iPad, which really opened people's eyes about the power of tablet based computing, even though tablet computers have been around for a decade now, it wasn't until Apple showed us really how to do it right, and showed us that it could be a personal media device. And that's one of the things that's made tablet computing so attractive to people.

But at the same time we had this rapidly maturing eReader business with Kindle from Amazon, Nook from Barnes & Nobles, Sony who's been at it actually longer than any of them, all bringing their prices down, thinning out their devices, making their screen refreshes so that they're almost instantaneous compared to what they were just three years ago. I'm sitting here with my original Sony PRS505, which was the eReader that came out from Sony before there was a Kindle from Amazon. And it was an elegant and amazing device for its time period, but it feels like a rock in terms of its weight. The screen refreshes super slow now when you compare it to the latest Kindle, when you compare it to the latest upgrade to the Nook.

And then not to mention what's happened now with the blurring of the lines between tablet PCs and these eReaders where we have Nook Color, which is essentially a smaller tablet designed to be a reading device first, but also a tablet device second.

So, really this platform of devices on which, or upon which, a reading revolution can take place is now out there. And coming to the end of 2010, there will be more than ten million of the dedicated eReaders in people's hands in the United States. And there will be close to that same number of tablets in people's hands in the United States.

So we're looking a very robust platform capable of sustaining this digital book reading revolution that we've seen happen.

Q: Well, it's a great point in those ten million and more devices that are out there. It's really going to mean a lot of change for both publishing and for readers as well. And I think it's kind of, and I don't mean to sound glib, but it's summarized by the name that was used. That very early reader had a name something out of *2001 A Space Odyssey*, PRS, right? Whereas now (laughter) we're talking about Nooks and Kindles and iPads, something much more friendly and that really conveys this notion of a personal media device. It's fascinating to see that evolution.



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In your report you looked at three important legs of this stool, of this platform, if you will. You've got the eReaders, you've got the publishers taking a stake in their future as you put it. Tell us what – why that's important.

- A: Well, this is really critical here, because if you go back and watch what's happened in music, you look at what's happened to the news business and the magazine business, it's always been difficult for media companies to decide what to do when digital presents itself in their business. Now do you go aggressively after digital at the risk of cannibalizing your analog business? And the music industry they said no. The television industry said yes, and they co-founded something called Hulu in 2007.

In the book business, surprisingly, the book business, one of the most conservative media industries on the planet has been one of the most aggressive at supporting digital platforms. And I think part of that is because they've had the luxury of watching over the last decade what happens to companies that don't participate in digital. They watched music labels that are half what they used to be five, ten years ago. And they think, OK, we don't want that to happen to us.

So when Amazon came in and said we're going to sell this new device, and we'd like to buy your digital books wholesale. And then we'll price the books themselves whatever way we want, because that's the traditional retailer's prerogative.

And so they did and major publishers in the United States, the biggest ones that matter the most and carry the most volume said yes. And Amazon turned around and undersold their books, taking a loss on the best sellers in order to drive consumer acceptance.

- Q: James, rather, just to be clear that we're talking about underselling their print books?

- A: Well, no, actually underselling the wholesale price. So Amazon, for example, might have bought a best seller, a Dan Brown best seller when it first came out last year at \$12.99 wholesale. And then turned around and sold it to \$9.99 to a Kindle owner. Actually taking a \$3 loss on the digital book. And they did it as a marketing exercise, it was a write-off as a marketing expense.

And as a result they'd get people to buy the Dan Brown book at \$9.99, and then they'd turn around and fill up their Kindles with a whole bunch of other books that Amazon wasn't taking a loss on. So it was a typical loss leader strategy. It's the



way, for example, Wal-Mart has sold CDs and DVDs for years. They sell them at wholesale or even below wholesale as a way to drive people into the store so they'll buy other things.

So Amazon was just practicing in a digital realm the kind of tactics that had been used on media for years in the physical space. And as a result, the publishers got a little nervous. But it was too late, they couldn't pull back, they couldn't say, well, wait a minute we don't want to sell you digital books anymore, because now you're reducing the price of books to \$9.99. Meanwhile we're trying to sell this thing for \$24.95 in hardback at Barnes & Noble, or at your corner bookstore.

So it was a very challenging moment for the industry, I'd say, coming into 2010, these publishers, many of them, were starting to say, wait a minute. Maybe we've made a mistake. We started to hear them say maybe we shouldn't make digital editions available until six months after they've been available in hardback. Let's use the practice of windowing as a way to preserve physical revenue.

Well, you can argue whether that's good strategy or not, you had CEOs of major publishing enterprises insisted that it is. But in the end we've just seen historically that it doesn't work. That if people want digital content, they will generally find it. And often they will pirate it.

