



# **Productivity Commission Study**

## **Submission by Hachette Australia**

### **Executive Summary**

Exclusivity is an essential component of copyright. Any undermining of copyright in Australia would reduce investment in Australia, its authors, booksellers, and printers.

The 30/90 day rule, and competition from international internet booksellers, such as Amazon, already prevents abuse of exclusivity, so that there is already a healthy balance between the interests of participants in the book industry. There is no balanced reason for any change.

This submission sets out to show the particular effect that such a change would have on Hachette, as a major player in the industry, and the effect that it will have on the industry at large. These are, without exception, profoundly negative effects, and are summarised as follows:

- A reduction in sales, in the range of 10-15%
- Less secure environment for continued investment.
- A decline in the number of Australian authors being published.
- A\$1.4m reduction in spend with Australian printers.
- A 40% reduction in stockheld titles.
- Minimum loss of 18 positions at Hachette, and further impacts on agents and freelancers
- Minimum loss of 6 positions in Distribution.
- An environmental and cost impact, caused by the increased use of airfreight.
- Cost increases relative to scale increasing across the board.
- No impact on price to the consumer.
- A diminution of the wider book industry.

As such, Hachette supports the maintenance of the 30/90 day rule legislation, as it stands, and urges the Commission to reject the current proposals.

## **The Role of a Publisher**

The publisher acquires the intellectual property of a creator (author and illustrator), normally through the payment of a royalty advance, and takes on the full financial risk of publishing their book in all its forms – that is estimating market demand, editing, designing, printing, marketing, selling and distributing the book to market both in Australia and overseas, and managing the ongoing supply of the book to market.

Importantly, this publishing risk is identical to that of a distributed book, in that a quantity for the market has to be estimated, and that quantity (albeit without the cost of unearned advances, editing and design) forms the basis of a print run, which then is also sold on sale or return.

No description of the role of a publisher should exclude the commitment to growing the careers of its authors, and it can be many years, and often many books, before an author “breaks out”, to the extent that he or she, along with the publisher, may enjoy a return on investment.

## **Who is Hachette?**

The Hachette Group is the second largest publisher in the English language, and a major publisher in both the French & Spanish languages. It owns businesses in the US, UK, Ireland, India, Australia, Canada and New Zealand, France, Spain, Portugal, South America and Mexico. These businesses are locally managed, and comprise, in the main, of a combination of publishing or distribution of international authors, and the publishing of authors from their respective countries, the latter activity seen to be critical to the growth and standing of each business. In the English language, Hachette publishes under a total of 86 imprints, the better known of which are Hodder & Stoughton, Orion, Headline, Little, Brown, Octopus, John Murray, Lothian, Sphere, Virago, Weidenfield & Nicholson, Orbit, Gollanz, Teach Yourself, Edward Arnold, and Franklin Watts.

## **Who is Hachette Australia?**

Hachette Australia is Australia's second largest trade publisher, with a turnover of A\$108m (*Source: Management Accounts 2008*), which has grown from a turnover of A\$28m in 1998, and it has a market share of 13% (*Source: Nielsen Bookscan 2009*). The company was first registered in Australia in the 1950's, and now employs 230 staff in the areas of publishing, editing, production, design, sales, marketing, inventory control, finance, IT, administration and distribution. It is based in Sydney, Melbourne and also in Tuggerah, where Hachette's Alliance Distribution Services annually distributes over 20 million books, and has been awarded Book Distributor of the year for 7 of its 10 years of existence. In addition, management control of Hachette New Zealand vests in Hachette Australia.

Hachette Australia publishes and distributes in almost all areas of human endeavour, including fiction, non-fiction, biography, Children's, illustrated books, and tertiary education texts. In a typical year, it publishes 120 new Australian titles (with 700 backlist titles), and 3,000 new internationally published titles (with stocked

8,000 backlist titles). Its Australian authors include: Peter Fitzsimons, Lian Hearn, Shaun Tan, Trudi Canavan, Hugh Mackay, Gary Crew, Laurie Oakes, Penny Green, Gabrielle Lord, John Marsden, William McInnes, Colin Thompson and James Phelan.

The company's turnover derives approximately 85% of its output from the distribution of international titles, and 15% from Australian books, making its Australian publishing component probably in the top six (by turnover) of publishing companies, when compared to other stand alone Australian publishers, or international companies with similar Australian publishing components.

## **The Economics of Publishing**

Worldwide, it is generally accepted that, out of every ten books published, two make a profit, three break even, and five make a loss. This ratio is as applicable to Australian Publishing, as it is any other market's publishing, which should be seen as an affirmation of the efficiency of Australian publishers, given the small population base Australian publishers have to work with.

The key difference between a book making a profit, or a loss, revolves around whether, or not, a book reaches its predicted sales. If it doesn't, then three things usually happen.

Firstly, the royalty advance becomes unearned, and has to be written off. Secondly, regardless of how many books were delivered to sales channels (gross sales), if it doesn't appeal to the Australian public, the books are returned by the retailer to the publisher, under a Sale or Return policy, which exists to protect the retailer from inventory risk. Thirdly, as many of the books returned are received in unsaleable condition, the books are pulped, or sold at knock down remainder prices.

