Book Distribution in Canada's English-Language Market

turner-riggs

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The opinions expressed herein are those of the author and do not necessarily reflect those of the Department of Canadian Heritage.

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Turner-Riggs
Strategy Marketing Communications
Vancouver, British Columbia, Canada
knockknock@turner-riggs.com • www.turner-riggs.com

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EXECUTIVE SUMMARY

Commissioned by the Department of Canadian Heritage (PCH) and conducted from December 2007 through March 2008, this study aims to contribute to our understanding of the book trade by presenting a comprehensive overview of book distribution in Canada's English-language market, and by exploring current issues and market trends related to the book supply chain.

All major categories of book publishing, including educational texts, are considered but the focus throughout is largely on trade publishing—that is, books that are published for a general audience and sold mainly through bookstores.

The term "distribution" is generally used to refer to a wide range of activities within the book supply chain. These encompass functions such as sales and marketing, warehousing and inventory management, order processing and administration, logistics and fulfillment, collections, data management, and customer service. Book distribution is therefore concerned with the functions required to manage book inventories along with all of the transactions involved in trading these inventories between publishers and customer accounts throughout the supply chain.

The major participants in the supply chain are (a) publishers, who acquire rights to titles and prepare them for sale; (b) distributors, who provide fulfillment and warehousing services to the publisher for a fee, have exclusive territorial rights to the publishing lines that they represent, and sell to all types of customers, including wholesale accounts; (c) sales representatives, who provide sales representation for a range of publisher-clients and are paid on a commission basis; (d) wholesalers, who buy selected titles from many publishers and distributors on a non-exclusive basis and then re-sell to retail and institutional accounts; and (e) customer accounts, including retailers and institutions.

Controlling sales and distribution within the publishing house can be thought of as an ideal state for many publishers. Nevertheless, most publishers will contract for some combination of sales representation and distribution services. This approach remains the norm in Canadian publishing, and the reasons are straightforward: the need to manage costs relative to sales volume, the greater market access that larger distributors and sales teams can provide, and the need to manage risk.

The paper explores a number of issues and trends that flow from the following broad characteristics of book distribution.

> Capacity. Available distribution capacity—both in terms of the capacity of an individual distributor and in terms of the distribution capacity of the book system as a whole—has a direct effect on (1) the distribution options available to Canadian publishers, (2) the costs of distribution, and (3) the selection of titles that can be kept in stock and delivered quickly to Canadian accounts and consumers.
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> Scale. The significant investment required in facilities and systems means that successful distributors and wholesalers are those that are able to spread these high fixed costs over the largest possible sales volume. This pursuit of economies of scale

is a powerful force in centralizing and consolidating distribution capacity within the book supply chain.

Focus. Book distributors and wholesalers have emerged as distinct specialists in the supply chain. Many of the respondents to this study noted that "focus" was a key success factor for a book distributor—highlighting the importance of an ongoing commitment to reducing errors, improving processes, investing in systems, and accumulating concentrated expertise in book logistics.

Cash. Distributors are generally bound by contract to pay publisher receivables within a specified time frame. Because of this, the distributor's ability to effectively collect and manage cash, and, in particular, to manage the timing of cash receipts from accounts and disbursements to client-publishers, is critical to its survival.

Margin**.** The need to maintain an adequate operating margin drives the constant search among distributors for greater operating efficiencies. This also bears on the distributor's selection of publisher-clients, in that those publishing lines that offer higher volume and greater profitability will be more sought after than lower-volume clients that will be more expensive to serve.

The paper also considers the issue of market access for Canadian-authored titles, and notes the challenges faced by Canadian-owned publishers—particularly those with $500,000 or less in annual sales—in securing affordable and effective distribution. We observe that these smaller firms have a relatively limited field of potential distributors to choose from, and that their ability to access effective distribution has a significant bearing on the ease with which the books they publish can be discovered by Canadian consumers.

Given that Canadian-owned firms are responsible for publishing a majority of Canadian-authored titles, this in turn indicates that the wide availability of a diverse selection of Canadian titles is heavily dependent on the ability of Canadian publishers to access effective distribution.

The study concludes with an overview of a parallel supply chain in the book trade—a digital supply chain—that moves digital content from publishers to retailers and other aggregators. As social and consumer behaviour, and reading behaviour in particular, continues to shift online, these new models and platforms for digital content distribution bear on the distribution of print books in that (1) the channels by which different kinds of digital and print content are sold are becoming increasingly intertwined, and (2) some of the market-leading firms in print distribution, notably Ingram, HarperCollins, and Random House, have begun to invest heavily in digital distribution.

There are many parallels to be drawn between the market dynamics of digital distribution and those of print distribution. These include the importance of economies of scale, the natural competitive advantages of market leaders, and the presence of powerful gatekeeping effects in the marketplace. These parallels are important if we are to understand how print distribution may change in the coming years as a result of developments in the digital realm.

1.0 INTRODUCTION

Distribution is a part of the book business that is not easily visible to many of those involved in the book trade, and certainly not to the average book reader in Canada. However, effective management of the supply chain—the process of getting books to where they need to be, when they need to be there, and as efficiently as possible—is a critical function in publishing. Further, it is a process that increasingly touches virtually all other aspects of the Canadian book trade, from editorial acquisitions to marketing to consumer behaviour.

From the publisher's perspective, the importance of distribution is two-fold:

1. Sales and distribution functions account for a significant share of costs—as much as 30% of net sales (or more) for many publishers.

2. The degree to which a publisher has effective sales and distribution systems greatly determines its market access and sales performance. This is especially true in a book market, such as Canada's, where (a) trade accounts and consumers have an abundance of books to choose from, (b) customers of all types expect to be able to get the books they want right away, and (c) buying decisions are heavily influenced by the books that are immediately available and well promoted within the sales channel.

All these points considered, decisions around distribution are arguably among the most important strategic choices a publisher can make.

This study aims to contribute to our understanding of the book trade by presenting a comprehensive overview of book distribution in Canada's English-language market, and by exploring current issues and market trends related to the book supply chain. All major categories of book publishing, including educational texts, are considered but the focus throughout is largely on trade publishing—that is, books that are published for a general audience and sold mainly through bookstores.

The study was commissioned by the Department of Canadian Heritage (PCH) and conducted from December 2007 through March 2008. It began with an extensive research phase that identified and examined existing data and analysis pertaining to book distribution in Canada's English-language market. This initial research phase was complemented with a country-wide interview series with book professionals, and by further original research that explored major aspects of cost-scale relationships in book distribution.

We should note at the outset that there is not a great deal of publicly available data on book distribution in Canada's English-language market. This paper draws on data from Statistics Canada and other published studies for its statistical foundations, and expands on this with observations and insights gathered through industry interviews as well as additional proprietary data contributed by individual firms or organizations.

The research for this paper was further informed and supported by a previous study conducted for PCH throughout the spring and summer of 2007: *The Book Retail Sector in*

Canada. This earlier study was published on the Canadian Heritage website in January 2008[1], and readers are encouraged to review it as a complementary resource.

Similarly, a complementary study on book distribution in Quebec was also carried out during the first half of 2008. The completed study, "La diffusion et la distribution du livre de langue française au Canada", is available in both official languages on the PCH website: http://www.pch.gc.ca.

Our findings with respect to book distribution in Canada's English-language market are summarized in this paper and organized in the following chapters:

- Trading Partners: An overview of principal roles and types of trading partners in the book supply chain.

- Terms of Trade: An overview of key components of cost in book distribution and current terms of trade among publishers, distributors, retailers, and institutional accounts.

- Issues in Book Distribution: A summary of current and emerging market dynamics having a material effect on the book marketplace and/or trading practice in the supply chain.

- Market Access for Canadian-Authored Titles: An analysis of how book distribution in Canada's English-language market affects the availability of Canadian-authored titles for Canadian readers.

- Digital Distribution: An overview of emerging models and platforms of digital distribution, and their relationship to the supply chain for print books.

[1] The paper is available in PDF and HTML editions, and in both official languages, on the Department of Canadian Heritage website: http://pch.gc.ca/progs/ac-ca/pubs/index_e.cfm

1.1 DISTRIBUTION BASICS

The term "distribution" is generally used to refer to a wide range of activities within the book supply chain. These encompass functions such as sales and marketing, warehousing and inventory management, order processing and administration, logistics and fulfillment, collections, data management, and customer service.

Book distribution is therefore concerned with the functions required to manage book inventories along with all of the transactions involved in trading these inventories between publishers and customer accounts throughout the supply chain. This is best understood as a collaborative process and one that involves the active management of multiple business-to-business trading relationships.

Book distribution in Canada is heavily influenced by an important structural aspect of the domestic marketplace: Canada is a relatively small market, with a modest population spread over a large geographic area. Economies of scale are particularly difficult to achieve in such a market, and as will see in subsequent chapters in this paper, this has broad implications for the structure and operation of the book supply chain.

For the moment, we will simply note that the book trade in Canada's English-language market—particularly with respect to publishing houses, distributors, customer base, and warehouse capacity—is heavily concentrated in central Canada. This has created a supply chain where inventories are largely aggregated and stored in and around the Greater Toronto Area—both with respect to titles originated in Canada and the large volume of books imported to Canada—with supply routes running east and west to the relatively lower population regions in the rest of the country.

Figure 1. The geography of the book supply chain in Canada's English-language market.

2.0 TRADING PARTNERS

2.1 THE BOOK SUPPLY CHAIN IN CANADA'S ENGLISH-LANGUAGE MARKET

In some respects, the different players in the supply chain defy easy classification. Some firms play multiple roles (e.g., publishers that are also distributors; booksellers that are also wholesalers), and services offered may be packaged in varying combinations for different clients.

For the purposes of this paper, we will classify individual firms by their primary role(s) in the industry. Similarly, we will define a few broad categories of participant in the supply chain as illustrated in Figure 2 below.

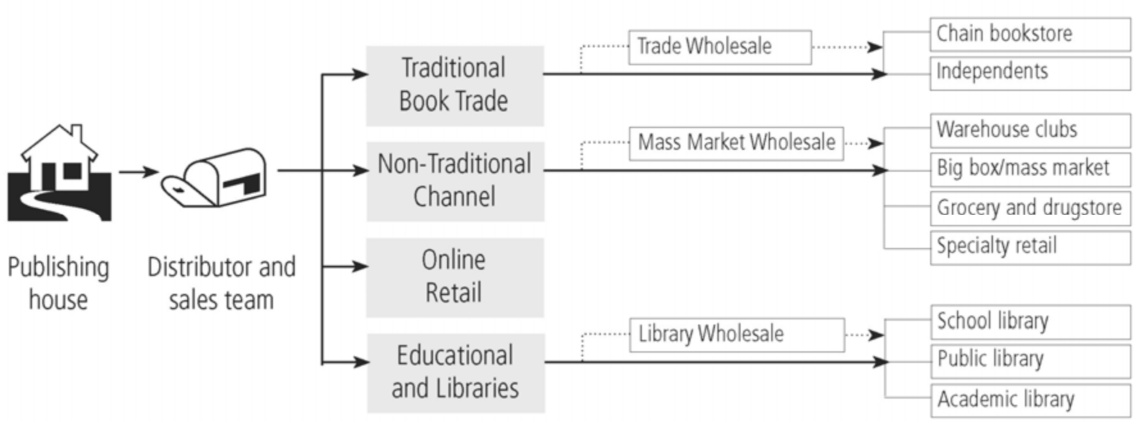

Figure 2. Major sales channels and trading partners in the book supply chain[2].

