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**Submission from Penguin Group Australia in response to
“Restrictions on the Parallel Importation of Books:
Productivity Commission Discussion Draft”**

We have received, read and digested the Discussion Draft and wish to make the following observations.

- We endorse the retention of the 30-day rule.
- We endorse the retention of territorial copyright for the first 12 months.
- We see no need for further reviews.
- We oppose the lifting of territorial copyright after the initial 12 month post-publication period. This submission will seek to demonstrate exactly what an ill-conceived idea this is and will make it clear that territorial copyright should be maintained in perpetuity.

General Observations

It strikes us that the foundation of the Draft is that “PIRs, by restricting competition, place upwards pressure on book prices in parts of the market” (Draft, P.xiv), that all references and recommendations flow from this and utterly rely on the truth of this statement. To say we are not convinced that the Commission has made a convincing case would be an understatement the size of a small developing nation. As we shall see:

- There is so much competition under the current legislation – all of it healthy – that there is no case to suggest that introducing further competition would lower prices.
- If PIRs were removed after 1 year (or at any time in the life of a book), the economies of scale would be reduced by a significant factor, putting up costs of printing, distribution and the other cost-variable parts of the industry, with the inevitable result of *increased* book prices. We note that this effect is neither anticipated nor modelled by the Productivity Commission.

Much of this has been spelled out in previous submissions from various parts of the industry, but the Commission ignores most of this. Dotted throughout the Draft is the varied mantra “PIRs, by restricting competition, place upwards pressure on book prices in parts of the market” (Draft, p.xiv) “In putting upward pressure on book prices in parts of the market...” (Draft p.7.7) etc. Not only is this reiteration of a completely unproved position irritating, it’s also mystifying. What parts of the market could they mean? Sadly, we never find out.

A PEARSON COMPANY



Some attempts have been made by the Commission to compare book prices in Australia with those in the UK and the US. So did many of the submissions from various parts of the industry. The results of all this effort were unsurprising but ultimately meaningless. Those opposed to the removal of PIRs found that our prices were fine in comparison with other markets; the Coalition for Cheaper Books said “in almost all cases, Australian recommended retail prices are substantially more (sic) than the UK or US”. The Commission, while finding that some books were in fact at certain times more expensive in Australia, surrounded its findings with so many caveats and health warnings (“caution is needed in interpreting the results of the comparison”) because

- a) They relate to only one period.
- b) Comparisons based on RRP data suffer the inherent limitations of such data, and
- c) They contain no recognition of freight costs,

that any changes to the current legislation based on such incomplete data are at best unadvisable.

All of this is about as relevant as comparing the price of a bag of flour in these three countries. The only certainties emanating from everybody’s research seem to us to be:

- a) Sometimes books are more expensive in Australia and sometimes they’re cheaper, and
- b) These variables are driven by factors such as exchange rates, retailer discounting and freight charges.

SOME THOUGHTS ON THE PRICE OF BOOKS

A. Should books be cheaper in Australia than they are?

We have seen just how difficult it is to compare overseas prices with ours and we agree with the Commission that such comparisons are not the issue. We cannot ignore the Commission’s sole attempt at the “Should” question, which comes up on p4.14 of the draft. Here’s what they say; “...average price levels should generally be lower, or at most a little higher, in Australia than in the U.S., reflecting our lower income level.”