All the above has the profit effect on the title in question of increasing the unearned advance (if applicable), Secondly, reducing the net sales, increasing the loss recorded against the title on subsequent remainder sales sold at below cost and, thirdly, there is a net loss of the manufactured cost of pulped copies. All three of these elements dramatically reduce the title's profitability.

The gearing that returns, stock destruction, and the increase in unearned advances for a title, which fails to meet its sales expectations, is often misunderstood, and certainly underestimated (see later).

## **The Nature of a Company Comprising International and Australian Components**

Multi-national publishers are sometimes unfairly painted as being not committed to the Australian Market, or its authors, and exist purely to remit profits offshore. Research, by Melbourne University, indicates that "over three quarters of Australian publishing is attributed to multi-nationals with offices in Australia".

There is a very good reason for this, and that is because Australia is seen (as are Canada, South Africa, India and New Zealand) as a crucible of much creative writing talent and, as the *raison d'être* of any self-respecting publisher is to find and grow author talent, and realise its potential on the international stage, it is

important for Hachette to invest in Australian publishing, as long as it can afford to do so. Multi-nationals have a long history of doing just this, and many Australian authors owe their international success to the endeavours of their multi-national publishers – viz. Matthew Reilly, Tom Keneally, Garth Nix, Mary Moody, Andy Griffiths, Kathryn Fox, Maggie Alderson, John Birmingham, and Monica McInerney, to name but a few. Over the last ten years, Hachette's export income, through sales of physical books and sales of rights, is \$9.3m (*Source: Management Accounts*).

In Hachette Australia's case, there is a symbiotic relationship between its Australian publishing and its international publishing endeavours. Because of market size (and thus, often economically marginal print runs), Australian publishing is risky, and is not always particularly profitable, and by no means do all profitable authors become the international success, which publishers desire. It is often the international publishing which underpins the investment in Australian publishing.

This symbiosis works in reverse and, for reasons which are about emotion, and thus, cannot be quantified, the Australian book trade is both passionate, and proud of our Australian literary culture, its manifest success, and the way it is viewed from afar. All publishers and booksellers applaud and celebrate the success of one of our own, even if they are published by a competitor. As a result, there is a tendency to view a company who just distributes international books, but doesn't publish Australian books, as not sharing these ideals and passion, and thus, not a serious player. It is therefore in the interests (but, as discussed above, not the only reason) that multi-nationals, such as Hachette, invest vigorously in Australian Publishing.

It is one of many points in this submission that, as a result of a change in copyright legislation, any diminution of Hachette's business, either in its international publishing or its Australian publishing endeavours, will not be confined to that specific sector, but will have an effect on the whole business, including its valuable export business, owing to this symbiosis.

## **Hachette's Investment**

Over the 10 year period to December 2008, Hachette's pre tax profits were \$44.9m. Of this, only \$10.9m has been remitted by way of dividend to its shareholder. Hachette has paid \$9.5m in income tax, has invested \$11m in capital expenditure, paid Australian authors nearly A\$30m, and has quadrupled in size (*Source: Audited Accounts*).

In addition to the investment outlined above, Hachette has recently purchased land to extend its current warehouse capacity by 40%, and has plans to invest A\$6m in advanced distribution technology including new Warehouse Management Systems, voice picking, pick to light, carton erection, intelligent conveyor systems, and automated returns handling.

Hachette, along with many other multi-nationals, invests in the book industry at large, through its funding of initiatives, which benefit the entire book trade. A typical example of this, along with five other multi-nationals, and one independent publisher, Hachette contributed \$100,000 of seed capital to set up an industry wide internet based Price & Availability System for booksellers ("Titlepage"). This was launched in 2005 to acclaim by the entire industry.

There are many other examples of Hachette's support for such industry initiatives, including very early support of Pacstream (an Australian company, committed to the standardisation of EDI transmission of book orders), and Nielsen Bookscan (provider of industry statistics). Hachette is also a significant contributor to the Government's "Books Alive" programme, administered by the Australian Council, as well as numerous literary awards, industry awards, and literary festivals.

Hachette also proudly supports many charitable institutions (predominantly involved in literacy, and the provision of books to disadvantaged communities), and donated \$50k to such causes in 2008, as well as donating many thousands of books to worthy charitable causes throughout the year.

There is a vital background to Hachette's overall commitment to, and investment in Australia, in that it views Australia, despite its relatively small size, as a market in which it has a successful and profitable business, and which is underpinned by Australian's respect for, and upholding of the tenets of international copyright law and conventions, which is the only basis on which a publisher can invest and serve authors on any scale.

Any move away from the upholding of international copyright, as is proposed, would significantly alter that view. On the premise that capital is scarce, resources would be moved to markets, where there is greater potential.

To be specific, India, with an English speaking population of 1.15 billion, and an emerging middle class, Europe (including Eastern Europe), with its universal language emerging as English, the US, where Hachette is a medium, rather than large, player, and the Hispanic countries (apart from Mandarin, Spanish is the fastest growing language), are all more compelling candidates than Australia for investment, with a relatively static population of only 20 million, and the investment case for Australia would be further weakened, if copyright was surrendered.