Figure 2 illustrates the key sales channels, and the major roles within each, for the domestic book market. We can make a few broad observations based on this illustration:

1. The major participants in the supply chain are (a) publishers, who acquire rights to titles and prepare them for sale; (b) distributors, who perform a range of order processing, warehousing, fulfillment, and collections functions; (c) sales representatives, who sell to and support customer accounts; (d) wholesalers, who sell to retail accounts; and (e) customer accounts, including retailers and institutions.

2. Publishers, through their sales and distribution systems, may sell directly to retail and/or institutional accounts, or may sell to wholesalers who service these accounts.

As noted earlier, it is not unusual that an individual firm will occupy more than one of these categories. In particular, there are those publishers that self-distribute and provide their own sales representation. These are generally the larger publishing houses, such as HarperCollins Canada, whose scale of operation allows them to maintain their own distribution systems and sales teams, or more specialized publishers with a well-defined market niche and, often, a limited reliance on large national trade accounts.

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[2] Note that Figure 2 is not an exhaustive list of sales channels for Canadian publishers, and illustrates only those domestic channels that are commonly served by distributors, wholesalers, and sales agencies.

Edmonton-based Company's Coming Publishing, with its focus on direct sales to non-traditional retail, and Victoria's Orca Books, with its emphasis on the library and school market, are good examples of this latter category.

Controlling sales and distribution within the publishing house in this way can be thought of as an ideal state for many publishers. As US publishing consultant Thomas Woll has said, "No one cares as much about the success of a publisher's books as the employees of that house. Books will get much more individual and focused attention from house reps than from others."

In-house control of sales and/or distribution also has the effect of connecting publishers more directly with their customer accounts, and this generally means more ready access to sales information, greater awareness of promotional opportunities, and improved capacity to gather market intelligence.

Nevertheless, most publishers will contract for some combination of sales representation and distribution services. This approach remains the norm in Canadian publishing, and the reasons are straightforward: the need to manage costs relative to sales volume, the greater market access that larger distributors and sales teams can provide, and the need to manage risk.

2.1.1 CONTRACTING FOR DISTRIBUTION

The following figure illustrates the major practical considerations for a publishing house in deciding whether to contract for sales and distribution services, as opposed to managing these key functions in-house.

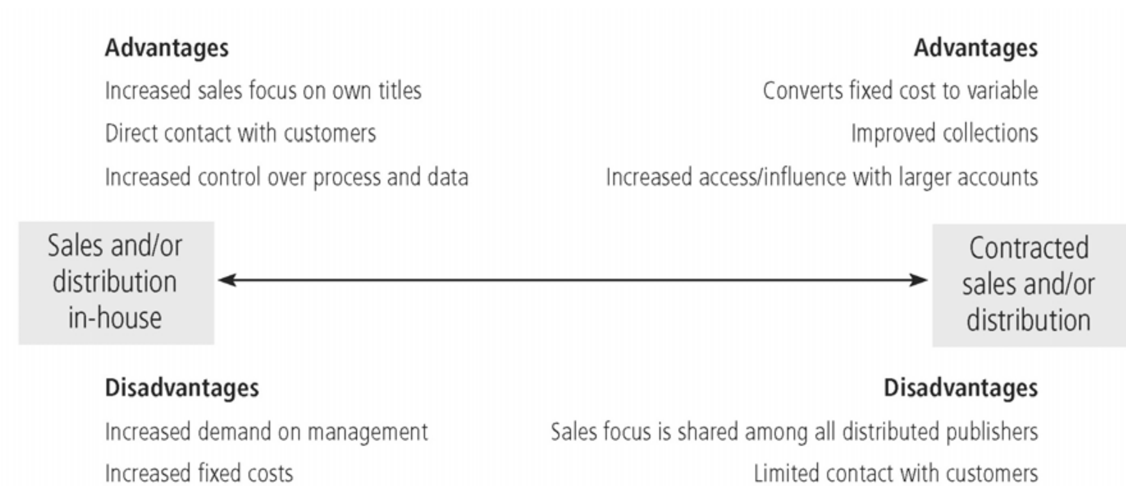

Figure 3. Advantages and disadvantages of managing sales and distribution in-house.

As Figure 3 indicates, cost is a major consideration in the publisher's decision. Maintaining a sales team and/or distribution system in-house is expensive—particularly taking into account the considerable investment in staffing, facilities, and technology that the modern supply chain requires. These will be borne by the publisher largely as a fixed cost. Contracting with a distributor for these services converts these potentially significant components of company overhead to variable costs. The publisher pays for only the portion of the system it uses, not the entire facility or the overhead that supports it. The publisher pays commissions only for its actual sales, and is relieved of responsibility for the payroll of a national sales team.

Further, larger retailers will be reluctant to maintain separate accounts with smaller publishers or with those with which they have a modest sales volume. It is more efficient for the retailer (or institutional account) to place consolidated orders with a single distributor or wholesaler. In this sense, distributors play an important aggregating function in the marketplace that allows smaller firms to trade effectively with larger accounts.

Similarly, smaller firms will generally have a lower payment priority for larger accounts, whereas a larger distributor can collect receivables more effectively and predictably. This in turn generally means a shorter receivables period, a stable flow of payments, and a more reliable cash flow for the publisher.

With these points in mind, we can modify our earlier observation about the ideal state for the publisher being to bring as much of the sales and distribution function in-house as possible by saying that this is dependent on:

a) the relative costs of in-house sales and distribution versus contracting these out;
b) the optimal mix required to serve the publisher's main channels to market.

The economics of distribution and the dynamic of the marketplace will mean that, for the majority of publishers, the most effective approach will involve some level of contracting out to specialized distributors, wholesalers, and sales agencies.

2.2 AN INTRODUCTORY NOTE ON THE PARTICIPANTS IN THE SUPPLY CHAIN

The remainder of this chapter will explore the different types and characteristics of distributors, sales representatives, and wholesalers in the Canadian marketplace.

As we noted earlier, the lines between the different participants in the supply chain are not always clear. However, the basic distinctions that can be made between wholesalers and distributors are that distributors provide services to the publisher for a fee, have exclusive territorial rights[3] to the publishing lines that they represent, and sell to all types of customers, including wholesale accounts. In contrast, wholesalers buy selected titles from many publishers and distributors on a non-exclusive basis and then re-sell to retail and institutional accounts.

In some markets, notably the US, the incorporation of an in-house sales team can be a further distinguishing characteristic of a book distributor. This is true among some of the largest distributors in Canada as well, but more common is the distributor that operates without an in-house sales team. This means that Canadian client-publishers generally have more flexibility with respect to sales arrangements, and will often contract for distribution services and sales representation separately. With this in mind, we will treat sales teams as a distinct category of participant in the book supply chain, along with distributors and wholesalers.

[3] The term "exclusive territorial rights" refers to the distributor's exclusive right to distribute the publisher's titles within a specified territory. In theory, this territory can be defined in any way that is mutually agreeable to the publisher and distributor. In practice, this most often refers to the right to distribute in Canada.

2.3 DISTRIBUTORS

Leaving aside the issue of sales representation for the moment, Canadian distributors otherwise offer a comprehensive range of services to their client-publishers. These typically include the following:

Basic fulfillment

- Warehousing
- Receiving and processing orders
- Order fulfillment: picking, packing, and shipping
- Data management of inventory and orders for client-publishers and customer accounts[4]
- Returns receipt and processing
- Invoicing and collection of accounts receivable

Marketing services (may be optional fee-for-service items or bundled with basic fulfillment)

- Publicity
- Sales catalogue
- Trade advertising
- Representation at trade shows and sales conferences
- Administration of co-op budgets

Additional services (generally charged on a fee-for-service basis over and above basic distribution fees)

- Warehousing of publisher overstock
- Packaging and shipping of promotional displays
- Shipment of advance reading or review copies
- Stickering
- Special promotions or title-specific marketing programs

Given the majority market share of imported books in Canada[5], we should note that these services are often packaged differently for foreign and domestic publishers. Generally speaking, foreign publishers are more likely to contract for a bundle of fulfillment, marketing, and sales services from a single distributor. In contrast, Canadian publishers will

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[4] Note that in many cases this includes the aggregation of bibliographic data from publishers and its onward transmission to key trading partners or other data aggregators within the supply chain.

[5] 2004 Statistics Canada data indicates that Canadian-owned firms accounted for 41% of domestic sales by Canadian-based publishers (with Canadian subsidiaries of foreign-owned multinationals accounting for 59%). However, due to the Statistics Canada survey methodology, these figures likely overstate the share of market for Canadian firms, as some large distributors of imported titles are excluded from the survey sample.

often contract separately for distribution and sales representation, and will retain many aspects of marketing support for their titles in-house.

But for that distinction, the participants in this part of the Canadian supply chain can be broadly classified in three categories: (1) publisher-distributors, (2) distributors, and (3) self-distributing publishers.

2.3.1 PUBLISHER-DISTRIBUTORS

Publisher-distributors are publishing houses that maintain their own sales and distribution systems. For the largest firms in this category, the distribution part of the business may be spun off as a separate division or subsidiary company with strong organizational and operational ties to the publishing parent.

These publisher-distributors take on other publishers—and in the case of foreign-owned firms, the lists of the international parent—as distribution clients. In such cases, the publisher-distributor has created a distribution system with more capacity than it needs to handle its own titles. Rather than carrying the additional overhead associated with this additional capacity, the publisher-distributor is effectively re-selling the excess capacity to its client-publishers—and, in so doing, is sharing system costs among its distribution clients and generating an additional revenue stream in the process.

Carrying additional distributed lines also allows the publisher-distributor to increase its overall sales volume and market presence. In a relatively flat marketplace like Canada's, the distribution side of the business can therefore be an important source of sales growth.

In fact, a number of Canadian publisher-distributors act as in-Canada distribution agents for foreign publishers. These agency revenues have historically been a critical aspect of the business model for many publishers and distributors in Canada. Some of the oldest publishing houses operating in Canada today—both Canadian subsidiaries of foreign-owned firms and companies founded in Canada—began as distributors of imported titles, using distribution revenues to finance their first original publishing programs. Many others continue to rely today, to varying degrees, on agency revenues from imported lines.

Contemporary examples of distributors in the publisher-distributor category include the foreign-owned firms Penguin Canada, HarperCollins Canada, Random House of Canada, McGraw-Hill Ryerson, Scholastic Canada, and John Wiley & Sons Canada; and the Canadian-owned firms Thomas Allen & Son, H.B. Fenn and Company, University of Toronto Press, Nimbus Publishing, and Firefly Books.

2.3.2 DISTRIBUTORS

Distributors do not publish their own original titles, but instead focus entirely on distribution services for client-publishers[6]. Examples of distributors in this category include the Canadian-owned firms Raincoast Books, Publishers Group Canada[7], Fraser Direct/Jaguar Book Group, Georgetown Terminal Warehouse, and Sandhill Book Marketing[8]; and the foreign-owned Simon & Schuster Canada.

In addition to their core distribution services for Canadian clients, Fraser Direct and Georgetown Terminal Warehouse also do a significant freight forwarding business. This involves clearing consolidated international shipments, mainly from the US, through Canadian customs and then processing this inventory for onward shipping to Canadian accounts.

Along with these major trade distributors, the Canadian supply chain also features a number of educational and scholarly distributors along with those specializing in one or more subject categories such as Dempsey (self-help, personal growth), ABC Art Books (art), BND Distribution (religion), and Fernwood Books (academic)[9].