And so what happened instead is Apple came in at the perfect time with the iPad, and said to the publishers, I tell you what. We don't want to undersell your books. Why don't you take control of the price of your books? This is something called agency model. Industry insiders are very familiar with it now, but a year ago it was kind of new. Because they said, what do you mean? We get to set the price for the books you sell, Apple on the iPad? And Apple said, absolutely, yes, and all we ask is a fixed percentage, generally 30% of whatever sales you make. And the publishers were very happy most of them. Five out the top six in the United States joined up and participated in this.

Random House notably did not. And you can still actually find Random House books at \$9.99, best sellers at \$9.99 on the Kindle and on other platforms because Random House does not participate in the agency model.

But the agency model has essentially done two things. One, it's guaranteed the continued participation of the major publishers in this revolution, because they feel like they at least have some influence over price. They've raised the price to \$12.99 or \$14.99 as a way to make sure the perception of the value of books hasn't dropped precipitously. Number two, it has made sure that the people who were selling the eReaders can now sell them for a lot less, because they're going to get



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30% of most of the books they sell, even though they're selling them at higher prices.

So it's basically goosed the industry. It's kept the publishers in and it has made it so that Amazon can drop the price of its Kindle Wi-Fi model to \$139, which is an unthinkable price if you even go back just a year ago.

Q: In fact quite remarkable. And all of which kind of sets the table for your report and the study you've made of these 4,000 US adults just this past summer. And there's some numbers here that I just want to sort of call out and maybe you could comment on.

For those who own eBook Readers eBooks make up half of all the books they buy.

A: Actually more than half. For people who own eBook readers, it's now 66%. If you average in the people who read eBooks and don't have an eBook reader, yet, a dedicated device like a Kindle or a Nook it goes down to less than half, it's about 40%, roughly. But once you have one of these devices, bam, you're reading a majority of your books digitally.

Q: It's quite remarkable. And I think the other thing that's interesting is that people are still reading eBooks without the eReaders. It's a point that kind of gets, I think, overlooked.

A: It is. And it's – what's interesting is it appears at least for now that this is a transitional phase. That people say hey, I'm hearing a lot about eReading. I'm not sure I have a lot of confidence in it, but I'm already a customer on Amazon, or I'm a customer from Barnes & Nobles, and they're telling me that I could read this on my laptop. And I'll have my laptop with me on my next flight, or I always have my laptop with me around the house. Maybe I'll try this out.

That's the sense we have about what's happening now, that people test eBooks on their laptops, because it is the platform where most people do the most eBook reading right now. But within about a year, they generally find the need to have an eReader. And what we think is going to happen is that it's going to shorten dramatically. It'll sort of within six months of starting to read eBooks on your laptop that you'll become an eReader owner, just because it's so cheap now. You can walk out there and you can find an eReader on sale at Best Buy this holiday for \$99.

Q: And I think the holiday season is going to make the decision for a lot of people. I think they're going to find it under the tree.



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A: (laughter) Someone else in the family will have made that decision for them.

Q: Absolutely. They'll be good to go. And yet what we are still talking about today here, December 2010, is just about 7% of US adults reading eBooks. But that number is going to change by the end of next year.

A: Well, and that's what's remarkable. All of this change that we're talking about, Barnes & Nobles released its quarterly earnings and said, hey, physical book sales are down. And all of this change is happening on the backs of a very small base of people. It's that 7% of eBook readers.

Now another 8% tell us they're about to try it in the next 12 months. And that was back in the summer, so we think a lot of those people have already converted. Reading eBooks, because it is a relatively low commitment exercise, is one of those things that if you say you're going to do it, you probably will. It's not like saying you're going to buy a car in the next 12 months and it turns out you don't have the money so you don't do it.

When you say, yeah, I'm going to read an eBook for the first time in the next 12 months, generally it's something that you will actually do because it doesn't cost a lot and it's not a very large commitment. And as I said, once you try it on your laptop, the next thing that you do is decide that you need to buy yourself one of these devices so you can do this more conveniently and more regularly.

So we go from the 7%, and then probably doubling to the end of 2011 where we're looking at 15% of the population. Still, that's a small base for people who are saying, wait a minute, you're talking about a revolution here but it's still only 15% of the population. That's not even a fifth of the people in the population.

What you need to understand, though, is of readers, these people are the *crème de crème*. They spend the most, they read the most, they are the most interested in best sellers, in literary works, in what's winning the latest literary prizes. These people are the people that you want to have coming in and out of your bookstore. And if they're not coming in and out of your bookstore anymore because they are reading so much digitally, they do inadvertently cause a dramatic shift in the business.