## **Hachette's Investment Policy Changes in New Zealand**

There is no clearer example of this cause and effect than in New Zealand, when the New Zealand government changed its copyright legislation in 1998, exactly along the lines that is being proposed by the Australian Productivity Commission.

At the time, Hachette and Penguin operated a book distribution centre in Auckland. It was the largest distribution centre in New Zealand, and employed 50, or so, people. As a direct result of the legislation, the shareholders decided that, not only was further investment in its publishing businesses inadvisable, but that it should be reduced and, accordingly, the Auckland Distribution Centre was closed at the termination of its lease, 50 jobs were lost and, today, the distribution of Penguin and Hachette books takes place from Australia. This has since been followed by other publishers, such as New Holland, Wiley, Hardie Grant, and Oxford University Press, withdrawing from their respective distribution arrangements in New Zealand, to Australia. It is likely that more will follow at the termination of their leases.

## Current Legislation 30/90 day rule

Under current legislation, the Australian publisher (or distributor), provided it meets the requirements of the legislation, can ensure that the market for which it has been entrusted by the author to publish, in exchange for the investment it has made (royalty advance and creation costs), will not be eroded by the import of editions from publishers in other markets, from which no investment in an Australian infrastructure has been made, or where piracy prevails, or from where remainders might flow.

In particular, an Australian publisher or distributor can invest in promoting its edition, without fearing that the importer of another edition (for example from the USA) will “free ride” on its promotion. Authors grant exclusivity precisely to incentivise their publishers to promote. They do not have to grant exclusivity, but they nearly always choose to do so, for this reason.

In more detail, an Australian publisher or distributor may invest securely and further in marketing and promoting its authors, through a combination of paid advertising, point of sale material, bookseller promotions, the seeking of reviews, and author tours. Exclusivity also means that the already perilous estimation of a print run is not made more perilous by an unknown quantity, which may, or may not, appear from other markets, in the circumstances described above.

The proposed abandonment of the current legislation would create not only uncertainty when setting print runs, which would result in fewer books being published, and diminished availability of imported books to Australian consumers, but also have a wider negative effect on authors, booksellers, printers, literary festivals, employment headcounts, investment in the industry, the Australian consumer, the Australian authors, and the Australian economy.

This submission sets out to cover the consequences of the abandonment of the current legislation starting with its direct effect on Hachette, and then addresses the wider consequences, for the Australian book industry.

## The Consequences of the Abandonment of Current Legislation for Hachette Australia

### Printing

Hachette prints almost all of its Australian adult books with Australian printers. Generally speaking, an Australian adult book is not viable, nor does it meet minimum efficient scale, unless there is a minimum print run of **6,000**, or a reprint quantity of **2,000**.

Hachette is a leading and award winning publisher of Australian children’s books (particularly picture books), and because of their colour content, the majority of children’s books are printed in Asia. The minimum efficient print run scale for a children’s title is **3,000** copies for a new book, and **2,500** for a reprint.

In addition, and largely for reasons of speed to market, and to reduce the economic and environmental cost of shipping (airfreight or sea freight), Hachette actively seeks to print all internationally sourced books which command an initial print (or reprint) of more than **4,000** copies, with Australian printers.

In 2008, Hachette spent A\$14m with Griffin Press in Adelaide, broken down as follows:

	<u>Printings</u>	<u>Units</u>
Australian Titles	185	1.05m
International Titles	549	5.7m

#### Australian Published Titles (Adult)

If the current legislation were surrendered, most Australian adult new books, with a print run of **6,000** or below, or reprints of **2,000** or less, would become unviable (as a direct result of the market becoming less predictable, owing to an unknown level of importing being permitted), and thus, would not see the light of day.

Attached to this submission (Appendix 1 (**confidential**)) are schedules of all adult book printings of Australian titles published by Hachette in 2008, showing which titles would not have been published under the proposed legislation change, and these are summarised by category below.

	<u>Printings</u>	<u>Units</u>	<u>Printings</u> <u>abandoned*</u>	<u>Variance</u>
2008 New Australian Adult Titles ( <i>Appendix A</i> )	88	612K	47	(53%)
2008 Reprinted Australian Adult Titles ( <i>Appendix B</i> )	86	446K	33	(38%)

*\* Printings and units abandoned under proposed legislation changes.*

This summary clearly illustrates that the effect of the surrender of Territorial Copyright would lead to 47 authors, currently published, not being published, being lost to Hachette, and their availability being denied to the Australian public at large. In addition, 33 reprints would have become unviable, and thus, published authors would be denied income, as would Hachette, and the book retail industry.

#### Case Study

Perhaps the clearest example illustrating this specific point is that, in 1996, Hachette was approached by a young professor from Sydney University (Dr Jennie Brand) who had written a book on the benefits of selecting low GI foods in family diets. At the time, low GI foods were not generally known about, and it was with a certain amount of trepidation that Hachette launched 'The Low GI Factor', with an initial print run of 6,000 copies.

