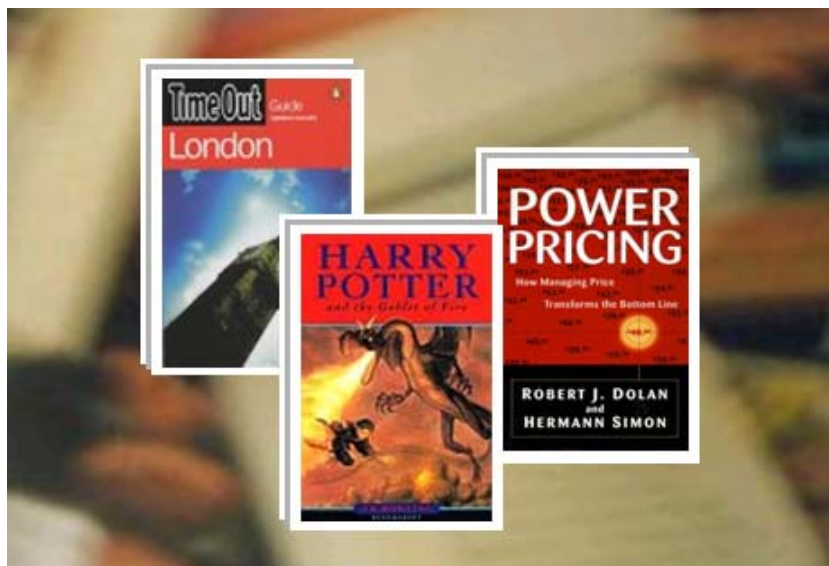


Medien

Revenue Increase for Book Publishers

**Beat the Crisis
through Optimised Pricing**

Dr. Rainer Meckes, Felix Krohn, Stephan A. Butscher



SIMON ♦ KUCHER & PARTNERS

Strategy & Marketing Consultants

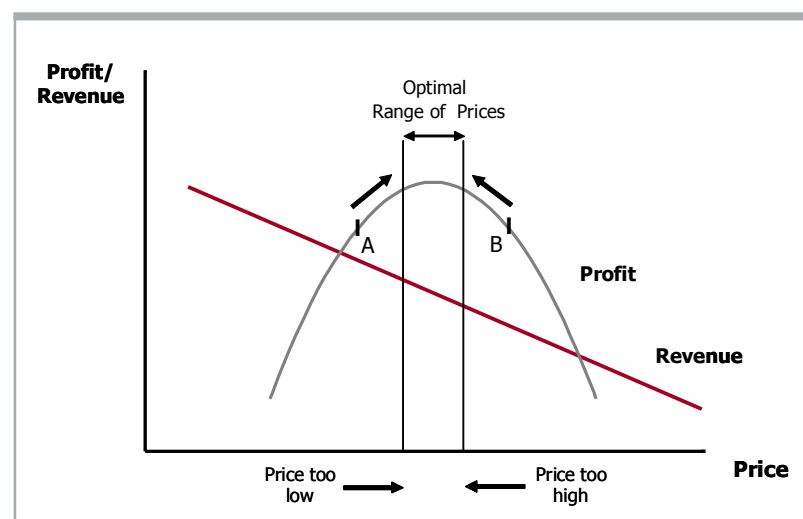
**Bonn ♦ Boston ♦ Frankfurt ♦ London ♦ Milan
Munich ♦ Paris ♦ Tokyo ♦ Warsaw ♦ Zurich**

www.simon-kucher.com

Publishing is something of a hidden giant among British industries - in the year 2000, industry revenues exceeded that of the pharmaceutical industry by more than 50%. Book publishing is at the very heart of this industry. Over the last few years, however, the media and publishing industry has seen an increasing number of problems. The Economist calls it a "time of turmoil", when most companies "have been losing money, bosses or both". Highly promising business models such as e-books did not materialise and efforts to internationalise the business have had mixed success. Some markets, like that for Business/Management books after the faltering of the "New Economy", have suffered from a considerable breakdown in demand.

Britain, with all global publishing powerhouses acting here, is an especially competitive environment for a book publisher to be in. In addition to that, the concentration process in book retailing is advancing further. Borders, for example, expanded its UK-retail space from 1999 to 2002 by more than 115%. This concentration process tends to create pressure for improved terms. The big book selling chains can try to strong-arm publishers in exchange for shelf space, which hits the publishers' margin.

What should publishers be doing now? Publishers now need to look for innovative ways to improve their bottom lines, and the answer will not just be cost cutting. So far, as is typical in crisis situations, rationalisation and staff cutbacks are booming within the publishing world. While every savings potential on the cost side is closely monitored and consequently pursued, a very important profit driver is almost being neglected - price. In our experience, a typical publisher can increase gross revenue by 3-5% through optimised pricing. In real terms, this means a doubling in profit for many publishing companies.