Q: Right, they're the real book addicts, if you will, and they're the ones leading where the publishers will wind up.



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We're talking with James McQuivey, Vice President and Principal Analyst from Forrester Research, and author of recently published report, *eBook Buying is About to Spiral Upward*. And while we've been looking at 2010, let's look ahead some to 2011, James, and you, in the report, anticipate some things that publishers and retailers alike really ought to be concerned about.

One is this notion of a media meltdown that the publishers have to be bracing themselves for. Talk about that.

A: Well, this is the tough news, because this is very exciting to talk about all the changes that are happening, anybody who's an avid reader is going to be passionate on this topic. Even if they are anti-technology. And that's fine, not everyone will have to read digitally for the whole business to change.

But the problem that happens in any media business, and like I said, in publishing industry has seen this coming for a while because they've watched this wave wash over the music business, the news business, and now the video business. And so what they could see coming is that so far no media industry has successfully postponed or delayed or certainly not headed off at the pass a shift from analog to digital that doesn't reduce revenues. We're talking about major media industries that are now making billions of dollars less each year than they did just a few years ago.

Q: I talk about it as going on a weight loss program.

A: Very much so. Very much so. And if you look at companies like EMI and the music business, Universal Music, they've had to absolutely trim back. You look at the movie business, even, which is only beginning to be hit by the digital transition as we see the rise of Netflix and other things that are cannibalizing DVD sales. Miramax has had to basically shut itself down and is only running a ghost crew at this point. Sony Pictures has laid off hundreds of people this year. And it's because people, even though they're watching more movies, they're consuming more news, they're actually listening to more music than they did ten years ago, they're doing it in a lower cost and more efficient and more effective way. That is digitally.

And people in these industries say that's not fair. If you valued my books at \$20 a piece on paper, you should continue to value those books at \$20 a piece digitally. And that makes a little bit of sense if you're in this industry and you have been for 30 years, and you think that people have paid \$20 a book because they really thought it was worth \$20 a book. But in reality, they paid \$20 a book because that



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was their only option. Now they have options, and those options are more effective and more effective cost-wise. And that's a challenge.

So it leads to this media meltdown. A phase in which every media industry has faced this pain and this realization, hey, you know what? Physical revenues are going to go down. And in the book business, it's not just the people will buy fewer books on paper, while that's already occurring. It's that as a result the retailers who keep the business alive, the Barnes & Nobles, even the Wal-Marts with their book, very successful book business, will start cutting back shelf space. They'll start cutting back the number of titles they'll buy. They'll start cutting back the number of pre-purchases that they make from publishers.

We're already seeing best sellers that are being released this year digitally and at a hardback at the same time. And 20% of the sales in the first month, in many cases, are going digital. Well, that means if you're Wal-Mart's book buyer, if you're Barnes & Nobles' book buyer, you're going to buy 20% fewer best sellers in the future. Likely best sellers. And as a result you're going to have less shelf space, even fewer stores. We saw it in music, it's going to happen again in book publishing.

And that's a very challenging reality to face, because even though people value books on paper, think they're a wonderful part of the culture and experience, suddenly the availability of physical books will start to dry up, because the distribution chain can't sustain the old economics of the business, which were based on only having paper as an option. It's a huge transition.

Q: I agree, and it's a really important one to keep hammering home for people to understand that a whole distribution channel is going away. The other piece that you predicted, and I was struck by it, because I think it's dead on, is this notion that adjacent media is going to begin to cherry pick book opportunities. So for example a cable television broadcaster, rather than doing a deal with a Random House or Doubleday, whoever it would be, to publish a book is going to do that publication themselves.

A: Exactly.

Q: Change the way the business looks at opportunities.

A: Well, and let's imagine you're Nick, Jr., and this has happened over the years with kids titles like *Dora* and the *Sesame Street* titles where these companies have been doing deals with other publishers to license their characters and make all these books available, because books have one form factor and they're distributed



through a narrow set of distributors. And so it makes sense to work with someone who's established in that business.

Well, suddenly when you're expecting a large portion of your business might actually go direct to an iPad or a Nook color for a children's book, why would you even bother sharing any portion of that profit with the physical book seller? And in fact, you're going to make an app that's not just texting graphics, anyways. You're going to add some video, you're going to add some flash animation and an interactive games because you already have all that stuff for you *Dora the Explorer* website. You might as well pour it directly into the iPad app and charge parents for it. As opposed to making it available for free online.