Suffice it to say, 'The Low GI Factor', and a number of spin off titles, became an international success and, 12 years later, has sold 3m copies in over 20 countries, earning A\$2.2m export dollars, and generating royalty income for Dr Brand and her Australian co-authors of over A\$3m (see Appendix 2 (**confidential**)). The GI brand has, as a result, flourished in a way that it could not have done if remainders and pirated copies

had flowed back into the Australian market, as would have happened had it been published under the proposed legislation.

More to the point though, is 'The Low GI Factor' would never have been published at all, as the initial print run would have fallen below Hachette's economic threshold.

Further case studies, showing when authors would not have been published, are outlined in Appendix 3 (confidential).

#### Australian Children's Books

In 2008, Hachette spent \$0.7m with Asian printers almost exclusively for Australian Children's Books. Similarly, using the economic profit thresholds for Australian Children's books of **3,000** copies for a new book, and **2,500** copies for a reprint, the reduction in titles printed by Asian printers would be 27 titles (please see Appendix 4 (confidential)), showing the following:

	<u>Printings</u>	<u>Units</u>	<u>Printings</u> <u>abandoned*</u>	<u>Variance</u>
2008 No. of New Titles or Series Printed	23	258K	11	(48%)
2008 No. of Reprint Titles or Series Printed	34	144K	16	(47%)

\* *Printings abandoned under proposed legislation changes.*

Further case studies, illustrating when authors would not have been published, are outlined in Appendix 5 (confidential).

This summary clearly illustrates that the effect of the surrender of Territorial Copyright would lead to 11 Australian authors currently published, not being published, and being lost to Hachette, and their availability being denied to the Australian public at large. In addition, 16 reprints would have become unviable, and thus, published authors would be denied income, as would Hachette, and the book retail industry.

#### Internationally Published Titles

Similarly, using the economic print run thresholds for initial print runs and reprints, international books of **4,000** copies, the reduction in titles printed by Griffin Press would be as follows (please see Appendix 6 (confidential) for supporting schedule).

	<u>Printings</u>	<u>Units</u>	<u>Printings</u> <u>abandoned*</u>	<u>Variance</u>
2008 New Imported Titles	342	3.95m	67	(20%)
2008 Reprinted Imported Titles	191	0.28m	88	(46%)

\* *Printings abandoned under proposed legislation changes.*



It is important to note that, whilst some Australian authors or titles would not be published at all, the printing of international titles would not be abandoned, but would be replaced by imported run ons of Hachette's overseas print runs, which would be shipped (most by sea, or by airfreight).

Quite apart from the economic and environmental cost of shipping books around the world, this places the Australian consumer hostage to overseas stock holdings and decisions about reprints, and will create unreasonable delays for them. (The lead time from an Eastern Seaboard bookseller order for a book, which has to be imported, is approximately 11 days by air (13 if Western Australia), and approximately 11 weeks by sea.) NB. It is usually new books which are sea freighted, as time allows for shipping to take place in time to meet publication dates but, if there is late demand for a book, or it is a backlist title, quantities would normally need to be air freighted.

In summary, the combined reduction in Hachette's spend, with Australian printers, is estimated to be A\$1.4m.

## **Editorial, Design and Production**

As a direct result of the anticipated reduction in the scale of its Australian publishing output, it is anticipated that the company would require one less production controller, and one less editor, a net reduction of two jobs. Hachette would also probably have to review whether it should pursue its endeavours in Children's Publishing at all, and this puts at risk a further three positions.

However, of equal concern is that Hachette outsources all of its typesetting and design work, and most of its editorial work. In all, the company uses the services in these areas of expertise, 23 companies. 90% of these are owner managed, and rely on Hachette for a significant proportion of their income. It is a moot point as to how many of them would survive the surrendering of Territorial Copyright, particularly as it will be difficult for them to find a replacement work in a diminished industry.

## **Stockholding**

Currently, Hachette carries stock of approximately 10,100 titles, with a further 10,600 titles not stockheld, but available on an "order to order" basis. The annual sales profile of stock held in Australia is as follows:

Sales in excess of 10,000 copies	– 158 titles
Sales between 1,000 and 10,000 copies	– 1,500 titles
Sales between 200 and 1,000 copies	– 3,127 titles
Sales between 50 and 200 copies	– 4,414 titles
Sales between 1 and 50 copies	– 11,445 titles

In an environment where there is uncertainty about the quantum of the market for a book, then it would be entirely natural for a publisher to reduce its risk by not ordering for stock, and only ordering to order, thus

reducing the overall Australian stockholding of books and, by extension, their availability to Australian consumers.

Thus, it is reasonable to expect that Hachette would reduce its risk by deleting, from its stockholding, any book selling less than 500 copies, in the present legislative environment, and designating them “Only to Order” titles. This will have the effect of making approximately 8,500 less titles (41% of current stockholding inventory) available for immediate despatch to Australian consumers.