Raincoast Books has emerged as one of the country's leading specialist distributors. It incorporates within its operations a full-service distributor (Raincoast Books), a wholly owned distribution subsidiary (Publishers Group Canada), and a trade wholesaler (BookExpress). Each of these operating units provides a different combination of sales, marketing, and distribution services to a distinct client group. However, each also shares a common infrastructure within Raincoast for warehousing, operations, invoicing and collections, ordering processing, customer service, and marketing.

Raincoast has been able to leverage its significant investments in plant capacity and systems by using this infrastructure to provide targeted services to a variety of customer groups. This is arguably a key reason for Raincoast's prominent position in the Canadian marketplace and an important contributor to the operating efficiencies the company has achieved.

In another interesting example of how fulfillment services can be bundled to fit the requirements of specific client groups, Fraser Direct also operates the Jaguar Book Group, a group of more than 30 small- to mid-sized publishers with annual revenues of between $500,000 and $1 million each. Jaguar Book Group allows these smaller firms to acquire some additional distribution efficiencies—and lower distribution costs—by consolidating orders, invoices, shipments, and collections under the Jaguar name.

[6] The exclusive distribution right described here is distinct from the territorial publication right that applies when a Canadian publisher purchases Canadian rights to a foreign title and then publishes the book in Canada under its own imprint.

[7] A wholly owned subsidiary of Raincoast Books.

[8] Sandhill specializes in titles from small presses as well as those that are self-published by the author. As such, it represents an interesting, and growing, subset of Canadian firms that provide publishing and distribution services for self-published authors. Other companies in this category include White Knight Distribution Services and Author's Choice Publishing Group.

[9] Each of the specialty distributors noted here is Canadian-owned.

Fraser Direct also plays a part in another innovative approach to small-press distribution in Canada as the fulfillment house for LitDistCo (the Literary Press Group Distribution Collective), a group of 35 Canadian literary presses. Fraser Direct again consolidates orders, invoices, shipments, and collections on behalf of LitDistCo, and LitDistCo takes on some of the administrative work of distributing sales information and payments to member publishers, supporting the member publishers, and carrying out trade negotiations and promotions planning on behalf of the group. Through this division of labour, the small presses in the collective are able to access a full-service distributor at more manageable costs than would otherwise be available.

This is an important feature of the LitDistCo model since, as we will explore further below, one of the great challenges of distribution is the inverse relationship between fulfillment costs and publisher sales volume.

2.3.3 SELF-DISTRIBUTING PUBLISHERS

Finally, the Canadian-owned sector of the book publishing industry is distinguished by an additional category of distributor: **the self-distributing publisher**. These firms publish and distribute their own titles, and, in some cases, the titles of one or more subsidiary or affiliated imprints. In contrast to the publisher-distributor category, the self-distributing publisher's original publishing program remains its primary focus and it has generally opted for self-distribution as the most economical and/or best strategic fit for its publishing program.

Both Harbour Publishing and Heritage House are good examples of firms in this category. Harbour distributes its own titles along with books from two other publishers in which it has or has had an ownership interest: Nightwood Editions and Caitlin Press. Similarly, Heritage House distributes its own books along with titles from two subsidiary companies, Touchwood Editions and Rocky Mountain Books.

2.4 SALES REPRESENTATION

Publishers' sales representatives make regular sales calls on buyers with retail accounts across the country. They sell the publisher's books into these accounts—with orders going to the distributor for processing and fulfillment—and play a critical role in field support for their retail accounts throughout the year.

As such, the degree of effectiveness of the publisher's sales team is a major determinant of success in a number of sales channels, as well as an important source of market intelligence regarding feedback from accounts, changing market conditions, and promotional opportunities.

As mentioned earlier, publishers organize their national sales representation in a variety of ways. Many publisher-distributors have in-house teams of sales representatives working in territories throughout the country, and so client-publishers of those firms will often have sales representation bundled with their fulfillment services.

Other publishers will rely on independent sales agencies, some of which are formally or informally affiliated with distributors, for national sales coverage. There are a number of well-established sales teams throughout the country, including Kate Walker & Company, Canadian Manda Group, Michael Reynolds and Associates, Hornblower Books, and many other regional and subject specialists as well[10].

Publishers may also choose to establish a mix of in-house and commissioned sales representation, where the publisher retains some regions of the country, or certain accounts, for its in-house staff. This can be effective in cases where the publisher has a concentration of sales in one part of the country—so that these accounts can be effectively served by a house rep, and there is a sufficient sales volume to support one or more permanent staff.

This highlights the biggest challenge of using in-house sales representatives: the cost. Comparative costs of in-house versus commissioned representatives will vary according to the sales mix, overheads, and local labour conditions for a given publishing house. But, as a rough measure, the salary, payroll, and travel budgets required to support a single in-house sales representative would suggest a requirement of as much as $1 million or more in annual sales to support each full-time in-house rep.

Even so, it has also become increasingly common for publishers to treat so-called national accounts (e.g., such as Indigo or Costco) as "house" accounts[11]. This reflects the growing market concentration at the retail level, and the corresponding growth in market share of these large retailers.

The Book Retail Sector in Canada study estimates that Canada's national bookstore chain, Indigo, alone accounts for 44% of the domestic consumer book market. Further, the study notes a broad pattern of concentration in Canadian book retail.

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[10] Each of the sales agencies noted here is Canadian-owned.

[11] A house account is one that the publishing house deals with directly, especially for initial sales orders, even in cases where it has otherwise contracted with a sales agency or distributor for sales representation.

> "As is the case in many world book markets, the Canadian consumer book trade is highly concentrated among a relatively small number of players. There is one national bookstore chain in Canada's English-language market, Indigo, and two regional chains that have comparable market power within Quebec, Archambault and Renaud-Bray. Beyond this, the retail market is composed of a number of mass market retail chains, notably Costco Wholesale, that have embraced the book category; a growing number of players in the online channel, led by the web retailer Amazon; and an independent bookstore sector that, while reduced in numbers in recent years and still under pressure, has lately shown some signs of recovery.[12]"

If there is a positive aspect to this market concentration it is that a publisher can typically address more than 50% of the Canadian retail market through sales calls to as few as three accounts—major retailers such as Indigo, Costco, and Amazon—whether by a dedicated house rep or by other senior staff from the publishing house.

Keeping in mind the maxim that in-house control of sales is an ideal state for most publishers, this type of account split is a sustainable step that more publishers are able to make in today's marketplace. Generally, a publisher that makes most of its sales through traditional book retail will have enough sales volume to justify its interest in dealing directly with major national accounts. The more pressing issue will be whether or not the account itself feels that the publisher's sales volume is sufficient to warrant a separate sales appointment as buyers will generally prefer to see smaller-volume publishers' lists presented together by a distributor's rep or commissioned sales representative.

As this last point illustrates, the choice between in-house and commissioned sales representation is not simply a matter of dollars and cents. The professional sales agencies working throughout Canada have, over a period of years, established close working relationships with retail and institutional accounts.

Needless to say, these publishers' representatives have also amassed considerable expertise and insight into the preferences and practices of key accounts as well as local market conditions in regions across the country. In this sense, the commissioned sales agency is not only a mechanism for sharing costs among publishers, but also a way for client-publishers to access additional expertise and business relationships to help them navigate the supply chain in every region.

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[12] *The Book Retail Sector in Canada*, Department of Canadian Heritage, January 2008.

2.5 WHOLESALERS

In contrast to distributors, most wholesalers do not actively sell to accounts via sales representatives. Rather, they receive orders to re-supply retailers, provide efficient mechanisms to consolidate orders for libraries and institutions, and in some cases, manage buying and fulfillment for non-traditional retail accounts.

Broadly, the wholesale supply chain can be categorized into trade wholesale, mass market wholesale, and library wholesale.

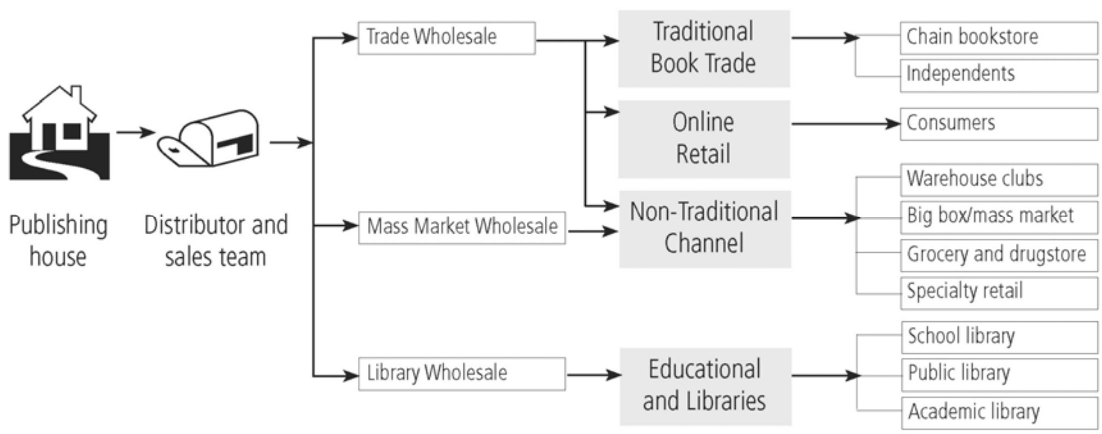

Figure 4. Wholesale channels in the supply chain.

2.5.1 TRADE WHOLESALE

Trade wholesalers have a relatively short history in Canada. The first, Cannon Books, was established in 1975 and closed in 1996. Today, there are two national trade wholesalers operating in Canada's English-language market: BookExpress, a wholly owned Raincoast subsidiary, and North 49 Books. Both are Canadian owned.

Each maintains an inventory of between 3,000 and 4,000 strong-selling titles, books that are "must have or hard to get," as one of our respondents put it—in other words: titles that are in demand but for which there is limited available inventory in Canada, meaning that retail accounts may have difficulty replenishing store stock from the distributor.

While initial store orders for new titles will generally be filled by the distributor, trade wholesalers act as re-suppliers to ensure that bookstores (mainly independent booksellers) as well as non-traditional retail accounts are able to quickly fill re-orders of fast-moving titles. They may also play a role in shipping online retail orders directly to customers.

The trade wholesaler's focus on independent retail highlights another practical aspect of book distribution in Canada. Most distributors consolidate shipments on a couple of levels. Many require accounts to meet a minimum order size. And many consolidate shipments geographically by shipping to a given region on a specified day or days during the week. The trade wholesaler therefore plays a key replenishment role for smaller retailers with orders below the required minimum, or for those that cannot wait for the next shipping window from the distributor.

In contrast, large retail accounts, including national chains, generally order directly from publishers and/or their distributors. Because of the importance of these accounts, and the size of a typical order from a major retailer, their orders will be shipped promptly and so they rely less on trade wholesalers for reorders.

Compared to other national markets, trade wholesalers account for a relatively modest share of book sales in Canada. In the larger US market, for example, a major wholesaler like Ingram is able to achieve considerable economies of scale and has emerged as a major player with nearly 1.4 million titles in stock. In terms of relative market share, the wholesale channel accounts for more than 25% of trade book sales in the US, but is generally estimated at less than 10% in Canada.

2.5.2 MASS MARKET WHOLESALE

The Book Retail Sector in Canada estimates that 20% of the consumer book market is accounted for by the non-traditional retail sector (i.e., non-bookstore retail). Many of Canada's mass market and non-traditional chain accounts, including Wal-Mart, are serviced by a mass market wholesaler.