What are the reasons for the lack of focus on the optimisation of prices?

1. In today's publishers pricing processes, the tapping of all possible profit potentials is not top priority. Cost, price thresholds (there are prices between £24.99 and £29.99!) and corridors, as well as "gut feeling" play the main roles.
2. The complexity of pricing – there are many thousands of prices to be determined within one publishing house. This leads to publishers following a standard rather than optimal procedure.
3. Lack of information on value drivers of books (beyond the content), price/volume relationships and the effect of price thresholds and corridors.

What needs to be done in order to tap the existing profit potentials more efficiently? We see three starting points, which are briefly outlined below:

Systemised pricing process: from price to pricing intelligence

Today's pricing process orientates itself essentially on Cost-Plus-Pricing, which is complemented by "unwritten pricing laws" of the publishing market. A target profit is added to the licence and production costs and the resulting price is sorted into "price categories" within the publishing market under consideration of the competitive situation. The question of value drivers in individual book segments plays as much of an insignificant role in this process as the analysis of historic price/volume relationships in the sale of books. The systematic analysis of a few hundred book titles shows a high correlation between page numbers and selling price. Is the weight of a book really the most important value driver for the fiction customer? What role do the author, the publisher, the title, the title page, the chapters etc. play?

A systematic pricing process has to answer the following questions, amongst other things:

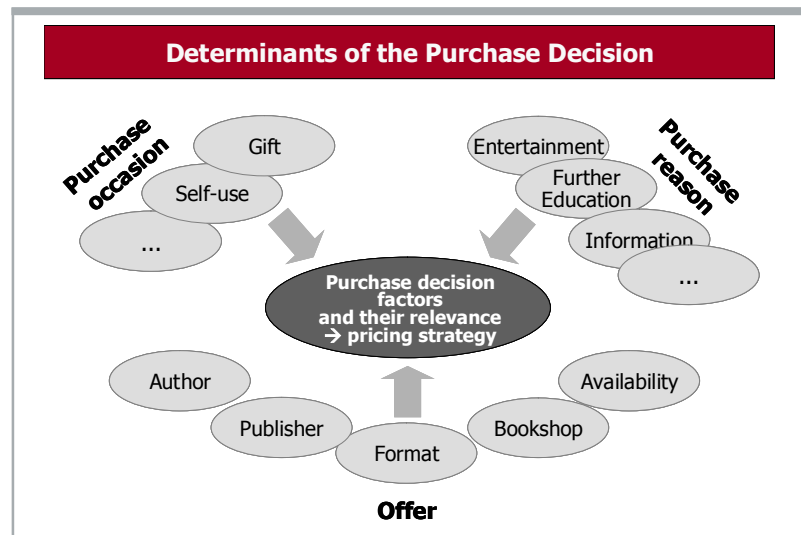
- What data and information should be used to determine a price?
- How should the data be consolidated and analysed? What weight do the individual components of the pricing decision carry?
- Which rules should be followed (on the basis of the available analysis results) when deciding on a price?

Such systematic pricing is not something that can be done by the press of a button. The "gut feeling" and the experience of book managers should be bundled and used optimally. A more professional decision making process and basing decisions on clear rules, guidelines and goals have the potential to vastly improve the revenue situation.

Value pricing and pricing structures: a price for every Customer!

The fact that the benefit of a product determines the customers' willingness-to-pay and consequently sets the price of a product is fundamental and at the same time trivial. Depending on the demand situation, the benefit of a book is individual to a customer. That is why not all customers are willing to pay the same price. One group of buyers sees the price as too high and will not buy. Another customer group thinks the price is "too low" and subsequently buys, however, existing willingness-to-pay is not tapped. In case one, revenue is given away and in case two profit.

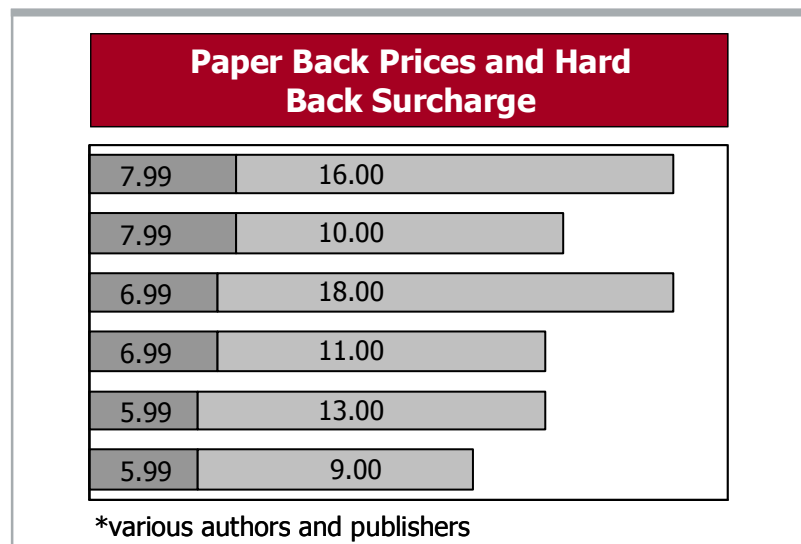
Value Pricing means that the customer preferences should be understood as precisely as possible and that willingness-to-pay should be optimally exploited. Differentiated information about value drivers (publisher, author, thickness of book, appearance etc.), as well as about purchase occasions (gift, self-use etc.) and purchase reasons (entertainment, further education etc.) are necessary for this.



