

## Productivity Committee Inquiry

### Restrictions on the Parallel Import of Books

#### Hachette Australia's Submission, in response to Discussion Draft

Hachette Australia welcomes the opportunity to respond to the recommendations of the Productivity Commission, as outlined in its Draft Submission and appendices, dated March 2009.

The Commission has recommended that PIR be lifted on books 12 months old – an astonishing proposal, given that not one of the 270 submissions from the industry put this forward as an option. In making this recommendation, the Productivity Commission has made a number of errors of fact, has made assumptions and, based on these, has drawn conclusions which fall into the “long bow” category. This submission sets out to highlight these, for the benefit of the Productivity Commission in finalising its submission to Government. The fact that books, less than 12 months old, retain PIR, in no way ameliorate the points made in Hachette's original submission, and the impacts outlined therein remain relevant, and should be seen as such.

Hachette's submission alights on the more glaring errors and misconceptions in the Draft Submission under the following headings:

- Price
- Proposed 12 Month Rule – Impact on Investment
- Export Rights Trading
- Data Appendices

#### Price

The Productivity Commission has failed to conclusively prove that books are more expensive in Australia. This is unsurprising, given the numerous caveats throughout the Draft Submission, highlighted below.

*“However, the comparisons had a number of aspects that, taken together, inevitably weaken the level of confidence that attaches to the results, as a basis for understanding the effects of PIR's.” (page 4.11)*

*“Measuring the magnitude of any price effects, caused by Australia's PIR's, is problematic. Indeed the Commission has had to draw on qualitative evidence, together with theory, as well as some quantitative evidence, to gauge these effects, and has not put a figure on them.” (page XIX)*

*“It needs to be recognised that making such assessments is not easy. As noted, up-to-date and comprehensive data on the books sector is not readily available, and gauging some of the impacts of the PIRs – for example, in terms of prices, industry activity, and cultural externalities – is inherently difficult. Many participants in this study, from different parts of the books sector, were themselves quite unsure about how changes would affect them. These information gaps and uncertainties suggest the need for a cautious approach to reform in this area.” (page XXII)*

The Draft Submission has, despite a very thorough process, tried but failed to prove that the Australian Consumer is being price disadvantaged (see later), as a result of current PIR's. Based on this, it has gone on to speculatively conclude that book prices, under the proposals, might fall because of the following:

1. *"In the music industry, a gradual rise in competition from lower priced parallel imports appeared to result in lower prices"* (ACCC page C.2).
2. The influx of remainders *"could greatly increase price competition for the trade backlist"* (page XIX).
3. DDS's will increase their stockholding of backlist if PIR's are removed.
4. Wholesalers in Asia *"might emerge"* in the absence of PIR's (page XIX).

In Appendix D, the Commission has gone to commendable lengths in explaining its methodology in establishing if book prices are higher in Australia. However, the methodology is fundamentally flawed, in three respects:

- a) A "trade paperback" in the US is a completely different format to a "trade paperback" in Australia, or the UK, and yet a matching of the two were performed by the Commission. This distorts the results, as they are not like for like.
- b) An average exchange rate of GBP 0.45 and USD 0.90 has been used, on the basis that the ACCC and PSA used the same methodology in earlier cases. As is well known, both the ACCC and PSA reports were the subject of considerable rebuttal by various agencies at the time of their publication. No other reason is given by the Productivity Commission for the selection of an average exchange rate in 2007/08 (in the case of the USA, the highest level in living memory), rather than a more realistic period.

The Productivity Commission then goes on to point out that, had GBP 0.41 and USD 0.69 been used, then the price gap *"would have been eliminated"*. A more realistic average exchange rate is the ten year average, which is quoted at GBP 0.40 and USD 0.69, and would thus eliminate any price gap, which the Productivity Commission perceived.

- c) No freight element has been factored in, and thus, assumes that an Australian consumer can access a book from the US and UK, with no cost of delivery. This is a fanciful notion.

It is for the above reasons that Hachette contends, along with many other submissions, that it is **not** proven that prices in Australia are generally more expensive than the US or UK. Furthermore, to the extent that any perceived difference *"might exist"*, it would fall into a reasonable margin of error.