Canada's two major wholesalers of books and periodicals in this category—Canadian Mass Media Inc. (CMMI) and The News Group, both Canadian owned—provide buying, inventory management, category management, and merchandising services for major non-specialist retailers in the mass market, grocery, drug, and convenience sectors.

Both firms are major players in the supply chain for books. CMMI buys all of the books for the nearly 300 Wal-Mart locations throughout Canada, and The News Group supplies nearly 8,000 retail outlets nationwide, including major grocery and drug chains such as Loblaws, Shoppers Drug Mart, and Overwaitea/Save-On. The News Group claims to be the second-largest buyer of book inventory in Canada, after the market-leading Indigo chain.

Publishers and distributors selling to CMMI or The News Group accounts will present new titles and plan promotions with the buyers within these organizations, and to a lesser extent, directly with the retailer in the case of very large buys or other major initiatives.

For the publisher, the advantage of this sales model is that the wholesaler provides a range of specialized merchandising services to the retail account that the publisher could not typically manage itself. This means that publishers can access the demanding mass market channel at a much lower cost than they would be able to otherwise. Similarly, the wholesaler's participation means that these large retailers can feature an actively managed book department without having to manage the large number of SKUs[13]—one for each title in inventory—that are associated with even a modest book selection.

[13] A Stock Keeping Unit is a unique identifier given to each of the distinct products listed in a retail inventory.

2.5.3 LIBRARY WHOLESALE

In comparison with other types of book wholesalers, Canada's library wholesalers provide additional value-added services for their institutional accounts. These firms receive title information and review copies from publishers and select the books that they will present to their public and school library clients. Selected titles are presented to libraries through a series of thematic seasonal catalogues, and in the case of school libraries, in listings that correspond to curriculum requirements.

These wholesalers provide an efficient ordering mechanism for libraries, allowing for consolidated orders, invoices, and shipments of books from many different publishers. Further, library wholesalers offer a range of services customized to the needs of individual libraries and library systems, including processing (even laminating) and cataloguing of new books.

There are a number of established library wholesalers operating in Canada's English-language market today, including S&B Books, Coutts Library Services[14], Libra Information Services, Library Bound, Library Services Canada, Skylight Books[15], and United Library Services. All of these, with the exception of Coutts, are Canadian-owned.

Another established wholesaler, National Book Service, announced in March 2008 its plans to cease operations by mid-2008. NBS cited declining school library budgets as a major factor in the decision to close. Library funding is no doubt a key aspect of the market context for library wholesalers, as is increasing competition from American suppliers and the shift in library acquisitions budgets from print to electronic resources. Nevertheless, the sector has appeared relatively stable—as has much of the Canadian wholesale sector—in recent years.

2.5.4 SPECIALTY WHOLESALE

To these three main categories of book wholesalers, we could add a fourth and final category: the specialist wholesaler that has a particular subject, regional, or niche focus. There are a number of such firms operating in Canada today—such as Accent Technical (technical guides), B. Broughton (religious titles), and Crown (government publications)—and one in particular that warrants additional notice for its unique role.

Markham-based Fairmount Books specializes in reselling publishers' overstock to both bookstores and non-traditional retail. "Overstock" refers to excess book inventory that has been sold to Fairmount at a deep discount, especially in the case of remaindered stock (i.e., books that the publisher feels can no longer be sold and that have been liquidated at extremely low prices[16]). This stock is in turn sold at deeply discounted retail prices. The publisher's goal in such cases is to recover some cash value from stock that has little or no

[14] Coutts Library Service was acquired by Ingram in December 2006.
[15] Skylight is the wholesale division of leading independent bookseller McNally Robinson.
[16] In fact, remainder inventory is often sold by weight, reportedly at prices ranging from $1,200 to $2,000 per ton, by publishers, distributors, or even larger retailers that have overstocked non-returnable inventory.

holding value: it is not likely to be sold and is in fact likely to incur additional carrying costs if the publisher continues to hold it in inventory.

As we will see shortly, there is mounting pressure throughout the supply chain to manage both store and warehouse inventories more effectively, and in particular, to remove as much surplus inventory from the supply chain as possible. This creates an opportunity for credible wholesalers, such as Fairmount, that have demonstrated they can handle such inventory well. It also creates an abundance of low-cost book product for retailers and consumers alike.

The handling of remaindered inventory and other overstock is not without controversy. There is some indication that the Canadian supply chain absorbs a disproportionate share of imported overstock, particularly from the US (and, in the case of Quebec, from France). This excess inventory can weaken the market for Canadian rights-holders[17], and at the very least, is an abundant supply of low-cost product that competes for the attention of Canadian book buyers.

2.5.5 DISTRIBUTION CENTRES: THE SUPPLY CHAIN WITHIN THE SUPPLY CHAIN

In addition to the range of wholesalers and distributors we have described above, Canada's largest national accounts, notably the national chain Indigo, maintain their own internal distribution centres. Such centres are commonly referred to as a "DC" within the book trade, and the largest of these greatly exceed the scale of the largest wholesalers or distributors in the country. Publishers and distributors are required to ship all orders to the DC, and these inventories are then processed into consolidated shipments to individual retail outlets throughout the chain.

We can understand the DC as a wholesaler that does not sell books, but nevertheless is a key logistics mechanism within the supply chain. In a concentrated marketplace, the degree of effectiveness and operations of any such major distribution point has a profound effect on the overall efficiency of the supply chain.

The significant point here is that there is a natural bias in such distribution systems toward centralization and standardization. While some publishers may ship directly to individual stores—with the permission or direction of the account—a large retailer will try to maximize the inventory volumes handled through the DC as much as possible. The goal is to lower distribution and processing costs, achieve more frequent store deliveries, and move stock to store shelves more quickly.

Such systems, however, also tend to ignore granularity in the marketplace and this can give rise to other types of inefficiencies. A centralized Indigo DC, for example, means that a BC-based publisher cannot directly re-supply a Vancouver Indigo store with a hot title in the weeks before Christmas. Instead, they would have to ship any additional required stock to the DC in Ontario, from where that same stock would then be shipped back to the store in Vancouver.

[17] This becomes an issue when foreign editions are remaindered in Canada at deeply discounted prices at the same time as a Canadian publisher has a Canadian edition of the same book for sale in the marketplace at the regular list price. In such cases, the value and sales potential of the Canadian edition is undermined.

Regardless of the DC's degree of efficiency, the result is that a delivery the publisher could have made locally within the hour will instead take several days or even weeks to travel back and forth across the country before landing back on the shelves of the Vancouver store. It will cost more to do so, in terms of direct handling and shipping costs, and sales will be lost while the store is waiting to receive its stock.

This phenomenon illustrates a couple of interesting points about the Canadian supply chain:

1. There are some natural inefficiencies that arise from the east-west supply chain that we described earlier.

2. When market share is heavily concentrated, as it is in the Canadian book trade, it is difficult to effect broad system improvements without the active participation of the nation's largest retailers.

   As a counterpoint to this, large retailers can themselves effect major system improvements that can benefit trading partners throughout the supply chain. For example, Indigo has invested heavily in its distribution and inventory systems in recent years, most notably in its implementation of the SAP system in 2004, and anecdotal reports suggest that this has had a positive impact on processing and shipping times, and on the stability of ordering and inventory patterns.

3.0 TERMS OF TRADE

The following chapter provides an overview of how—and how much—distributors, wholesalers, and sales agencies charge for their services. We also explore some of the major determinants of distribution cost from the publisher's point of view, including the effect of returns and the relationship between sales volume and cost of distribution.

3.1 A BRIEF INTRODUCTION TO THE CANADIAN BOOK TRADE

To recap, the major participants in book distribution in Canada's English-language market are as follows.

> **Distributors** provide fulfillment and warehousing services to the publisher for a fee, have exclusive territorial rights to the publishing lines that they represent, and sell to all types of customers, including wholesale accounts.
>
> **Wholesalers** buy selected titles from many publishers and distributors on a non-exclusive basis and then re-sell to retail and institutional accounts.
>
> **Sales agencies** are national teams of sales representatives, who may be formally or informally associated with one or more distributors. These teams provide sales representation for a range of publisher-clients and are paid on a commission basis.

The Book Retail Sector in Canada provides the following observations with respect to terms of trade in the supply chain.

1. Unlike in other retail sectors, in the book trade, the manufacturer (the publisher) establishes the list price[18] for each book.

2. Books are sold to wholesalers and retailers at a "trade discount" from the list price, which effectively represents the margin for a wholesale or retail account on each copy sold. For example, if a publisher sells a book with a list price of $20 at a 50% discount, the publisher will receive $10 for the book and the retailer will realize a $10 margin, presuming the book is sold for the full list price[19].

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[18] The list price (the established retail price of the book) is determined by the publisher and printed on the cover of the book. The list price provides a fixed reference point for the calculation of trade discounts extended by publishers to booksellers, price discounts extended by booksellers to consumers, and also author royalties. Prices may be listed in various currencies for imported titles or for Canadian books sold outside the country, in which case the currency of the nation where the book was originally published often provides the basis for a foreign-currency equivalent price. Publishers generally establish foreign currency prices (or Canadian dollar prices for imported titles) up to a year in advance based on anticipated exchange rates. For books sold both in Canada and the US, both the Canadian and American list prices are typically printed on the cover.

[19] Historically, these discounts have been in the range of 50% for wholesalers and 40–44% for retail. Over the past ten years, however, retail discounts have crept upward (particularly for high-volume accounts) and are now more commonly in the 44–48% range.

3. Contrary again to the trading practice in many retail sectors, all books sold through traditional bookstores are sold fully returnable; booksellers can return books to distributors or publishers if they find they are unable to sell them.

4. Partly because of established returns practice, most publishers accept a payable period of 90–120 days on bookstore receivables. This is a lengthy period compared to many industries, and one during which the publisher bears responsibility for underwriting all cash requirements of editorial, design, production, and marketing. If a retail account is itself pressed financially, this payable period can stretch beyond the 120-day mark and/or the publisher may receive a shipment of returns, as opposed to an invoice payment, to draw down accounts payable for the current period.

With this as a backdrop, this chapter will explore common terms of trade for book distribution. The discussion here will be necessarily general for the following reasons:

- These costs may be structured in various ways through the negotiations between any two trading partners (and the trading terms that these reflect).

- Out of respect for the confidential discussions carried out during this study we cannot disclose the terms of individual distributors or other firms.

3.2 SALES AND DISTRIBUTION COSTS

For purposes of illustration, let's assume for the moment the following scenario:

- A publisher with annual shipped (or gross) sales of $500,000
- Returns are 25% of shipped sales
- Sales are made principally through traditional book retail channels
- The publishing house relies on a commissioned sales team for its sales representation

At current market rates, this publisher's distribution costs will break down as follows:

- Basic fulfillment: 15% of shipped sales
- Returns process: 3% of returns
- Sales commission: 10% of net sales

These rates lead in turn to the following calculation of sales and distribution commissions:

Shipped sales	$500,000
Returns at 25%	$125,000
Net sales	$375,000
Sales and Distribution Costs	
Basic fulfillment at 15% of shipped sales	$75,000
Returns processing at 3% of returns	$3,750
Sales commissions at 10% of net	$37,500
Total Commissions and Fees	$116,250
Distribution costs as a percentage of net	21%
Sales and distribution as a percentage of net	31%

Table 1. Calculating sales and distribution commissions in relation to net sales.