Price sensitivity of product groups and customer segments can be determined on the basis of purchase experiments with the help of appropriate methodological procedures. This basic information about what are comparably stable behaviour

patterns is then included in the price optimisation. Such thoughts are only rarely observed in the book market. For example, publishers are investing heavily in building their publishing brands. They are improving the trust of and recognition by the reading customer and converting the brand value into higher purchase prices. However, what is a publishing brand actually worth? How far does the brand value of a publisher differ across book segments (fiction, advisory etc.)? The quantification of the value drivers and their inclusion into the pricing decisions of the publisher are vital levers for the enhancement of revenue potentials.

Based on the logic of "value-based prices", price differentiation offers a simple and intelligent possibility to realise untapped revenue potentials. A classic example is the differentiation between hard back, large paperback and paper back.



The former CEO of American Airlines, Robert Crandall, said this about price differentiation: "If I have 2,000 customers on a given route and 400 different prices, I'm obviously short 1,600 prices." Certainly a challenging demand for the publishing business, but the price differentiation scope and therefore the profit potentials are not tapped by a long way and many questions remain unanswered:

- What are the right price differences between hard back and paper back and how can total revenue be maximised?
- How does the price of a paper back book influence the sale of a hardback book and vice versa?
- Which other formats between paperback and hardback books are sensible, for example a "Premium Series"?

The mentioned points should be reason enough to review pricing in the book market. Additional revenue potential is guaranteed.

Condition and incentive systems

A further area, in which publishers give away significant profits year after year, is the sale of books through heavy discounting.

With companies such as WH Smith and Borders, there are powerful chains in the book market, who, similarly to the food chains, such as Tesco and Sainsbury's, use their power in the market and put considerable pressure on their suppliers, the publishers for better terms and conditions. The conditions in the book market are more a price guarantee for putting the book on the shelf. There are no agreed sales targets between the bookshop and publisher, no subsequent examination of the target achievement. Performance does not impact terms and conditions. How long will the publishers put up with this practise?

It is high time to develop and implement intelligent and performance-related condition systems. Such systems offer a publisher the opportunity to control the discounts granted to the bookshop in a more precise way. Why are conditions/incentives not differentiated by product areas/range and therefore by the respective importance of the shop? The shop has little or no influence on the purchase decision of the customer in some product areas, whereas an intensive consultation service is necessary in other areas. A bestseller, such as "Harry Potter", for which hardly any sales effort from the shop is necessary, would be treated differently from a discount point of view than a book from the history section, which might need to be recommended on the shop floors, as there are many similar alternatives from different publishers. An analysis of discount, turnover, profit and the contribution of the shop towards the success of sales is therefore helpful. The following questions take centre stage in such an analysis:

- Which concrete targets are pursued with the condition system? What exactly do I expect from the collaboration with the shop?
- Which instruments and discount types are especially suited for the design of the condition system?
- What implications on sales and turnover can be predicted and quantified?

- Where are implementation obstacles to be expected and how should these be met?

Implementation obstacles are certainly highest in the area of discounting. However, the goal is not to turn the world upside down, but to position oneself optimally along the value chain.

Conclusion

The book market should finally tackle the – often homemade - problems and discover professional marketing for itself. Cost reductions alone are not enough! Publishers have to look at the revenue side more intensively and consider the following:

1. Margin improvements go directly through to the bottom-line and normally do not require expensive initial investment. Optimised pricing therefore has highest priority.
2. Value Pricing means customer-orientation. Publishers have to deal with the requirements of their readers and need to align their offer and price for them.

The current condition practise should be checked. Without performance incentives the discount system collapses. Here lies a clear optimisation potential for publishers.

Stephan A. Butscher
Partner, MD London Office

Dr. Rainer Meckes
Partner, Co-Director Media

Felix Krohn
Director, contact person for Media & Internet

SIMON ♦ KUCHER & PARTNERS
Strategy & Marketing Consultants

**Bonn ♦ Boston ♦ Frankfurt ♦ London ♦ Milan
Munich ♦ Paris ♦ Tokyo ♦ Warsaw ♦ Zurich**

London

233 High Holborn · London WC1V 7DN
United Kingdom
phone ++44 20 7841 5750
fax ++44 20 7841 5751
e-mail london@simon-kucher.com