It is not, incidentally, correct to say that the Australian consumer would be supplied by overseas suppliers. By no means are all books available from such sources and, even when they are, books will often be in editions offering less relevance, or higher cost. Furthermore, individual shipping or air freighting is much more expensive than bulk distribution.

A specific example of this is the innovative Trade Paperback edition, which was introduced to the Australian market by Australian publishers in the 1990's, is now widespread and is the preferred format, and which provides Australian consumers with original editions in an alternative and cheaper format to those available overseas.

## **Airfreight and Sea freight**

In 2008, Hachette spent the following on the freighting of imported books from the UK and US:

Airfreight	A\$0.7m
Sea freight	A\$1m

In the light of substituting Australian printing of international books with imports, and the adjustments to stockholding policies described above, it is certain that these costs, both economically and environmentally, will double, and might even triple. This increase would particularly apply to airfreight, as 11 weeks' lead time is not acceptable to the Australian consumer, and Hachette would be obliged to use air transport.

It is worth noting that airfreight costs 20 times the cost of consolidated container sea freight and, of course, has horrendous impacts on the environment. It is also money which predominantly goes to overseas shippers, and thus, does not benefit the Australian economy.

## **Marketing**

Hachette spent over A\$4m in 2008 on marketing activity which, typically, includes paid for advertising, below the line advertising, point of sale, co-operative marketing with booksellers, and author tours. In addition, the company employs 10 publicists, whose sole function is to promote its authors' books, and to promote the book as a meaningful alternative to other forms of entertainment.

It's important to note that 80% of Hachette's cost of marketing goes directly back into the book industry (as opposed to external media) and, to a large extent, underpins retailer promotions, literary events (such as the

Dymocks Literary Lunch), and author appearances at literary festivals. Typically, Hachette finances 40-50 (both Australian and international) author tours each year, by paying for flights and accommodation, and arranges to make them available at literary festivals around the country, all of which are well attended by the Australian public. Without authors, such festivals would cease to be viable, and the anticipated reduction in sales will certainly force Hachette to curtail many of its author tours.

This marketing and promotional activity and expenditure is predicated on the fact that Territorial Copyright is enshrined in Australian law, and thus, it has a direct bearing on the sales of Hachette Books.

In an environment where overseas suppliers are given carte blanche to export competing titles, there becomes a distinct disincentive for Hachette to advertise those books, which will benefit opportunistic offshore suppliers who have no interest in nurturing the careers of authors in Australia, and do not contribute to the Australian tax base.

Hachette conservatively expects, under such legislation, that it would cut its marketing and promotional expenditure by 30%, and would reduce its publicity personnel by half, resulting in a nett loss of 5 jobs.

## **Sales Costs**

Hachette employs the largest sales force in the industry. All up, there are three sales teams, comprising some 50 people, broken down as follows:

Sales Management	4
Key Accounts (Head Office based)	5
Field Sales Representatives	28
Merchandisers	9
Field Sales Agents	7

Key Account staff deal with larger chain booksellers (Dymocks, Angus & Robertson, Collins, Target, K-Mart, Big W), who have centralised buying and marketing functions. Field Sales personnel visit and service independent bookshops and franchisees countrywide. Merchandisers visit and service Discount Department Stores (Target, K-Mart and Big W).

By far the largest cost is the key account field sales force, who visit mainly independent bookshops and franchise owners. In 2006, Hachette made the strategic decision to treble its sales force, so as to service the Independent and Franchise sector more diligently, as it is in this sector where it perceives it can grow its expanding list of new Australian and international authors. This was a brave decision, and went against the industry trend of reducing sales forces.

However, it is a fact that this strategic decision would be reversed if the legislation be abandoned, for the simple reason that many of the stores are too remote and too expensive to visit after publishing quantities have been eroded (and publishing decisions reversed), and less international books distributed. Thus, the current structure of three teams would be reduced to two, and 15 staff would be made redundant.

Furthermore, this action if, as is likely, was mirrored by other publishers, it would constitute a major blow to the independent bookselling sector, and many would become economically unviable and close.

## Terms of Trade

Currently, the terms of trade, between Hachette and its customers, offer “sale or return” facilities to all its retail customers, regardless of their sector. Typically, Hachette receives returns, as a result of this policy, equivalent to 18% of its gross sales (*Source: Management Reports 1998-2009*).

The policy, effectively, removes inventory risk from the retailer, and enables publishers to ensure that sufficient quantities of books will be ordered to meet a demand, which is often difficult to predict (by either publisher, or retailer). This system works very well under the current copyright regime.

In an environment where a retailer is either replacing, or supplementing Hachette editions with overseas imports, this facility would be withdrawn, either selectively from retailers, who did import, or across the board. This would be as a direct consequence of overseas importers who do not sell on sale or return (and are unlikely to in the future, on account of the tyranny, and cost, of distance), being able to selectively supply competing editions into the market. Thus, it will be in the interests of the retailer to sell “firm” sale editions from overseas, before Hachette’s editions, and thus, return any overstocks to Hachette – a risk too onerous for the company to bear.