## **CD's**

The assumption that prices in the book industry will follow the path of CD's (even if it could be proved that it was the removal of PIR's, and not the emergence of digital downloads, that reduced CD prices) is naive at best. The Commission states that *"Sound recordings in a physical form, like books, are generally mass produced consumer goods, with their manufacture characterised by high fixed costs (the cost of developing the original work) and low variable costs (the costs of producing an extra copy of the CD or book.)"* (page C.1)

This is palpable nonsense, as a single CD can be digitally copied for the same cost per unit as can 5,000 copies. Books do not enjoy this luxury, and the printing of one book digitally costs approx. four times, per unit cost, as much as printing 5,000 copies (Source: Griffin Press Price Grid).

As has been repeatedly stated that, it is this very sensitivity to reduced volume that makes the removal of PIR's ineffective in lowering prices. Quite the opposite in fact, as it is likely to create upward pressure on prices of books in Australia.

Hachette's original submission argued that the removal of PIR's would diminish the industry and, in particular, the publishing of Australian authored books. This point could not be made more emphatic than by the Commission's own revelation that *"17% of all commercially released tracks were recorded by Australian artists"* (page C.4).

Compare this figure with the Commission's findings that *"38% of the retail value of the top 5,000 trade books were Australian authored"* (page C.4), and it is self-evident that the Book Publishing Industry is thriving, and the Australian music industry is on its way to being moribund. If the Productivity Commission considers 17% of books sold to be Australian authored, a good thing, then it is no wonder the Draft Submission studiously ignores the fate of Australian authors in its submission.

Hachette contends that the music industry is not the template to support the notion that there will be downward pressure on price. Furthermore, Hachette contends that it was the very removal of PIR's in 1998 that has caused the music industry's decline.

## **Remainders**

*"Opportunities to import remainders from abroad could greatly increase price competition for the trade backlist"* (page XIX).

This comment, along with others throughout the Draft Submission, displays a lack of understanding of the remainder market, and prompts its 'one size fits all' conclusion.

How much does the Productivity Commission think the current remainder market will increase, and thus, *"increase price competition for the trade backlist"*, and from what base will it increase?

The Remainder market already flourishes, and remainders are, today, widely available to every retailer at prices a fraction of the RRP, but the Productivity Commission has made no attempt to quantify the current market, or estimate the extent that it will grow and provide an estimate of its downward pressure on price.

How can the Productivity Commission possibly think that remainders will increase price competition for the trade backlist when, by its own definition, backlist is *"low volume"* (page XI), or very low volume (page 21)?

It is important to understand that the remainder market is, by definition, a segmented one. As follows:

- Brand authors
- Marginal authors
- Generic books (often illustrated – cooking, gardening, etc.)

Many publishers (including Hachette) do not remainder their author *"brands"*, which is from where the majority of backlist sales derive. They pulp overstocks of these books to protect the author's brand.

Remainders principally derive from end of line and marginal titles, which have either failed, or not sold to their expectation. Generally speaking, if an international book has failed, or is overstocked in one market, it will fail, or be overstocked, in all markets. By definition, this means the title is marginal, and there is limited or no demand, and it is not being stocked by booksellers of any variety. This does not now, nor will it in the future, create downward pressure on the price of author brands, from where the majority of backlist sales derive. Hachette contends that remainders may increase, but because of the nature of those remainders, they will not place downward pressure on backlist prices.

(NB. Please note that this does not apply to the Australian authored works exported to the US and UK, and which are referred to in many submissions. In such cases, it is very rare for an Australian author to be a brand in the US and UK and they are more often than not classified as a marginal title in those countries. As such, they are re-exported to Australia where, because of its *"home market"* appeal, the title remains in demand. This, as is well documented, poses one of the single biggest threats to publishers of Australian books, such as Hachette, and its Australian authors.)

## **DDS's**

The Commission states that *"Trade books are sold through a variety of channels. Competition is most robust on 'front list' titles, with many discount department stores frequently selling bestsellers for substantially less than the recommended retail price. This puts pricing pressure on the retail book chains, while independent bookstores compete more on levels of customer service. On 'back list' titles, prices are often higher as competition, especially from discount department stores, is limited."* (page XV)

This is just plain wrong. Any visit to Big W, K Mart and Target will reveal that discounts (usually 35% off RRP) apply across the board on all titles, including backlist.

There seems to be an assumption, throughout the Draft Submission, that it is only frontlist titles that are bestsellers and, by extension, only frontlist titles that are bestsellers in DDS's.