In practice, the distributor may charge a combined rate for basic fulfillment that factors in an estimate for returns handling, or they may bill returns as a separate item (as in our example above) that reflects actual returns rates.

The difference in accounting for this cost may simply be a matter of approach for a given distributor, or it may reflect the negotiated terms (and the accommodation re: returns risk in particular) between a given publisher and its distributor. Either way, it has become more common in recent years for book distributors to incorporate a charge for returns handling.

There have been other notable changes in distribution terms in recent years as well, particularly in the following areas:

1. <u>Rising freight charges</u>. Historically, book retailers have been responsible for shipping costs from the distributor. In recent years, however, it has become increasingly common for distributors to pay some or all of the freight costs of shipping orders to retail accounts, and to high-volume accounts in particular. These costs are now commonly passed on to the distributed publisher as an additional charge. These costs are hard to measure with certainty, but the examples we reviewed during the study suggest that they range from 2 to 6% of net sales, depending on the publisher's sales volume.

2. <u>The introduction of excess inventory charges</u>. In previous years, distributors would normally warehouse virtually all of a publisher's inventory. Today, it is more common for a distributor to limit the volume of inventory that can be warehoused under a basic distribution agreement. Typically, this stock limit is equivalent to 6–12 months of sales, either by publisher or by title, and the publisher is charged a carrying fee on any inventory above this limit. These costs are again difficult to estimate as a percentage of sales as they may be charged by the distributor on a pallet, carton, or unit basis—with costs of $.01–$.03 per unit not uncommon.

   This type of charge is a perfectly rational step for any distributor given the focus throughout the supply chain on reducing unnecessary cost and inefficiency at every turn. However, overstock charges also have a number of significant implications for publishers. First, they represent a new, additional cost passed to publishers. Second, they compel publishers to manage warehouse inventories much more actively, meaning that:

   a) this becomes an additional demand on management time within the publishing house;
   b) the publisher may have to accept lower print runs (and so diminishing economies of scale) on new titles and reprints; and
   c) the publisher may have to incur additional costs for separate warehouse space and/or more frequent re-supply shipments to the distributor.

With both these additional costs and the earlier estimates in mind, we can imagine that a comprehensive calculation of sales and distribution costs for a typical publisher can easily approach 30–35% of net annual sales.

3.2.1 THE EFFECT OF RETURNS ON DISTRIBUTION COST

The practice of selling to retail accounts on a returnable basis persists in the book trade under the following rationale: each book is, at least to some extent, a unique product; even a small general bookstore will carry roughly 20,000 titles (a daunting buying and inventory management proposition for any retailer), and given the oversupply of books there is considerable pressure on retailers to buy aggressively. Seen in this light, returns practices in the traditional book retail channel can be understood as an accommodation between publishers and booksellers, and as an attempt to establish an equitable distribution of inventory risk, particularly with respect to new titles, across the supply chain.

There are different ideas about what constitutes an ideal rate of returns in the Canadian book trade. However, many publishers believe a certain level of returns is a necessary cost of doing business, and that otherwise it would be impossible to get retailers to take the same degree of risk in stocking new titles.

That said, the problems of rising returns levels are well documented. When returns get too high, publishers wind up with falling receivables, burgeoning inventories, and a cash flow crunch. Using the example we explored above, the following table illustrates another effect of rising returns: an increase in distribution costs.

As the table indicates, distribution costs in this example rise between 3 to 4% of net sales for every 10% increase in returns levels.

	Distributor Rates	20% Returns	Fees	30% Returns	Fees	40% Returns	Fees
Shipped	15.0%	$500,000	$75,000	$500,000	$75,000	$500,000	$75,000
Returns	3.0%	$100,000	$3,000	$150,000	$4,500	$200,000	$6,000
Net		$400,000	$78,000	$350,000	$79,500	$300,000	$81,000
Effective distribution cost as a percentage of net sales:			19.5%		22.7%		27.0%

Table 2. The effect of rising returns on distribution costs.

3.2.2 THE EFFECT OF SALES VOLUME ON DISTRIBUTION COST

As noted earlier, there is an inverse relationship between distribution cost and a publisher's sales volume. Distribution is more expensive, as a percentage of sales, for smaller firms and less so for larger firms. This is because the costs of serving a lower-volume client are spread over a smaller number of orders and units shipped whereas the larger volumes and order sizes of larger clients can be processed and shipped more efficiently.

Table 3 illustrates this phenomenon using the actual sales and distribution costs for a sample of English-language literary presses and a standard 30% returns level throughout.

Annual Shipped Sales	Effective distribution cost (percentage of gross, no returns)	Effective distribution cost (percentage of gross, 30% returns)
$90,000	18.4%	19.4%
$60,000	18.9%	19.9%
$30,000	22%	23%
$10,000	27.8%	28.8%

Table 3. The effect of sales volumes on distribution costs.

The significance of this cost-volume relationship is two-fold:

1. It means that the distribution marketplace rewards size. Larger players accumulate efficiencies that strengthen their competitive position. Smaller firms face additional margin pressure arising from relatively higher distribution costs.

2. It also means that it can be challenging for smaller firms to secure effective sales and distribution arrangements. These publishers will be more expensive to serve, and so less profitable, than will higher-volume clients. Even if, as is generally the case, the distributor passes these higher costs to client-publisher in the form of higher distribution fees, the overall profit contribution of the publisher's account is still limited due to its small sales volume. As a result, smaller firms are less attractive to many distributors and have fewer viable distribution choices within the supply chain.

This reflects as well the significance of distribution collectives, such as LitDistCo, for small publishers in Canada's English-language market, and illustrates that, absent such a mechanism, there would be few sustainable distribution options for such firms. In aggregating their individual sales through a distribution collective, a group of small publishing firms can effectively operate at a more cost-effective sales volume.

3.2.3 THE DISTRIBUTOR'S CONTRIBUTION TO PUBLISHER CASH FLOW

The distributor's payment schedule is an additional formative aspect of trading practice, and often one of the great advantages of contracting for distribution services. Distribution contracts specify a payable period—typically between 90 and 120 days—in which the distributor will transfer payment for the publisher's current sales.

This usually includes a holdback to reflect a forecasted amount of returns. Even so, the distributor's schedule of payments represents a relatively predictable and stable revenue stream for the publisher—relative, that is, to the speed with which a publisher, especially a smaller firm, could expect to collect receivables directly from its retail accounts.

3.3 WHOLESALE TERMS

In comparison to typical fee structures for sales and distribution commissions, wholesale terms are relatively straightforward. Generally speaking, wholesalers buy from publishers or distributors at a 50% discount from the list price and then sell on to their customer accounts at a 40% discount. In other words, the wholesaler's operations and profitability have to be supported by the 10% margin between the wholesale and retail prices.

While the terms in the wholesale channel are straightforward, the competitive environment for wholesalers is less so. In the intensely competitive book marketplace, retail accounts are compelled to buy at the best price in order to boost their own margins, and this creates additional pressure for them to cut out the middleman—the wholesaler—and buy directly from the publisher or distributor. As noted earlier, publishers' discounts to high-volume retail have crept up above 45% in recent years. Therefore, an increasing number of traditional and non-traditional retail accounts can recover several additional margin points by buying directly from the publisher. This pattern can push a wholesaler out of an account, and at the least, creates what one of our respondents described as "a constant grind on price"—a steady pressure for wholesalers to move to higher discounts.

At the same time, costs are rising for wholesalers, and for that matter, for all other members of the supply chain. Freight costs go up each year (a pattern that could be accelerated by the recent dramatic increases in oil prices), and labour markets are tight in many parts of the country.

Most wholesalers respond to these pressures by offering a range of specialized, value-added services targeted to the requirements of their key sales channels. The challenge is to deliver services that offer real value to the customer account, with effective market access/inventory management for the benefit of the publisher-vendor account, and all at a sustainable cost and as efficiently as possible.

4.0 ISSUES IN BOOK DISTRIBUTION

4.1 IMPORTANT CHARACTERISTICS OF BOOK DISTRIBUTION

The preceding chapters have mapped the trading partners and terms of trade in book distribution in Canada's English-language market. We can now summarize and extend the overview we have seen to this point through the following broad characterizations of book distribution.

Book distribution is a **capacity** business. Available distribution capacity—both in terms of the capacity of an individual distributor and in terms of the distribution capacity of the book system as a whole—has a direct effect on (1) the distribution options available to Canadian publishers, (2) the costs of distribution, and (3) the selection of titles that can be kept in stock and delivered quickly to Canadian accounts and consumers.

Book distribution is a **scale** business. The significant investment required in facilities and systems means that successful distributors and wholesalers are those that are able to spread these high fixed costs over the largest possible sales volume. This pursuit of economies of scale is a powerful force in centralizing and consolidating distribution capacity within the book supply chain.

Book distribution is a **focus** business. Book distributors and wholesalers have emerged as distinct specialists in the supply chain. Many of the respondents to this study noted that "focus" was a key success factor for a book distributor—highlighting the importance of an ongoing commitment to reducing errors, improving processes, investing in systems, and accumulating concentrated expertise in book logistics.

Book distribution is a **cash** business. Distributors are generally bound by contract to pay publisher receivables within a specified time frame. Because of this, the distributor's ability to effectively collect and manage cash, and, in particular, to manage the timing of cash receipts from accounts and disbursements to client-publishers, is critical to its survival.

Book distribution is a **margin** business**.** Like most other participants in the publishing value chain, the operating margins of book distributors are being squeezed by rising costs on the one hand, and by a limited ability to increase prices (or even price deflation) on the other. The need to maintain an adequate operating margin drives the constant search for greater operating efficiencies (and economies of scale) on the part of distributors and wholesalers. It also bears on the distributor's selection of publisher-clients, in that those publishing lines that offer higher volume and greater profitability will be more sought after than lower-volume clients that will be more expensive to serve.

In this sense, book distribution is a **selection** business in a couple of significant ways. First, distributors have an important role in selecting the publisher-clients they serve, and, by extension, the publishers and books that will be more prominently available within the book system. Similarly, wholesalers select the titles they will carry in stock, and so influence which books are readily available to be re-supplied to retail accounts and/or ordered by institutional buyers.

Book distribution is a **retail** business, in the sense that major developments in book retail—notably the concentration of market share within large national retail chains—work their way back up the supply chain to affect the structure and operations of book distributors. For example, the declining numbers of independent bookstores has reduced the customer base for trade wholesalers across the country. Similarly, the growing market power of large bookstore chains and non-traditional retailers, such as Costco and Wal-Mart, has placed additional demands on the systems and operating standards for Canadian distributors.

And finally, book distribution is a **people** business. The working relationships between publishers, distributors, sales representatives, and retailers are invaluable sources of market intelligence and market access. Through the trust invested in a knowledgeable sales representative by the retail buyer, the publisher can enjoy improved access to the sales channel. Similarly, decisions made between trading partners in the supply chain—for example, the decision of a major publisher to sell directly to a national retailer—can have a significant effect on book distribution systems.

The balance of this chapter will expand on these broad observations by exploring a series of key issues in book distribution.

4.2 EFFICIENCY AND TECHNOLOGY

Any serious consideration of the supply chain quickly turns to how the logistics and systems of moving books around the country can be made more efficient. Customers at every level in the chain, perhaps the end consumer most of all, expect the books they want to be quickly and readily available. This expectation is contributing to the quickening pace of trade and competition throughout the business.