To understand the impact of this on profit and loss accounting, and because of the accounting requirements surrounding Sale or Return arrangements (*Australian Accounts Standard “No. 37 provision, contingent liabilities, and contingent assets”*), publishers are required to make a provision for anticipated returns in their books. The effect of this, coupled with the reduction of nett sales, and the expensive nature (relative to shipping books) of physically handling returns is in the attached Appendix 7 (**confidential**).

In 2008, Hachette’s turnover was reduced by \$18,871K, for credits issued to booksellers for stock that those booksellers returned to Hachette. Of the stock returned, only 16.3% was returned to stock, and the remaining 83.7%, was either pulped, or remaindered below cost, at a total cost write-off to Hachette of \$9,414K (*Source: Hachette Unaudited Accounts*).

In 2008, the cost of returned stock from retailers, that was either destroyed, or remaindered at below cost, amounted to 9% of net sales. In addition to this, Hachette wrote off \$495K (*Source: Hachette Unaudited Accounts*) of unearned advances.

The reduction in turnover for credits issued on return, and the associated stock write-off, is analysed as follows:

	<b>Total Company \$000's</b>	<b>Australian Publishing \$000's</b>	<b>Imported \$000's</b>
Reduction in sales (credits issued to booksellers for returns)	18,871	2,201	16,670
Cost of the stock returned:			
Pulped	7,090	349	6,741
Remaindered	2,324	62	2,262
Sub total - written off by Hachette	9,414	411	9,003
Returned to stock	1,832	98	1,734
Total	11,246	509	10,737
% of returned stock pulped and remaindered	83.7%	80.7%	83.9%

Attached to this submission is a full analysis (see Appendix 8 (**confidential**)) of Hachette's profit and loss by title for Australian published books, with summaries for each, showing the effect of returns, stock destroyed or remaindered, and unearned advances (Source: Post Mortem analysis – Hachette management accounts).

This analysis shows that, as Australian publishers do not enjoy the scale of publishing as its UK and US contemporaries, with their relative greater size of population, the profit sensitivity to returns, and the flow on effect of increasing unearned advances and reduced net sales is acute. As it is certain (for the reasons stated above) that Hachette would fall victim to being the recipient of much higher returns than would be the case if firm sale editions were not being imported from US or UK wholesalers, Hachette would have no alternative but to move to firm sale and, in so doing, would reduce retailers' ability to order sufficient stock, and would thus limit the opportunities for its books and authors to be displayed in such a way as to achieve optimum sales. The argument for maintaining S.O.R., despite the above consequence, does not hold water, as this would render many more titles and authors unviable, with the consequent loss of minimum efficiency scale for Hachette, and further diminishing Hachette's business.

The loss of S.O.R. facilities would diminish the entire book industry including retailers, wholesalers, publishers, and would be most keenly felt in the Independent and franchise book sector, who currently bear minimal stockholding risk, but who would now be exposed to that risk. This sector would be most unlikely to survive in any meaningful way, and the resultant reduced range, and availability of stock, would be to the detriment of the Australian consumer.

## **Distribution**

The impact of a reduction of sales volumes of 15% would provide a number of challenges to Hachette's distribution. Not the least, lower volumes would render further investment in facilities, technologies and resources, difficult to justify. Expensive technology requires high levels of secure distribution volumes to justify the risk of such investment.

The potential loss of volumes from ADS will have an immediate flow on effect on Hachette's freight providers. In 2008, \$5.4 million has been spent on freight with an Australian owned national carrier who, in turn, supports numerous sub-contract, owner operated courier businesses throughout the country. A reduction in Hachette's volumes would result in less economical, smaller, and fewer parcels, which will create higher, per unit, distribution costs.

As an example, a 15% reduction would lead to fewer cartons being despatched but, importantly, a drop in the number of multiple cartons per delivery, and hence, supply chain efficiency. A conservative estimate indicates that the annual freight expense, as a percentage of net sales, will increase by 10% to 2.8% for Australia. This does not take into account potential freight rate increases, due to an implied reduction of scale.

Hachette spends more than \$1 million on carton and packaging expenses, directly related to activity and shipping. Such expenses will not fall in direct line with sales. This will lead to an increase in cost, as a percentage of the whole. An estimation of a 15% drop in gross sales volume would equate to an expense reduction of only 7%.

Finally, the impact on the labour force will be immediate. ADS employ 90 people directly, and up to 40 casual agency employees throughout the year, depending on activity peaks. Labour costs for ADS were \$ 7.19 million for 2008. All agency employees, and 80% of the labour resources, are directly related to volumes and, as such, any decreases will lead to a reduction in staff in very similar percentages (eg. a volume fall of 15% will lead to staff reductions in the vicinity of 6 to 8 ADS permanent staff, and a minimum of 6 agency staff).

The direct impact of a volume drop for Hachette is that the cost of distribution would increase in the range of 0.7%, as a percentage of net sales for the year.

## **Conclusion for Hachette**

As can be seen from the above, there is hardly an area in Hachette's business that would not be affected by the proposed changes to copyright legislation. Such would be the extent of current business model change, it is very difficult to be precise about the level to which sales would fall, but it would be reasonable to assume that it would be in the range of 10-15%, based on the curtailed publishing output, reduced stockholding and lost reprint opportunities. It is clear that, as a result of the increased costs, relative to sales, brought about by the reduction in scale of Hachette's business, this will have a withering effect on Hachette's profits.