- *“For most trade books, the bulk of sales are made in the period immediately after publication. The majority of backlist titles are sold in very small volumes.”*
- Of total sales to DDS's, the following was derived from titles published more than 12 months prior to 2008 Appendices 1, 2 and 3 (confidential).
  - Big W 48%
  - K Mart 50%
  - Target 45%

The above compares with Hachette's total sales revenue percentage of 50%.

Hachette figures show the Productivity Commission's assumptions about the current level of backlist in DDS's is wrong, and contends that it is space that limits DDS's from stocking more books, and not the lack of availability of backlist. Hachette further contends that there will not be downward pressure on book prices, as a result of an increase of backlist titles in DDS's.

## **Wholesalers in Asia**

The notion that wholesalers in Asia might emerge to put downward pressure on prices is pure fantasy.

Whilst the involvement of Asian wholesalers might seem logical to an economist (because this is the pattern with commodities such as whitegoods, televisions, and even music), it is totally illogical for books, because they are language based. In Australia, it would be a fair assumption that 98% of books sold are in English. In Asia (and this, admittedly, will vary from country to country), English is a minority language, and English language books are a minor part of the Asian book market.

To try and give some meaning to this, Hachette, as one of the largest English speaking publishers in the world, employ 230 staff in Australia, and 30 staff in New Zealand, to service those markets respectively. By contrast, Hachette services the whole of Asia (with the exception of India, where a local publishing business was started in 2008), with export representatives visiting the region every six months from London or New York.

Furthermore, any visitor to an Asian bookshop will immediately notice the vast difference in reading culture between Australia and Asia, as manifest in the books on display. It is impossible to properly summarise these differences, other than to say that Australia is a reflective culture, with an appetite for fiction and biography, whereas Asia is an aspirant culture, with massive sales of books such as “*One Minute Manager*” and “*Rich Dad, Poor Dad*”. It is recommended that the Productivity Commission assure themselves of these differences by comparing English language bestseller lists of countries in Asia, and those of Australia.

There is little synergy in the range required by an Asian wholesaler to service his or her own market, and that of Australia (unlike televisions), and it is difficult to imagine a viable business case for what the Productivity Commission is suggesting.

Hachette asserts downward price pressure on book prices in Australia will not occur through the emergence of Asia wholesalers.

## **Proposed 12 Month Rule**

The Commission appears to have formed the view that, by abolishing PIR's on content older than 12 months, this will have a limited effect on the Book Industry. This is borne out by the following extracts from the Submission:

1. Backlist is sold in “*low volumes*” (see Glossary), or “*very low volumes*” (see Key Points, page 2.1).

The Commission goes further, presumably as a consequence of the above, to suggest that this 12 month PIR arrangement will have a limited effect on publishers, authors, and cultural externalities, and will continue to foster a climate where publishers are willing to invest. This view is borne out by the following extracts from the Submission:

2. *The Commission has, however, formulated a package of amendments to the existing provisions of the PIR regime, which aim to introduce greater competitive pressures into the broader book market, while preserving a defined period of certainty for local publishing, authorship, retailing and printing (page XXIV).*
3. *Its approach is to focus on the part of the book market where the upward pressure on prices from the current PIR's is ostensibly the highest, and/or the likely cultural externalities are the smallest (page XXI).*
4. *Conclude that local publishers would still have the incentive to invest, despite losing PIR on backlist (page XXIV).*

Hachette contends that the Commission has completely underestimated the importance of backlist to publishers (both in revenue terms, and in the initial decision to acquire, and thus, invest), and have wrongly concluded that by introducing the 12 month rule, that this will somehow diminish the effect that this will have on the Book Industry as a whole, a subject widely covered in Hachette's original submission, and those of numerous others. It further fails to acknowledge the portfolio nature of publishing risk, which again was covered in numerous submissions, and totally ignored by the Commission.

Throughout the Productivity Commission's submission, there is an underlying assumption that each book, but, more particularly, each edition, or format, of each book, has its own product life cycle, which conforms to the typical modelling of consumer commodities.

The very fact that the Productivity Commission is proposing the blunt instrument that is "*12 months after publication*", regardless of format or edition, is affirmation of its total misunderstanding of the publishing decision making process. It has utterly failed to comprehend the concept of building an author's works over time, and the critical role that the interdependency of each edition, coupled with the release of newer works by the same author, plays in the building of an author's career and, critically, in the initial investment decision.

And, this is the central point. Publishers don't typically invest in one book – they invest in an author's career and, at acquisition time, will often seek to acquire multi book contracts (or secure options), so that they can invest in marketing and promoting an author in such a way that the investment is recovered over time. Sales of backlist is a crucial element of this, and the Productivity Commission has manifestly failed to understand why this is so crucial.