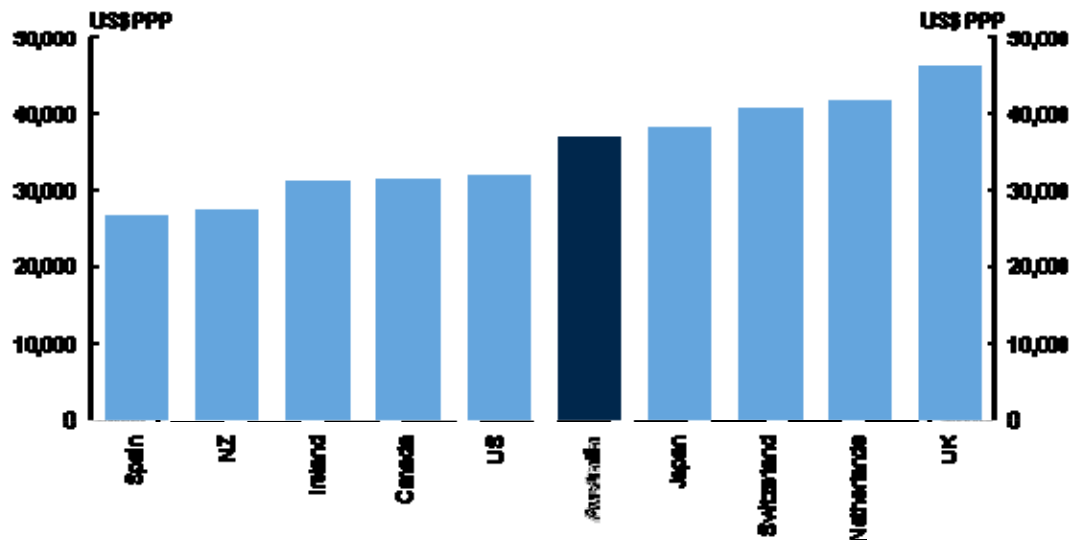
Whether or not one buys the arguments that lower incomes in a country should lead to lower book prices, the lack of evidence backing up glibly stated fact is damning.



Chart 4.8 shows the average wage across the OECD-10 on a purchasing power parity basis.

Chart 4.8: Gross wage earnings for an average worker

OECD-10, 2005 (US dollars)



Source: OECD *Taxing Wages*, 2005.

Using the Commission's logic, then, it seems books *should* be dearer here than those in the US.

And perhaps it *is* reasonable to expect slightly higher prices. If books are to be imported, someone has to pay for 14,000 miles of sea freight. And if they're locally published titles, Australian print runs are always going to be smaller than those in the UK and US, so production costs per volume are necessarily higher. We're numerically a small country occupying a large continent, on the other side of the globe from our two biggest trading partners. Of course there are costs attached and it's plain that it's harder to do business at a distance than it is when your imports are tiny (the UK and US) and your population large.

B. Could books be cheaper than they are?

In theory, yes. Under the Commission's recommendation, booksellers would be free to bring in books from markets outside Australia when it suited them. These would be books published in Australia more than a year ago or books for which the local copyright holder had failed to establish copyright under the 30-day rule. They would typically be A & B format paperbacks bought at negotiated trade terms from UK or US wholesalers, or (more likely) remaindered paperbacks from (different) UK and US remainder wholesalers.



A word on remainders. We need to remind ourselves that the remainder market is already large in Australia, as it is in the US and UK. Publishers and distributors sell overstocks to booksellers or to remainder wholesalers. Booksellers buy from publishers or from remainder wholesalers, either local or overseas. Specialty book remainder shops can be seen all over the country. Some of what's being imported is illegal, but most are books for which there is no local copyright holder. This market is huge, vibrant and price-sensitive. The lifting of the PIRs would have no effect on prices in this part of the market: it's here already, there's no shortage of goods currently, so nothing would change. Making more titles available for remainder import will have little effect other than to enrage and impoverish Australian authors, whose royalties would be compromised.

C. Would books be cheaper if PIRs were removed?

We don't disagree that from time to time, when the exchange rate is favourable, some booksellers would land a small number of profitable titles more cheaply than by buying from local distributors/publishers. The question is, how much of this saving would be passed on to consumers. The Commission believes that "lower costs are generally likely to be passed on to the consumer over the longer term". The reasons given are:

- a) Competition between different titles.
- b) Competition between different booksellers on price and other services.
- c) Lack of significant barriers to entry in the bookseller's market.

None of this illustrates any understanding of booksellers' current behaviour and what drives it. The retail book trade as a whole is operating on ever-narrowing margins as the cost of employing staff, of utilities and particularly of rent relentlessly increases. Any opportunity to finesse the retail profit margin would inevitably be seized by retailers, and would stand no chance of being passed to consumers. All the evidence points to this. At the moment two of our biggest chains are selling many titles significantly above RRP. Our nearest open market, New Zealand, sells books at higher prices than in Australia (even the Dymocks stores there, despite the protestations of the Coalition For Cheaper Books). And competition, which the Commission finds lacking "(PIRs, by restricting competition...)" has never been keener in the book industry. Retailers compete fiercely with each other for authors, for retail space, on price. Bookselling rivalry is fierce, with Chains, Independents, Discount Department Stores and online sales competing on service, stockholding and price. Australia is a healthy, buzzing book bazaar with all of the tensions necessary to create downward price pressure.