At the same time, every trading partner in the supply chain has reason to shorten the distance between manufacturing and retail. Inventories are being managed more carefully at every link in the chain. Print runs are being reduced, and per-title economies of scale are under pressure as a result. Finally, virtually every publisher, distributor, and retailer in the market is on the hunt for improved sales and profitability, and this in a marketplace where overall sales are flat, prices are falling, margins are shrinking, and input costs keep creeping up.

Part of the answer to this challenge lies in more efficient management of the supply chain: in ensuring, to the greatest extent possible, that the right numbers of books are available in the right places when they are needed.

The quality of trade data and of the communications systems between trading partners are key to this improvement. Both the industry as a whole, and many individual firms within it, have invested heavily in new technologies in recent years to address (1) bibliographic data standards, (2) electronic data interchange (EDI) systems, and (3) point-of-sale data systems.

BookNet Canada, a non-profit organization funded by Canadian Heritage and focused on Canadian supply chain improvements, has introduced new innovations in all of these areas over the past five years, including Canadian Bibliographic Certification (bibliographic data standards), Pubnet (an EDI service contracted from Bowker), and BNC SalesData (a point-of-sale tracking system). These investments represent major steps toward improved gathering, management, and flow of data throughout the supply chain.

Bibliographic data is a critical foundation technology that allows for the effective transmission of product information among trading partners. In so doing, it sets the stage for further improvements with respect to EDI and point-of-sale tracking.

Point-of-sale tracking allows retailers, distributors, and publishers to make better decisions, particularly with respect to inventory management and marketing. The traditional approach in the supply chain is to "push" product—that is, trading partners throughout the chain project demand and place product accordingly. The better sales data now available in Canada presents an opportunity to adopt more of a "pull" orientation that manages inventory according to actual demand.

Similarly, EDI has already delivered substantial efficiencies in the form of streamlined ordering, order processing and administration, and account management. Trading partners now exchange standardized transactional data regarding orders, shipments, invoices, and returns. The majority of such exchanges throughout the supply chain are now conducted via EDI, and this opens the door to greater standardization in production, packaging, and handling of book inventories down the road.

We are beginning to understand more about how these new systems and practices are affecting the book trade. While there are few publicly available measures of supply chain efficiency, *Quill & Quire* has conducted a semi-annual survey of order fill times over the past several years that provides some interesting indicators.

	2002 (average delivery time, business days)	**2004 (average delivery time, business days)**	**2006 (average delivery time, business days)**
Fastest distributor	Raincoast 3.9 days	Raincoast, 3.4 days	North 49, 1.9 days
Slowest distributor	H.B. Fenn, 11.5 days	Oxford, 11.9 days	Oxford, 9.5 days
Overall average	–	7.7 days	6.3 days

Table 4. A summary of the *Quill & Quire* semi-annual distribution surveys. Source: *Quill & Quire*.

In each of its surveys, *Quill & Quire* has drawn a slightly different regional mix of participating bookstores and this naturally introduces some variation from year to year. Even so, the survey data and accompanying anecdotal commentary from distributors and retailers paint a clear picture of improving delivery times over the four years from 2002 to 2006[20].

[20] Also of note, the leading US wholesaler, Ingram, figures prominently in the survey findings, ranking ahead of the majority of the Canadian distributors in each of the survey years. See page 37, "The US-Canada Supply Chain", for more on Ingram.

It appears likely that many of the factors we have explored here—competitive pressures and new technologies in particular—have played an important role in this improvement.

4.3 ECONOMIES OF SCALE

Along with technology improvements, the pursuit of increasing economies of scale is another tried and tested strategy for realizing greater supply chain efficiencies. This is partly because, in an environment where distributor margins are constrained by both rising costs and limited pricing flexibility, the distributor's greater prospects for sales growth and improved profitability lie in increasing overall sales volume.

At the same time, the modern supply chain generally requires significant investment in plant capacity, systems, and technology. As book industry consultant Mike Shatzkin has noted, the largest distributors and retailers invest millions in building this capacity.

> "Scale is an advantage for virtually all aspects of distribution. If you've got a warehouse, you want to fill it, because you pay the same for empty space as you do for utilized space. More volume gives you more leverage to collect money and makes it easier to support a sales force. And we live in times where systems costs keep rising: several of the largest [firms] have spent double-, or even triple-digit millions in the past few years putting in new 'enterprise' systems to manage their business. That's one of the factors driving the growth in distribution activity now. It is helpful to amortize those costs over more books.[21]"

A firm achieves increasing economies of scale when it uses its available distribution capacity effectively, thereby spreading the organization's fixed costs over the largest possible sales volume and reducing unit costs in the process.

The concentration of book sales among a relatively small number of large retail accounts, the investment in inventory and systems required to serve those accounts, the need to stock a critical mass of salable titles that can be shipped quickly, and the level of investment required generally to build a distribution system of any scale all play an important role as well. These self-reinforcing factors contribute to a natural bias in the marketplace toward the concentration of distribution activity among a number of large distributors and publisher-distributors.

The pursuit of economies of scale is therefore a powerful, centralizing and market-shaping influence in the book supply chain. It accounts in part for the existence of a single national distribution centre for Canada's national bookstore chain (an attempt to exploit economies of scale), and the absence of a large-scale national trade wholesaler in the Canadian market (reflecting insufficient economies of scale to support this type of business). Similarly, it accounts for the high level of investment in technology and other system improvements within the supply chain.

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[21] "The Future of Distribution" by Mike Shatzkin. Remarks to the Stanford Professional Publishing Program, July 20, 2005.

4.4 INVENTORY MANAGEMENT

As noted earlier, inventories are being managed more carefully at every stage in the supply chain. Stores are reluctant to hold more inventory than needed, and just-in-time inventory arrangements have become the norm. In practice, this means smaller orders and more frequent re-orders as the store tries to balance its current inventory holding with the need to maintain a reasonable breadth and depth of selection and to ensure that books are in stock when needed.

Similarly, distributors are no longer prepared to carry excess inventory for publishers. But they too have to balance inventory levels with the need to ensure stock availability in order to supply customer accounts as quickly as possible.

These pressures work their way back up the supply chain and collide on the publisher's desk. From the publisher's point of view, setting the print run, particularly for new titles, is an exercise in finding the right balance between the need to maximize the economies of scale of the largest-sustainable print run with the need to avoid printing too many books that will tie up funds in inventory, incur additional carrying costs down the road, and/or eventually have to be written off or remaindered.

If too many copies are printed, the publisher is exposed to all of these problems, and in the case of remaindered stock, the supply of low-cost book product competing with other new-book inventories expands accordingly. If too few copies are printed, the publisher has to accept decreasing economies of scale on the print run, and may lose the sales for orders that cannot be filled for lack of stock.

The further practical constraint here is that the manufacturing link of the supply chain can only be shortened so far. Even with good printer capacity and a fast turnaround on reprinting, the need to go back to press for a reprint can create weeks of delay while the book is on press and then as distributors and customer accounts are re-supplied. During that time, a critical sales window can close and sales could be lost.

The following figure sums up the current imperatives and trends facing retailers, distributors, and publishers with respect to inventory management.

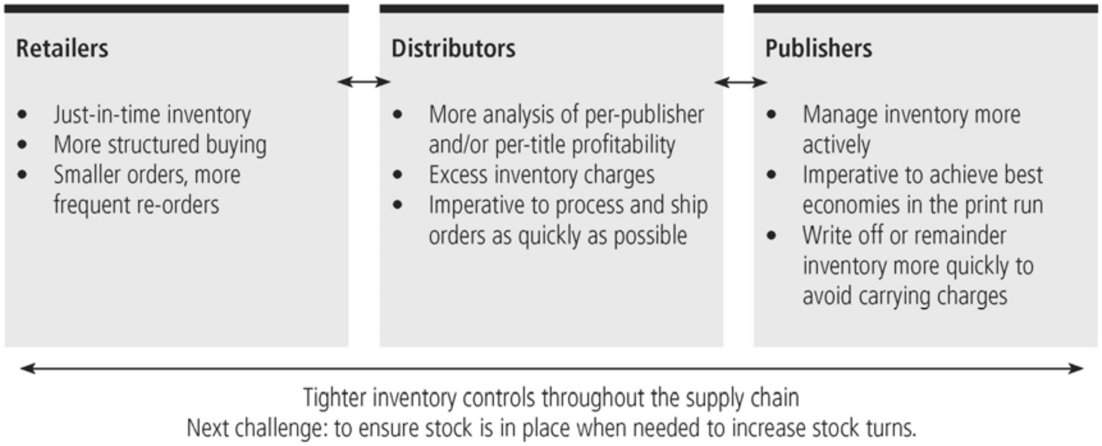

Figure 5. The current context for inventory management in the supply chain.

In some respects, inventory management throughout the supply chain is the point at which the earlier issues we have explored in this chapter—efficiency and economies of scale—come into conflict. Efficiency demands that books be available when and where they are needed. If this means that retailers order more conservatively and distributors won't carry excess inventory, then it also means that publishers will find it more challenging to achieve economies of scale in their print runs and that unsold inventory will be remaindered or written off at a loss more quickly.

Similarly, the need for distributors and wholesalers to achieve the best possible economies of scale generally means that book inventory is not always readily available when needed. BookNet Canada reports that of the 689,020 unique ISBNs tracked in its system in 2006, 373,402 titles sold one or more copies during the year. For the sake of quick response within the supply chain, we could say that an ideal state would be to have a series of warehouses across the country, each of which would have these 400,000 titles available for immediate re-supply to customer accounts as needed. However, the size of the Canadian market will not support the investment required to create a re-supply network on this scale.

4.4.1 THE IMPORTANCE OF STOCK TURNS

The idea of a more nimble supply chain—one that can respond quickly to market demand by reloading store shelves as needed—connects to another important concept in inventory management: stock turns.

The terms "stock turns" or "inventory turns" refer to salability of stock and are used to measure the relationship between inventory holdings and sales. In practical terms, stock that sells more quickly, meaning that the retailer "turns" its inventory more during a given period, is an important measure of operational efficiency.

As one of our study respondents put it, "With increased pressure to control inventory, there is an increased argument to use wholesalers to quickly replenish and help improve stock turns."

A 2004 brief from The Retail Management Advisors explains the concept more fully:

> "The inventory of the typical store represents the largest single element of its total assets. The sale of goods from this inventory is the merchant's chief source of operating profit. Thus, the way in which this merchandise investment is put to work is of utmost importance in achieving a profitable operation…All other things being equal, a higher stock turn rate tends to lead to higher sales and a higher profit…Another advantage is that a fast Stock Turn Rate will actually increase sales due to the increased flow of fresh new merchandise into the store to create excitement for the sales staff and a reason for the customers to come back frequently.[22]"

The broad supply chain systems introduced by BookNet Canada in recent years, as well as the proprietary enterprise systems installed by publishers, distributors, and retailers alike, have set the stage for more active analysis and management of inventory at all levels in the Canadian supply chain[23]. However, the industry is still searching for the distribution economies of scale, through a large wholesaler or otherwise, that would help shorten the supply chain further.

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[22] "What is stock turn rate and why is it important?" The Retail Management Advisors, June 2004.

[23] Indusry consultant Mike Shatzkin has demonstrated in his firm's work with Borders and Barnes & Noble that careful analysis of retailer sales data can lead to a measurable improvement in stock turns.

4.5 THE ROLE OF A LARGE-SCALE TRADE WHOLESALER

Some observers, including the Canadian Booksellers Association, have argued that the Canadian supply chain would be greatly improved by a larger trade wholesaler that operates at a scale comparable to leading wholesalers in the US. As the example of the American market illustrates, a large efficient operator such as Ingram can play a much greater role in a publisher's national distribution strategy, the efficient movement of inventory throughout the supply chain, and increased stock turns for retailers.