So you're really looking at the opportunity for everyone, and children's media are an easy example. But educational media, we're talking *National Geographic*, *Discovery*, who have a lot television content which could easily be wrapped into a tablet app with lovely color illustrations and video integrated and lots of text, because these companies have a lot of text resources.

And suddenly not only does this create new competition for readers mind's, but it also changes the definition of the word book. And that's the next order change, which is not only do we change distribution of these things, we change the economics of the industry, but now we're going to change the form factor. Now what it means to be a book is completely subject to revision over the next two, three years.

Q: Well it's going to make your job a fascinating one, James. But probably it's going to make your job harder, too, because you'll be tracking eBooks. And people will say to me, well – or say to you, what do you mean by eBook exactly? Are you talking about a video or a game or a book with all three elements in it? It's going to make your job a lot harder.

Finally, a question if I can, because I know you made a point that the research is based on trade book publishing and isn't looking at textbook publishing, an area that we care a good deal about here at Copyright Clearance Center. Any thoughts as to where that may all lead? And how we going to start tracking that?

A: Yeah, that's a tricky issue. The textbook world, first of all it's gated by institutional factors, not consumer factors. So when you're Amazon or Barnes & Noble, you can't just come into this business and say we're going to offer consumers a new device and it will start this cycle of change. At the high school level, at the Pre-K – at the K through 12 level you're looking at decisions that are made by famously, in the case of Texas, the state legislature. You're looking at



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decisions that are made by individual school districts and principals. So they're not necessarily thinking in terms of new user experiences.

At the college level you have yet another situation. I could speak personally about this as a former college professor myself. I went to three different schools in my academic career, and every time as a student I felt like the text book process was broken. And as a professor, I felt like the textbook process was broken. But there's no motivation to change it. There's no reason for professors to really change – invest any energy in innovating the way information is aggregated and shared with students.

What's going to happen, though, in the college business is the students are going to suddenly show up with tablets. They're going to show up with tablets as they've shown up with laptops for the last five years. And they're going to say why can't I have a more meaningful textbook experience on this device? I can keep my notes here, I can grab a paragraph and share it with a friend in class.

And this challenges, completely, many of the notions of copyright, which I know is very important to your audience. But it also challenges the notion of what learning is. And how we're supposed to learn, because realize that just like the other media industries, the trade book business, the music business, they all existed because certain things were just impossible. It was impossible to distribute music in other ways and distribute books in other ways. Now that's changed.

Well, the same thing is true of knowledge. We distributed knowledge the way we did in the past. When I was a professor I was complicit in this. Because that was the only way to really do it at scale and effectively. Get a whole bunch of kids in a classroom, give them a printed text that they have to read in between classes and come and discuss or come and interact with the professor and hear the professor's lecture.

That model is broken on many, many levels in a world where information and knowledge is available much more flexibly, much more interactively, and in a much more up to date manner than the textbooks of a prior generation where and still are.

So, get off of my soapbox for a moment just to say, where is change likely to happen? It's likely to happen from the end user. That college student. And I hate to say it, but this is a market that's very likely to be damaged by piracy. It is already possible to find a lot of these pirated textbooks. But gratefully it's not super easy. And most students aren't aware of it, because it's not something that



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they really care about. They're not trying their hardest to save their parents money. (laughter)

But eventually they – eventually it will become obvious to them as their friends say, hey, you can just grab this textbook from this Torrent site online. And I think that's the danger here. That's why I would encourage that universities rethink, and I know as I speak to academic publishers, they understand this. They're just waiting for the institutions and the professors to move with them. Because they're saying, look, we have individual tables and images and paragraphs and chapters, all of which can be disaggregated and redistributed in a way that makes sense for your class, or for your student. We could pull content from this remedial or lower level introductory book to help get your non-major students up to speed without them having to buy a separate book, or playing catch-up in class.

There are so many innovative things that could happen in that business. It's just that we need the academic institutions and the professors to care about change. And right now they don't. So we'll just have to see how long it takes before the pain of piracy and the desire to innovate sort of collide and cause the institutions and the professors to say let's step up to this challenge and let's educate and inform in ways that are complimented by digital rather than threatened by it.

Q: Well, James, you sound like the perfect person to be watching that and when you write the report, we hope you let us know. And we hope to have you back on *Beyond the Book*.

A: Absolutely.

Q: Enjoyed chatting with you. We've been talking to James McQuivey, Vice President and Principal Analyst for Forrester Research and author of the recently published report, *eBook Buying is About to Spiral Upward*.

Again, James, thanks so much for joining us on *Beyond the Book* today.

A: Thank you for having me, Chris. I enjoyed it quite a bit.

Q: And for all us at Copyright Clearance Center, this is Chris Kenneally wishing you a great day.

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