If the Productivity Commission doubts the likely destination of the returns available to retailers from eroding copyright, it may care to compare the typical local and foreign retail prices of books which have no local copyright holder. The evidence will show that the presence of a local publisher – who needs to compete within a standard price cohort, and would inevitably vacate the market for many titles under the Commission's proposed regime – actually places a downward price-pressure in the market.



We note that it is an unreasonable assumption, and one which appears implicit in the Commission's proposals, that the restriction of territorial copyright, that there would be a competitive market for most books in Australia. The more likely outcome is a substantial reduction in Australian publishing, putting consumers at the mercy of large chain retailers. Many Australian book publishers do not have the capacity to remain in business if the Commission is successful in transferring market power to retailers, while leaving product and market development risk with the publishers.

We have seen with the music industry that it is simply a matter of market power and margin transfer from the risk-taker to the retailer.

But in the case of books, it seems this level of investigation and analysis is either too difficult or too inconvenient for the Commission. Price comparisons don't matter, they say, but rather "whether there would be opportunities at least from time to time, for the importation and sale of at least a subset of books at lower prices from abroad. Thus, it is pertinent for assessing the effect of PIRs to recognise that movements in the currency would, in the absence of those restrictions, occasionally provide opportunities for Australian booksellers to source some stock quite cheaply from markets such as the US."

And so we come to it. We arrive out of breath, bewildered and already slightly nauseous at the prospect of being a little bit pregnant, on the shores of mediocrity and self-justification. If the Commission has its way, we're to operate under a system which recognises the importance of territorial copyright, but which removes it after a year because somehow the worth of a book; the value of its ideas; the importance of it, has evaporated.

We now need to examine the unmodelled assumptions the Commission has made about books a year or more after their first publication.

D. Subsequent Editions

It's clear that the Commission is aware of the existence of 'A' and 'B' format paperbacks: they refer to these editions in the Draft (Box 4.1) when discussing pricing issues. The proposal though, acts as if they don't exist. These paperbacks are typically published about a year after the publication of the first edition and are intended to provide a long-term, cheaper option for the consumer and a steady revenue stream for publishers, booksellers and authors. On publication of these paperbacks, there is often renewed promotional activity, marketing co-op, point-of-sale material and prominent merchandising by booksellers. Yet the Commission's proposal hints at a belief that books have only one edition and that after 12 months they sink gracefully into some sort of backlist swamp.



E. Sales of Backlist Titles

Some quotes from the Draft need to be challenged, viz:

“in most cases, the bulk of the returns to publishers will come from sales in the months following release”. In other words, publishers (and distributors, and authors, conveniently forgotten here) make their money shortly after release date, and backlist sales are relatively unimportant. They will accordingly sail on unchanged as “(this action) would not excessively diminish current returns”.

While blithe assertions backed up by nothing are a daily occurrence in the popular press, they surely have no place in a Productivity Commission review. Publishers live on their backlist. This is worth repeating so we'll repeat: Publishers live on their backlist. Once the original investment in editing, designing, marketing and selling is over, it's every publisher's wish that as many of their books as possible repay them and their authors for as long as possible. And *that's* what enables them to invest in new authors.

At Penguin, around 40% of our sales stem from the backlist. We, like our competitors, nurture these books with re-promotions, new covers, bindups and a steady stream of reprints. We take backlist every bit as seriously as we do new books. It's quite true that many books don't survive past the first twelve months of either their first or second (paperback) edition. Others live on successfully for several years, and some keep going for decades. For some reason the Commission has formed the view that Australian publishers should only receive the fruits of failures, rather than successes: this is a punishment for risk-taking and will critically attack the portfolio structure of the publishing firm, which at the very least seems antithetical to good regulation.