4.5.1 THE STORY OF PEGASUS

The recent history of Canada's book trade provides a singular, if highly controversial, example of an attempt to establish a major national wholesaler. In May 1999, Chapters (then the country's leading national chain) announced that it was converting its 306,000-square-foot Brampton, Ontario, warehouse into a subsidiary company, Pegasus Wholesale, in which it would retain a 75% stake. Pegasus would establish itself as a national wholesaler, operating at arms length from Chapters and with an inventory of 400,000 titles in stock.

The reaction from the book trade was immediate. Independent booksellers were opposed to ordering from Pegasus as they felt that in doing so they would be contributing to the profitability of their largest competitor. Publishers were opposed as they saw the creation of Pegasus as a move by Chapters to recover a deeper wholesale discount on all shipments from its vendors—standard wholesale discounts at the time would have been 5 to 8% higher than Chapters' typical retail discounts from publishers and distributors.

This broad-based resistance to Pegasus might have been enough to ensure its failure, despite pressure from Chapters to have all of its vendors trading through Pegasus. As it happened, the wholesaler never did establish effective operations. Rather than serving as an effective new logistics platform within the book trade, Pegasus became a notorious bottleneck that added extensive delays to publisher shipments and returned books to vendors in great numbers.

These operational problems reached their peak in September 2000 when Chapters asked three of its largest vendors—HarperCollins, Random House, and H.B. Fenn—to stop shipping to Pegasus and to ship directly to Chapters stores instead. Later that fall, Pegasus was put up for sale.

By January 2001, with no other buyers available, Chapters had bought back the outstanding shares in Pegasus, effectively concluding the attempt to create a national wholesaler and re-establishing the Brampton warehouse as an internal distribution centre for Chapters stores, which it remains to this day.

4.5.2 STILL WAITING FOR A NATIONAL WHOLESALER?

In spite of Pegasus's failure to establish itself in the market, the prospect of a large aggregated inventory that can quickly re-supply retailers throughout the country continues to inform the call for a large national trade wholesaler in Canada. In the wake of the Pegasus closure in 2001, a guest column in *Quill & Quire* argued for the creation of a new national player in the wholesale channel.

> "The Canadian book distribution sector has been consolidating recently, into fewer, larger players…The problem is that even the largest of the current Canadian book distributors can't match the scale (and cost efficiencies) of a true national wholesaler[24]."

The same article goes on to say:

> "There are several logical ways to create this national wholesaler:
>
> 1. From existing Canadian wholesalers (if they're willing and able to make the heavy investments and change of focus required to expand);
> 2. Indigo, with a reborn Pegasus-style spin-off of their internal distribution system (if you assume that Indigo will be looking to dramatically reinvent its business to stem what is likely to be a long-term decline);
> 3. One of the major U.S. wholesalers, via a Canadian subsidiary or direct shipments from the U.S.;
> 4. An existing Canadian wholesaler in another industry looking to expand and spread its own costs out further."

Proponents of a national wholesaler point out that the leading wholesalers in the US have contributed some of these efficiencies to the market there. Ingram, with its focus on trade accounts, and Baker & Taylor in the library market, have each become a major factor in the US supply chain.

As an illustration of this, an increasing number of large publishers in the US now ship directly to their largest retail accounts, relying on Ingram to re-supply both new and previously published titles to trade accounts and to fill orders to regional and smaller accounts. This reflects the imperative of large suppliers to sell directly to their largest accounts, as we have explored earlier. But it also illustrates the confidence of publishers that a major wholesaler, such as Ingram, can efficiently serve many other channels outside of the large national chains.

In contrast, the Canadian book market is unable to re-supply itself as efficiently, and so the broader goals of more aggressive inventory management are only partly realized. Retailers and distributors are able to manage their inventory investment downward, but publishers are not always able to quickly move books to where and when they need to be in order to maximize sales.

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[24] David Hunt and Ken Smith in "Bring back Pegasus," *Quill & Quire*, February 2003.

4.6 THE NORTH AMERICAN SUPPLY CHAIN

For an increasing number of Canadian publishers and retailers, the search for distribution economies extends beyond the Canadian border. Sourcing book from outside of Canada is hardly a new idea, but within the last five years some of the largest publishers operating in Canada have begun shipping Canadian orders from US-based warehouses, and the leading US trade wholesaler, Ingram, has continued to expand its share of the Canadian book trade.

As Figure 6 illustrates, the Canadian supply chain is in some respects being reshaped into a more integrated North American supply chain.

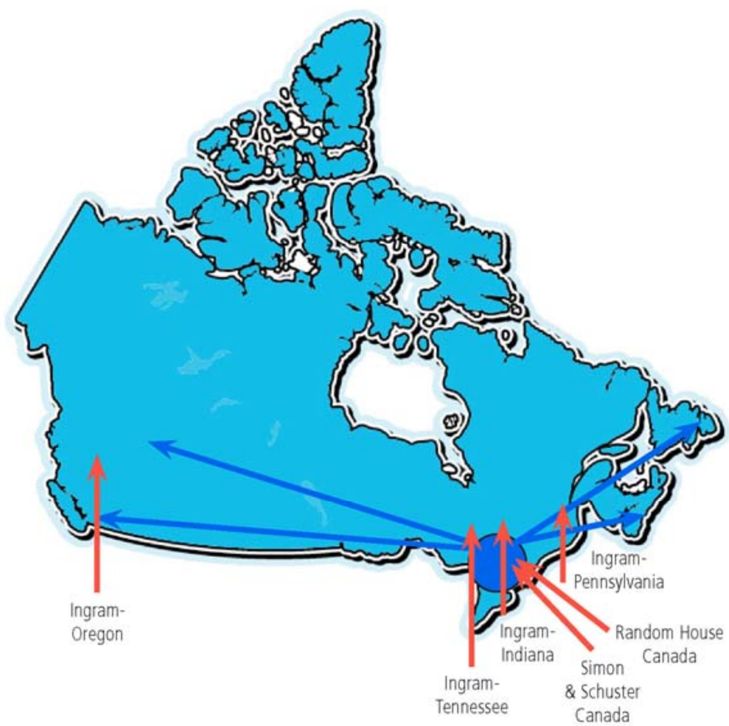

Figure 6. The expanding geography of Canada's book supply chain.

In the following pages, we will explore the regulatory environment in which this cross-border trade occurs, as well as the main supply routes for US-sourced orders shipping to Canada.

4.6.1 THE REGULATORY ENVIRONMENT

The regulatory environment for the cross-border supply chain is largely guided by two federal acts: *The Copyright Act* and *The Investment Canada Act*, and related regulations and policies.

The *Copyright Act* and Parallel Importation

The Book Importation Regulations of the *Copyright Act* offer protection to firms that have purchased the territorial rights to distribute a given title in Canada. However, the Regulations require that the Canadian list price for a title imported from the US not exceed the Canadian-dollar equivalent of the US currency list price by more than 10%[25]. If the Canadian price exceeds this point, Canadian retailers are permitted to source the book from outside of Canada regardless of territorial rights.

Recently, the Canadian dollar appreciated greatly against the US dollar, reaching parity with the US currency in the fall of 2007. As publishers typically set list prices several months in advance of publication, this currency movement effectively resulted in Canadian list overpricing for imported titles relative to US list prices. More to the point, this currency-price relationship created a situation where Canadian retailers could source some books outside of Canada at lower cost.

This currency movement appears to have contributed to an increase in parallel importation within the Canadian book trade. Parallel importation occurs when one party imports goods into the domestic market outside of the authority of the firm that owns the Canadian territorial distribution rights. This practice is colloquially known as "buying around."

The practice of buying around is controversial within the Canadian book trade, and is generally understood to weaken the competitive position of Canadian distributors and publishers as well as the integrity of the Canadian territorial rights for foreign titles secured by Canadian firms. However, as we describe below, there are also some perfectly sound reasons for Canadian retailers to order from US sources. Further, so long as the Canadian list price exceeds 10% of the US list price for any such orders, a Canadian bookseller can order from a US supplier without breaching the provisions of the Book Importation Regulations[26].

The *Investment Canada Act* and Foreign Ownership Restrictions

The *Investment Canada Act* provides a basis for government review of prospective foreign investment transactions and aims to ensure that any such investments are of net benefit to Canada. Net benefit includes, among a number of factors, the compatibility of a prospective investment with national cultural policies, and in the particular case of investments in the book industry, with the government's policy objective of ensuring that Canadians have access to Canadian-authored titles.

[25] Or by more than 15% for books imported from countries other than the US.
[26] For more on Canadian Book Importation Regulations, please see http://www.cb-cda.gc.ca/info/regulations/99324-e.html

Foreign investments in the book industry are also subject to the Revised Foreign Investment Policy in Book Publishing and Distribution, which constrains foreign ownership of businesses in the publishing, distribution and retail sectors. As our focus here is on book distribution, we note that the current policy includes the following:

- Foreign investment in new book distribution businesses is restricted to Canadian-controlled joint ventures.

- The foreign acquisition of a Canadian-owned distributor is prohibited, except in cases where (a) the business in question is in clear financial distress, and (b) Canadian interests have had a full and fair opportunity to purchase it[27].

Although the current foreign investment policy effectively means that foreign-owned book distribution firms are prevented from entering the Canadian market, foreign-owned firms nonetheless have a dominant presence in the Canadian book industry. Most of the key multinational players in the book business were active in Canada at the time the *Investment Canada Act* came into law and were permitted to remain subsequent to its passing.

Market Effects of Current Policy

In practical terms, the Revised Foreign Investment Policy in Book Publishing and Distribution provides a measure of protection for Canadian book businesses by discouraging, through both its provisions as well as the uncertainty associated with the review process, new foreign investment in the sector. Nevertheless, within the current regulatory framework in Canada, foreign firms can and do play a significant role in the distribution of books in the domestic market, making for an increasingly integrated North American book supply chain.

- It is possible for a foreign-owned firm that operates in the Canadian market but that conducts the majority of its business, including distribution, in the US to operate its Canadian distribution system largely from the US, and to fill Canadian retail orders from its US warehouse(s).

- A US supplier, such as Ingram, is permitted to supply Canadian retail accounts regardless of territorial rights under certain conditions (such as when the Canadian list price of a title exceeds the 10 % guideline established by the Book Importation Regulations). However, foreign investment policy prevents such a firm from establishing a Canadian-based extension of its US operations.

In the following sections, we explore some current examples and trends in cross-border book supply that are emerging in this environment.

[27] The complete text of the current policy guidelines is available online at http://www.canadianheritage.gc.ca/progs/ac-ca/progs/eiic-csir/bookp_e.cfm

4.6.2 THE US-CANADA SUPPLY CHAIN

Use of US Warehouses

Two of Canada's largest publishers and distributors now rely heavily on the warehouses of their international parent companies for Canadian fulfillment.

Random House Canada ships stock directly to Canadian accounts from Random's US distribution centre in Westminster, Maryland. Random House Canada also moved its customer service desk to the Maryland centre in 2003, but continues to operate a warehouse in Mississauga to re-supply key titles and process Canadian returns.

Similarly, Simon & Schuster Canada closed its Canadian warehouse operations in 2004, moving to a system of consolidated shipments from S&S's distribution centres in Pennsylvania and New Jersey. These shipments are freight forwarded[28] via Georgetown Terminal Warehouse for onward shipment to Canadian customers.