It would be disingenuous to suggest that Hachette would not survive. It is large, and substantial enough to do so. However, lesser resourced publishers would not, and the retail landscape would be changed forever, with less authors published, publishers, independents and franchisees disappearing, such that the Australian Book industry, in its widest sense, would be diminished, as would the contribution it makes to our cultural identity, to the Australian tax base, and to the consumer. The book, which is universally acknowledged to be the cornerstone of literacy, would decline as both a source of information, a form of entertainment, and the essence of our cultural identity and history.

Further, Australia, as a first world nation, would be entering the murky arena of third world nations, where the creators of intellectual property are not rewarded fairly for their contribution to society as a whole.

## **Wider Industry Concerns**

The above has, largely, concentrated on issues specific to Hachette and, to a greater, or lesser extent, these will affect all publishers.

However, there are wider industry concerns, which the proposed surrender of Territorial Copyright brings into sharp focus. The fate of authors, printers, literary festivals, industry investment, and the negative effects upon the environment should be self-evident from the commentary above, and will be documented in more detail in submissions to the Commission by parties representing those interests. However, there are concerns within the wider industry, which have a direct bearing on Hachette and other publishers, which are addressed below, in no particular order.

### **Book Retailers**

This submission has discussed the symbiosis between international and Australian publishing. This symbiosis is equally important between publisher and retailer, as one cannot do without the other.

Book retailers face ever increasing pressures on their cost structures, not least being rent rises from, often monopolistic, landlords, and the threat of industry consolidation, such as the recent purchase of Borders by Angus & Robertson. They also have much to fear from the possibility of digital book content delivery from internet sites to e-readers, mobiles, and smaller and smaller laptop devices.

From discussions, it would seem that book retailers are, predominately, in favour of retention of the basic tenet of Territorial Copyright, subject, in some cases, to some reduction in the 30 and 90 days. It is noteworthy that the one or two, and most vocal, proponents of surrender represent large retailers, who perceive that they have advantages to gain by the total removal of Territorial Copyright restrictions. Such arguments are put forward under the guise of increasing choice, and reducing price for the consumer.

It is Hachette's contention that it will do neither, and that this is a cynical attempt to increase larger retailers' dominance of the market, by using their size and geographical footprint to gain advantage over the smaller, and less cohesive, independent sector of the trade. Before discussing the arguments about price and choice, it is important to understand the critical role that the Independent Booksellers play in the industry.

### **The Independent Bookseller Sector (including Franchisees)**

The independent bookselling sector (including franchisees) in Australia is the envy of the publishing and bookselling world, and represents **26%** of Hachette's sales (*Source: Management Accounts*). Interestingly, the New Zealand independent sector represented **32%** in 1998 and, primarily as a result of the change in

copyright legislation in that year, now represents **17%** of sales (*Source: Hachette New Zealand Management Accounts*).

Apart from the diversity of choice Independents and Franchisees offer across the range of Australian and imported books, publishers particularly value them as champions, and passionate advocates of new Australian voices from new authors emerging in the Australian cultural firmament. It is they who read and circulate advance reader proofs, and create the groundswell of enthusiasm for our nation's talent, and then go on to hand sell books to an eager audience. Large chains and Discount Department stores with their "one size fits all" policies, and concentration on evergreen, and proven titles, simply do not employ the personnel, or have the flexibility, to do this.

Bringing these new authors into print is the very essence of what publishers do, and they will be hard put to publish a fraction of the current output, should the Independent sector wither, which it will do, based on the experience above in New Zealand, and the fact that less books will be published sale or return, facilities will be withdrawn, and they will be operating in a diminished industry

The surrender of Territorial Copyright is not a slight threat for independent booksellers and franchisees.

## **Price**

Bob Carr, former premier of NSW and Dymocks Director, in his recent article in *The Australian*, makes comparisons between the relative prices of books in Australia and the United States, to support his hypothesis that the current Territorial Copyright legislation disadvantages Australian consumers because, he claims, it allows Australian publishers to charge higher prices. He is disingenuous, however, in the calculations he uses to support this hypothesis, and in the selective examples that he cites. His chosen selection of five new, and old books, all support his argument – that US publisher recommended retail prices (RRP) are lower than the same books available through Australian publishers.

Below is a schedule of Hachette's top 20 bestselling books in 2008 (source Nielsen Bookscan), and applied to it is Mr Carr's simple comparison principle. For the sake of this exercise, today's (20<sup>th</sup> January 2009) exchange rate of 0.68 has been used (NB. Interestingly, this equates to the average exchange rate for the 10 years since 1999, which is 0.6985 (*Source: Reserve Bank of Australia's website*)), and the figures in red show those titles which are cheaper, if imported from the US.