It seems that the 40% statistic has been misinterpreted by the Commission as meaning 60% of the sale of any book occurs in the first 12 months. Rather, the point of this number is that around 40% of Penguin's entire sales in any given year are derived from the backlist. While we appreciate the Commission's desire to have a clear understanding of what the percentage sell through is of a book in its first 12 months of life, such a number is impossible to quantify. Publishing is a portfolio business and as such variables exist from book to book, from author to author, from adult writers to writers for children and young adults. Granted, established authors do settle into a relatively established pattern but the key word here is '*established*', and it is this which can take time, sometimes years. A first time author may enjoy modest success with their first book and then three or four or five or ten year's later 'break through' with a later book that then sees the previous books enjoy similar success. This is but one variable, as with variables; there are many more.



The table below illustrates in more detail than necessary just how important are sales in the years after publication.

It gives BookScan sales volumes of 119 books published 3-5 years ago which have sold a greater number in the years post- publication than in their publication year.

ISBN	Title	Year 1	Year 2	Year 3	Year 4	Year 5
9780552149518	Da Vinci Code,The	677,971	229,799	47,302	2,219	780
9780143004141	CSIRO Total Wellbeing Diet,The	554,760	79,444	20,591	8,160	
9780552150736	Angels and Demons	74,667	300,722	112,151	35,492	10,460
9780733317125	Spotless:How to Get Stains, Scratches and Smells Out of Almost Anythin	250,752	99,060	36,160	11,537	
9781582701707	Secret,The	259,192	51,661	10,679		
9780670040247	Mao's Last Dancer *	79,533	76,244	63,515	33,757	33,288
9780552151696	Digital Fortress	143,141	94,453	38,232	10,097	5,843
9780552151764	Deception Point	135,113	96,153	38,255	10,657	6,127
9780670917099	Memory Keeper's Daughter,The	160,598	65,260	9,881		
9780747566533	Kite Runner,The	24,609	57,943	50,861	75,194	25,159
9780747550990	Harry Potter and the Goblet of Fire	119,499	41,473	32,705	6,428	11,322
9781741145052	My Sister's Keeper	65,423	53,375	53,107	38,238	
9780747562184	Harry Potter and the Chamber of Secrets	103,189	23,607	21,136	14,811	28,840
9780747558194	Harry Potter and the Philosopher's Stone	68,134	19,010	20,393	16,003	35,916
9780747546290	Harry Potter and the Prisoner of Azkaban	121,256	25,868	8,890	4,518	11,722
9780552997041	Short History of Nearly Everything,A	105,381	26,256	18,550	16,093	10,354
9780141011905	Stupid White Men:...and Other Sorry Excuses for the State of the Natio	137,193	35,932	910	228	125
9780140569322	Very Hungry Caterpillar,The	12,548	18,848	21,222	30,953	42,607
9780099456766	Curious Incident of the Dog in the Night-time,The	69,359	34,166	21,509	17,146	8,363
9780733620713	Marley and Me	66,357	45,040	31,777	4,180	
Other Titles		2,367,004	1,619,766	1,455,767	1,130,002	798,144
TOTALS		5,595,679	3,094,080	2,113,593	1,465,713	1,029,050

* It is worth noting that the sixth book on this list, Mao's Last Dancer will be released as a major motion picture directed by Bruce Beresford later this year. Another example of the portfolio nature of publishing; when a book that was published in 2003 and enjoyed English rights sales into both the US and the UK markets will find a new market with the release of the film some six years after it was first published.

This is the tip of a iceberg – for instance Shakespeare and the Bronte sisters would also undoubtedly show a similar pattern

All of this has an obvious benefit for Australia's book printers. Penguin printed approximately 1.4M backlist volumes in 2008, or 28% of its total local printing. There is clearly a lot at stake in terms of throughput, price stability, employment and regional wellbeing.

"From the trade books backlist, the competition from Discount Department Stores that often significantly constrains prices for frontlist titles is largely absent"



This may be an oversimplification. Perhaps what the Commission means is that while the DDS sector offers everyday thumping backlist discounts of between 20% and 35% off RRP, the range of titles on offer is smaller than that offered by other book retailers (although children's book ranges are almost as wide as those carried by most traditional booksellers).