A typical marketing strategy is to publish Book 1 in Trade Paperback, and then, a year later, publish Book 2, also in Trade Paperback, and so on in subsequent years. In year 2, simultaneously with publication of Book 2, a "B" or "A" format of Book 1 will be released, and so on in subsequent years, such that, after 4 years, an author has his/her new book available, along with 3 backlist books.

Why are books marketed this way? It's simply because consumers, who read the new book by a particular author, are often encouraged to read the backlist, and vice versa, largely because the backlist is in a cheaper format. It is also because an author, with three books, gives retailers something of greater scale to sell or promote, and the media becomes much more engaged in interviewing and promoting authors, who have a body of work, are becoming known, and aren't a one trick pony. Equally, the expectation of this growing scale encourages the publisher to invest in both the acquiring of the author in the first place, and in upfront marketing costs.

Not all books are marketed this way, of course, but most are. Crucially though, the product life cycle is totally different from, say, a washing machine, where sales of a new model will replace the sales of the old one. In fact, the opposite applies – the new "model" actually stimulates the sales of not just the previous "model", but also of the "models" launched over many years.

The proposed 12 month rule pays no credence to the above core publishing process. More critically, as evidenced by the submission's statements at the beginning of this section, it fails to acknowledge or

understand that the 12 month rule strikes at the very core of the publisher's decision to invest, and thus, the Commission is deluded in claiming that it has focussed on the area where cultural externalities are the smallest. It is the exact opposite.

Hachette's original submission covered in detail the sensitivity books have to volume reductions, and the impacts these would have on Hachette, and the wider industry. It is not intended to repeat these, but the following appendices shows that the Commission is massively mistaken in its contention that it has chosen the area of least impact to target its proposed change in legislation, and that, amongst other things, backlist is not "low volume" or "very low volume".

In summary, the following appendices shows that, in calendar 2008 (Hachette's financial year):

- Of total sales by Hachette, 50% of revenue (83% of titles) was derived from titles published more than 12 months prior to 2008. Appendix 4 (confidential)
- Of sales of Australian published works, 55% of revenue (87% of titles) was derived from titles published more than 12 months prior to 2008. Appendix 5 (confidential)

### **Export Rights Trading**

The critical importance of preserving a territory, from which to trade export rights has been well documented in many submissions. It seems that the Productivity Commission accepts that the removal of PIR's will prompt the re-export of remainders of Australian authored works into Australia, along with the consequences of that decision, and suggests a novel device by which publishers and authors can avoid such a fate. As follows:

*"The Commission notes that publishers of Australian authorised works would have the option of extending the effective period of protection from parallel imports by holding back release in foreign markets." (page XXIV)*

If such a statement didn't show total disdain for Australia's \$220m book export business, such a comment would be laughable.

The deliberate and cynical delaying of books into markets is exactly what the 1991 legislation set out to fix, and here we have the Productivity Commission seriously suggesting we should delay Australian exports, to fit in with their flawed, left field proposal. Books are topical, dealing often with the issues of the day, and that is why our trading partners buy them. Imagine if the US equivalent of the Productivity Commission suggested that US publishers delay exports to overseas markets. Australian's would be reading about Barack Obama's vision of the future, at about the time he was due for re-election!

Hachette asserts that delaying exports is completely unworkable, and the removal of PIR's on books, older than 12 months, will seriously damage its export market, and that of the Book Industry.

### **Conclusion**

This submission has only concentrated on the more glaring errors of assumption in this report. It is difficult to understand the reasoning behind the Productivity Commission's decision to propose something that not one industry participant either proposed, or even thought of as a possibility. Perhaps it was done in too tight a timeframe but, what is apparent, is that the Draft Submission lacks academic integrity. It has made numerous statements that are completely unsupported by analytical research, has drawn some conclusions which are correct, and some that are utterly wrong, and come up with an astonishing solution of their own. Frankly, the Book Industry in its market sense, and the Australian community deserve better.

Hachette calls for a retention of the current 30/90 day "use it or lose it" rule, which has underpinned the growth of the Australian Book Industry, including Australian authors, Australian agents, Australian publishers, Australian printers and, importantly, the export of our unique Australian culture, and which has served the Australian consumer well for nearly 20 years.

17<sup>th</sup> April 2009