Title & Author	1 Bookscan sales in 2008	2 Aus RRP incl. GST (Aus \$)	3 US RRP (Aus \$)	4 Bookscan ASP excl. GST* (Aus \$)	5 amazon.com sale price (Aus \$)	6 amazon.com sale price incl. shipping (Aus \$)
<b>Twilight</b> Stephenie Meyer	235,259	\$24.99	<b>\$16.16</b>	\$18.45	<b>\$8.88</b>	\$24.32
<b>New Moon</b> Stephenie Meyer	217,214	\$29.99	<b>\$16.16</b>	\$22.18	<b>\$8.88</b>	\$24.32
<b>Breaking Dawn</b> Stephenie Meyer	215,890	\$29.99	\$33.81	\$20.90	<b>\$18.59</b>	\$34.03
<b>Eclipse</b> Stephenie Meyer	191,994	\$29.99	\$29.40	\$21.79	<b>\$16.16</b>	\$31.60
<b>Parky</b> Michael Parkinson	77,137	\$49.99	\$55.81	\$31.36	\$36.84	\$52.28
<b>Scarpetta</b> Patricia Cornwell	68,836	\$49.99	<b>\$41.10</b>	\$25.30	<b>\$24.66</b>	\$40.10
<b>Heart and Soul</b> Maeva Binchy	62,084	\$35.00	\$39.63	\$20.83	\$26.16	\$41.60
<b>Host</b> Stephenie Meyer	41,540	\$32.99	\$38.22	\$25.62	<b>\$22.93</b>	\$38.37
<b>Careless in Red</b> Elizabeth George	35,146	\$32.99	\$41.10	\$21.45	\$27.13	\$42.57
<b>Fearless Fourteen</b> Janet Evanovich	34,836	\$32.99	\$41.10	\$21.49	\$27.13	\$42.57
<b>Bourne Sanction</b> Robert Ludlum	34,389	\$32.99	\$38.22	\$21.75	\$25.22	\$40.66
<b>Twilight Illustrated Film Companion</b>	34,379	\$24.99	\$24.99	\$17.55	<b>\$14.99</b>	\$30.43
<b>Power of Now</b> Eckhart Tolle	33,993	\$22.99	<b>\$20.59</b>	\$19.45	<b>\$12.35</b>	\$27.79
<b>Duma Key</b> Stephen King	33,519	\$34.99	\$41.18	\$21.02	\$27.18	\$42.62
<b>Just After Sunset</b> Stephen King	31,923	\$32.99	\$41.18	\$20.18	\$27.18	\$42.62
<b>Hold Tight</b> Harlan Coben	31,551	\$32.99	\$39.63	\$21.41	\$26.46	\$41.90
<b>The Last Lecture</b> Randy Pausch	31,531	\$29.99	\$32.28	\$22.55	<b>\$19.37</b>	\$34.81
<b>Broken Window</b> Jeffery Deaver	30,986	\$32.99	\$39.63	\$21.07	\$25.24	\$40.68
<b>One Fifth Avenue</b> Candace Bushnell	30,669	\$32.99	\$38.16	\$23.26	\$25.19	\$40.63
<b>Bodies Left Behind</b> Jeffery Deaver	28,027	\$32.99	\$39.63	\$19.92	\$26.16	\$41.60

\* Average retail selling price (Source: Nielsen Bookscan)

The conclusions from this comparison are as follows.

Hachette's bestselling 20 books in 2008, representing sales to Hachette of \$27.6m (and 25% of all Hachette's sales), sold over 1.5m copies to Australian consumers last year. 16 of these titles are sold at a recommended Australian dollar retail price **lower** than the equivalent available American volume.

Only four titles sold for a higher recommended retail price – two of those, *Twilight* and *New Moon*, contain extra content, exclusive to the Australian edition, and not available in the equivalent American edition. Of the

other two titles, *Scarpetta* is published as a hardback edition, as it is the US, which is unusual for the Australian market, and the price differential of *Power of Now* can be measured in cents.

It is clearly evident that Australian consumers are not disadvantaged by the price of current bestsellers, under the present legislation – quite the opposite in fact.

These comparisons are then taken further (column 4) and show what price do Australian consumers **actually** pay in the bookshops. The Hachette-set RRP is just that – a recommended retail price, and Australian booksellers are at liberty to price books at levels of their choosing. Nielsen Bookscan is able to report the average selling price in 2008 of Hachette's top 20 titles to the Australian consumer. This analysis demonstrates that no title, imported from the US, would exceed the average. Please note, that this is an average retail selling price, and not the lowest price a consumer might purchase a book for.

A further analysis compares Australian RRP's with the current price on Amazon (columns 2 & 5). Nine of the 20 titles in this comparison are cheaper in the US. However, this does not incorporate any postage & packing, when the freight cost to the Australian consumer of AUD\$15.44, has been factored in (column 6). No single book within the Hachette top 20 is cheaper to purchase via amazon.com, than it is available in the Australian retail market place at an average and, importantly, not lowest, price.

It is difficult to comprehend that prices will reduce, with the surrender of copyright, considering the cost pressures on retailers. The very fact that as some notable large chains already price books above Australian publishers' RRP's, under the current copyright legislation, would seem to, comprehensively, dispel this notion.

Ends