Let's not leave it at that, though. What backlist titles do we think might be carried by the DDS? Well, having a look at what they buy from us and others, we would characterise them as "popular": in other words, they're the books most people want to buy most of the time. Doesn't it follow, then, that if most of the "popular" backlist is available at high discounts from a sector which controls 20-25% of the market, then the Commission's proposition that "upward pressure from PIRs is ostensibly the highest" for backlist titles requires more than a little dilution? Competition is fierce in the Australian book trade, and price competition is its mainstay.

THE ROLE OF THE DISTRIBUTOR IN BACKLIST SUPPLY OF IMPORTED BOOKS

Given the Draft proposal to remove territorial copyright 12 months after a book's original publication, we think it useful to spell out in more detail the differences between Australian distributors and those in the Northern Hemisphere when it comes to selling backlist titles.

I know we talk a lot in our submission about the large number of UK and US titles printed here, but that's driven by the various needs of speed to market for frontlist books; in addition there is also overseas backlist printed locally.

In the UK and US, there is minuscule amount of importing. These are publishing cultures which exist almost totally on books written by natives, or books for which they've purchased rights (often from each other) and which are redesigned and re-edited for their local market. And they're PRINTED there. And reprinted again and again by UK and US printers which deliver stock back into their warehouses in 3-5 days.

Their inventory management of backlist titles is therefore pretty easy. Combine that with large populations spread nicely across these two territories and you have economies of production and distribution scale of which we can only dream.

Now look at us. All Australian distributors also import large quantities of backlist. It's our bread and butter. We place orders based on what sales patterns we see and have to allow 8 weeks before the stock appears in our warehouse. It's a very imprecise business and one which is easy to get wrong, but overall all Australian distributors do a pretty good job of it. And booksellers and consumers benefit from our efforts.



Remove the stability provided by the current arrangements and our ability to service retailers and the public will be unnecessarily trammelled. We'll be overstocked on some titles and others will be temporarily or permanently unavailable. We'll become less profitable, we will necessarily invest less in developing local writers, booksellers will lose sales to Amazon as impatient punters are forced online, the government will lose GST revenue, the costs of distribution in Australia will rise, the book trade will shrink and jobs will be lost.

INCOME LEAKAGE

If we understand this correctly, the Commission is saying that if PIRs push prices up (of imported books), then by whatever factor prices are inflated, money is leaving Australia to the benefit of the originating publisher and their author.

Given that we don't accept that PIRs are inflationary, this is all moot and a good thing too: trying to follow the Commission's Byzantine "preliminary estimates of the income leakage" in Box 5.7 has proved beyond us, and Appendix E.2 has done nothing to clarify the situation.

SOME THOUGHTS ON THE FUTURE OF AUSTRALIAN PUBLISHING UNDER THE PROPOSED CHANGES

Much has been written about the fate of small-to-medium sized publishers in Australia should PIRs be totally revoked and most of what's been said pertains equally to the proposed (partial) changes. We would have thought that enough submissions pointed out that the trade in rights was vital to the continued existence of those companies and if the Commission believes that a one-year moratorium fixes the problem, it is missing the point by a big margin. The draft, funny old document that it is, acknowledges the problem, but weirdly, offers some advice as to how to circumvent it. It suggests that Australian publishers delay selling overseas rights in order to minimise the potential loss of revenue caused by imports of overseas editions if "a publisher judged that protection for a book...for longer than 12 months was particularly important". In other words, if you've got something worth selling – don't. Just sell the other stuff. This should work brilliantly for exports, and one wonders what we should tell our authors: "sorry, we think you might be on a winner here, so we're shutting you down". It seems the logical end-point of this recommendation is not to publish at all – then there's no risk of being undercut.

More seriously, what about the buying of rights from overseas publishers? The big houses do a bit of this to enrich their lists by making a publishing commitment to a book which otherwise would probably never be brought to the attention of the public. And for some of the smaller houses, it provides a vital source of income which enables them to invest in local writing. For this stream of publishing, the current legislation is essential. There will be very little incentive to purchase rights when, a year thereafter, what Michael Heyward calls "the dumpers, the remainder merchants, the low-royalty free riders" are allowed to capitalise on the publisher's work – and to their detriment.



The Australian Book Trade is feeling mugged. Previous attempts at the removal of territorial copyright have foundered on the rocks of common sense, and the Trade has as a consequence continued to flourish to the benefit of its multifarious members and to the community at large.

The Australian book-buyer is well served in terms of price, of availability and of service. She can buy from a huge range of titles held by Independents, Borders or the bigger Dymocks stores. She can price-shop, comparing offers from the Chains and DDSs. Loyalty programmes abound which deliver rewards on future purchases. And really cheap remainders can daily be found in A&R, QBD, most Independents and Newsagencies, and remainder specialist outlets. If this isn't enough, our consumer can simply jump on the internet and buy online from local or overseas suppliers, ordering any edition she wants.

To suggest that any of the above has bred inefficiencies or softness in the industry is to misunderstand the competitive tensions therein. The Commission's assertion that "the presence of the PIRs lessens the imperative to operate at 'best practice' which can result in inflated costs structures and other inefficiencies in parts of the supply chain" is frustratingly misleading.

The real picture is quite the opposite. In the last ten years, massive improvements in efficiencies have been made. Distribution centres have been rebuilt, modified, improved. Supply times are now measured in days and hours, not weeks. Booksellers have made investments in sophisticated software which allows them full stock visibility, as have publishers. Printers have invested in faster, better equipment. Editing and design is screen based. Retail chains buy centrally rather than store-by-store. BookScan data gives great visibility of the trade as a whole and of individual titles. The efficiency improvements have been massive and are ongoing.

There are three main reasons for this.

A. Competition

The trade is highly competitive. Publishers vie with each other for authors, for agencies, for retail space, for market share. Booksellers compete fiercely for the consumer dollar. Only the efficient survive. Most importantly – and this is a mistake which is consistently made by the ideological supporters of copyright deregulation – there is massive competition between individual titles. We are not dealing with a commodity here, a point which the Commission needs to understand better.

B. Margin

Book trade margins are not huge. Trade publishers attempt to make profits of 10% against sales. Some do, some don't, but it's hard to get there and rare to do better. Bookseller margins are more variable but on the whole tend to be even thinner. There is thus no room for inefficiencies and this generates a constant striving for improvements.



C. PIRs

Much of the improvement in efficiency, particularly in distribution, has been possible only *because* of PIRs. The sort of investment made by Australian book distributors would simply not continue were territorial copyright to be abandoned or diluted. Distribution centres need throughput to stay viable and its removal – as the Draft suggest – would result in the downsizing or even closure of several warehouses.

So there we were, thinking we were all participating in an industry which was efficient and becoming more so (in significant part because of the balance provided by the current legislation), which gave the Australian book buyer the widest choice of formats, prices and retail offers in the English-speaking world, which encouraged local writers and publishers while allowing a free flow of books and the ideas they contain from around the world, which could buy and sell rights on a level playing field with the two other major English-language markets of the UK and the US - when, suddenly we're faced with yet another enquiry.

Meetings followed, and submissions. Lots of submissions. Publisher, writers, printers, booksellers, the public; 272 separate documents from all facets of the industry. The results were:

252 in favour of retaining PIRs
13 in favour of an open market
7 not sure, not relevant;

but the Commission has decided to ignore the weight of these opinions, opting instead for a qualitative approach. Those 13 must be pretty good, although in reading them I can't say we agree.

The point is, we know what we're doing, but we're talking to people whose understanding of our various businesses is necessarily limited. The Commission who, to quote Scribe Publisher Henry Rosenbloom have "learned just enough about the book business to be dangerous" have, probably unwittingly, chucked out the baby but kept the bathwater. Although they have grasped the importance of properly orchestrated frontlist publication and its attendant marketing, they've failed to realise the importance either of secondary editions or (more importantly) the extent to which some books continue to matter economically, culturally and educationally.

We find:

1. That the Commission has persuaded itself that PIRs place upward pressure on prices and that they have reached this conclusion without sufficient intellectual rigour and without permitting the inconvenience of considering a null hypothesis.
2. That the disrespect shown to the industry by ignoring much of the content of the vast majority of its submissions is regrettable.
3. That prices of books without PIRs would in all probability increase.
4. That the absence of PIRs would reduce employment and diminish tax revenue.



And we recommend

1. That the current legislation remain as it is, except for a reduction in the 90 day rule, probably to 30 days.
2. That there be no further review of this issue.
3. That any government industry funding go towards book marketing in a general sense, and the collection of industry data.