For major international subsidiaries like S&S and Random House, this type of fulfillment strategy offers the following benefits:

1. It avoids duplication in systems costs between the Canadian subsidiary and the international parent.

2. It allows the Canadian subsidiary to take advantage of the considerable economies of scale realized through these large distribution centres in the US. Random House alone boasts nearly 2 million square feet of storage capacity in its two facilities in Maryland and Indiana. Together, these distribution centres ship 1 million units a day to more than 15,000 locations per week.

3. It provides access to a much larger selection of in-stock titles. Most distributors will establish minimum sales levels to justify keeping a title in the warehouse for immediate shipment. In the smaller Canadian market, this necessarily means a more limited title selection. In a large US distribution centre, Canadian orders can draw from this larger stock selection and can also re-supply Canadian inventories of imported titles more efficiently.

4. It respects copyright provisions both for titles originated by the Canadian subsidiary and for its distributed lines as well (as the importer of the books in such cases is the company that holds the Canadian rights).

These integrated supply chains find their primary rationale in the greater economies of scale afforded by consolidated supply operations in the US. At the same time, they are greatly enabled by supply chain technologies such as EDI that streamline ordering, order

[28] As noted earlier, freight forwarding services involve clearing consolidated international shipments, mainly from the US, through Canadian customs and then processing this inventory for onward shipping to Canadian accounts.

processing, tracking, and all other transactional processes for the distributor and retailer alike.

US Wholesale

Ingram is the leading trade wholesaler in the US and is widely regarded as one of the best distribution specialists in the book trade. Founded in 1964, Ingram currently operates four distribution centres in the US—in Oregon, Pennsylvania, Tennessee, and Indiana. It holds roughly 1.4 million titles in inventory and ships to more than 30,000 customer accounts in America and abroad.

The company has grown its sales in a number of ways in recent years. Along with its shipments to retail accounts in the US, Ingram's direct-to-consumer shipments (in fulfillment of both online and offline consumer orders passed from Ingram's retail partners, notably Amazon), and international shipments (to Canada, Australia, and Europe) have expanded significantly[29].

As noted earlier, Ingram figures prominently in *Quill & Quire*'s semi-annual distributor rankings, and generally ranks ahead of most Canadian distributors for average shipping speed. This finding alone illustrates the willingness of Canadian accounts to order from the US wholesaler, and also Ingram's effectiveness in shipping to the Canadian market.

As one of America's largest privately held companies, Ingram does not report its sales publicly. However, anecdotal reports clearly indicate that the company's Canadian sales have grown significantly in recent years, and over the last two years in particular. As one of our distributor respondents put it, "We're seeing erosion [of sales] to American competition that scale-wise no one can touch."

There are two main factors that encourage Canadian accounts to order from Ingram:

1. Ingram is an extremely efficient distributor. Through its national network of warehouses in the US, it is able to make north-south shipments much more quickly than most domestic distributors can ship along Canada's east-west supply routes. This is a compelling factor given both the consumer and retailer demand for prompt delivery.

2. As noted earlier, recent appreciation of the Canadian dollar created a significant, and highly visible, gap between Canadian and US list prices on imported titles. Aided by electronic ordering and inventory tools (that allow buyers to quickly check price and availability between different suppliers), Canadian retailers can now easily source these books outside of Canada at a lower cost than they can buy them from Canadian rights-holders.

Whatever the reason, the structural effects of increased US sourcing are significant. First and obviously, increased foreign buying undermines the territorial rights of Canadian rights

[29] Ingram is also emerging as an important player in digital asset distribution through its Ingram Lightning Source and Ingram Digital divisions. See "Digital Distribution" below.

holders (by placing lower-priced US editions in the market at the same time as a Canadian publisher or distributor is trying sell a Canadian edition with a Canadian list price). This issue is relevant to Canadian subsidiaries of multinational publishing firms, Canadian distributors, and Canadian publishing houses that also act as distributors for foreign publishers (and so rely on distribution revenues to varying degrees to support domestic publishing programs). More broadly, increased parallel importation could also contribute to relatively lower-priced imported books (relative to Canadian titles, that is) claiming a larger overall share of the Canadian market.

4.7 PRICE DEFLATION

As an integral link in the supply chain, the book distributor is affected by changes in terms and practices throughout the book trade. For example, much has been made of the effects on publishers of increasing discounts to retail accounts. What is less widely observed is that since distributors' fees are based on the value of shipped sales this also reduced distribution revenues—at least until most distributors adjusted their fees to correct for this.

A similar phenomenon is now likely to play out around the current challenges in Canadian-US list pricing. As we explored earlier, the Canadian dollar's rapid appreciation in value has resulted in effective Canadian list overpricing on many books, and on imported books in particular. However, due to the large volume of imported titles in the Canadian marketplace, list prices on domestic titles are also heavily informed by the prices of imported books.

The result is that there is considerable downward price pressure on Canadian list prices for both domestic and foreign titles. Publishers have exhibited a wide range of approaches to the price adjustments that have followed these developments. As a result, it is hard to be precise about the overall level of price reductions in the market. In some cases, however, these appear to be as much as 12% as of spring 2008, relative to the 2006 prices of comparable titles.

This level of price reduction is deep enough to reduce publisher and retailer revenues but likely not enough to encourage a dramatic change in the volume of unit sales. The table below illustrates the effect on distributor revenues of a broad 12% price reduction, presuming the following scenario.

- Unit sales = 100,000
- Average 2006 price (net) = $20.00
- Average 2008 price (net) = $17.60
- Returns = 25%
- Distribution fee = 15% of shipped sales
- Returns processing = 3%

	2006 Values	2008 Values
Units shipped:	100,000	100,000
Value of shipped sales:	$2,000,000	$1,760,000
Distribution fees;	$300,000	$264,000
Returns:	$500,000	$440,000
Returns fees:	$15,000	$13,200
Total fees:	$315,000	$277,200

Table 5. An illustration of the effect of list price deflation on distribution revenues.

With all other variables remaining the same, this pricing change flows directly through the top-line values in the table, resulting in a 12% reduction in distribution revenues. The other significant value here, however, is unit volume. The distributor is shipping the same volume—and incurring the same system and operating costs—but recovering less revenue.

All things being equal, the effect is to reduce the margin and squeeze the cash flow of the distributor.

This has implications not only for the distributor but for its client-publishers as well. If price deflation persists and/or becomes more widespread, distributors will have to raise fees to compensate (effectively passing higher costs to the publishers who are also dealing with top-line revenue reductions from the lower list prices). The alternative for the distributor is to try to operate on narrower margins. However, as we will see in the following section, this presents another type of risk for the publisher.

4.8 THE PUBLISHER-DISTRIBUTOR RELATIONSHIP

As the previous discussion of price deflation effects suggests, the distributor-publisher relationship is an intimate one, in which each party shares a measure of business risk with the other. In particular, publishers have a vested interest in the financial health and stability of their distributors. For publishers who make any meaningful percentage of sales through a distributor, the solvency of the distributor, the sustainability of its operations, and its ability to effectively collect receivables are all issues of mutual concern.

This is because the publisher's inventory and receivables—which account for the bulk of the assets for most publishers—are under the direct control of the distributor. Equally important, the publisher relies on timely payments from the distributor for some or all of its cash flow. Any major disruption in the distributor's business is therefore likely to be visited on the publisher in one way or another.

In the modern history of Canadian publishing, there is no better illustration of this shared risk than the collapse of General Distribution Services (GDS).

For many years, General Distribution was one of Canada's largest book distributors and the distribution arm of General Publishing[30]. GDS operated a 300,000-square-foot warehouse in Toronto and a second smaller warehouse in Vancouver. It counted nearly 200 publishers among its clients. The GDS client base featured a large number of Canadian firms, including many of Canada's English-language literary presses.

By 2001, however, GDS was clearly in trouble. Returns, which normally ranged from 15 to 25% of sales, had ballooned in March 2000 and again in January 2001 with massive stock shipments coming back from Chapters, the company's largest retail client and the nation's largest book retailer. Sworn affidavits from GDS ownership indicate that returns rose as high as 40–60% during the years 2000 to 2002.

The same affidavits indicate that Chapters delayed payments to GDS by as much as 250 days, even as General was contractually obligated to pay its client-publishers within 90 days. Between the delayed payments and extraordinary returns levels, GDS quickly found itself running out of cash.

[30] General Publishing was founded in 1923 and acquired by the Stoddart family in 1957.

The problem was exacerbated by the low distribution fees that General charged its client-publishers. While smaller publishers especially appreciated the lower rates at GDS, the distributor's slimmer margins made it even more difficult for it to cope with the cash crunch.

The Department of Canadian Heritage guaranteed a $5 million loan to the company in October of 2001 to deal with immediate financing concerns. But a negative cash flow spiral had begun, and the company could not stop the slide. The bank began to pull back on its credit line, and by March 2002 major client-publishers, notably Douglas & McIntyre and Key Porter, had filed termination notices and begun to move their business to other distributors.

GDS filed for bankruptcy protection in April 2002, and by the end of the year the company had dissolved. At the time of bankruptcy filing, client publishers were owed $13.3 million. As part of the bankruptcy proceedings, receivables due to publishers, as well as publishers' inventory in the GDS warehouse, were frozen.

In October 2002, Canadian Heritage announced a $2.5 million assistance fund for affected publishers. Nonetheless, most publishers lost inventory, receivables, and sales in the process of recovering from the GDS meltdown and establishing new sales and distribution systems. While none of the firms went out of business, some still bear the scars of the General collapse on their balance sheets these several years later.

GDS was a brutal lesson in distribution economics for the Canadian book trade—one that highlighted the interconnected fortunes of trading partners in the supply chain and the dangers of unsustainable distribution terms.

Reflecting on lessons learned afterward, Jack David, the publisher of ECW Press and a former GDS client, has said, "[W]e'd learned two important truths. One, that by making good choices we could survive a distributor bankruptcy. Two, that we needed to choose a distributor wisely, so we'd never have to test truth number one.[31]"

[31] Jack David in "Distribution Disaster," *Publishers Weekly*, February 2007.

5.0 MARKET ACCESS FOR CANADIAN-AUTHORED TITLES

Having mapped the distribution system in the English-language market and examined the major trends affecting the sector, we can now move on to a further question of broad interest to industry participants and policy makers alike – namely, the ways in which the distribution system influences market access for Canadian-authored books.

5.1 KEY MARKET CHARACTERISTICS AND THEIR IMPLICATIONS

We can begin to answer this question by reviewing some of the basic characteristics of the Canadian book market. Earlier in this paper (and in more detail in *The Book Retail Sector in Canada*), we have described a number of significant shifts in Canada's book marketplace. These include a concentration of market share among large retailers; the growing importance of non-traditional and online sales channels; the impact of exchange rates on Canadian list prices and book imports; and the growth of the supply of new, used, and remaindered books relative to consumer demand.

These market shifts illustrate a period of dramatic change in the book trade. They highlight as well the increasing market-shaping influence of a relatively small number of dominant trading partners in the supply chain. And they suggest the rising power of arguably the most important market participant of all: the consumer.

Today's readers have more options as to what, when, and how they read than at any other time in history. The speed and ease with which they can acquire reading material is unprecedented, as is the range of choice available to them.

In such an environment, those who are most successful at reducing the amount of time and effort it takes consumers to search for, discover, and acquire their books will have a decided competitive advantage. In practical terms, those books that are easily, readily, and affordably available will have the edge over those that are not. This overarching characteristic of the book market draws attention to the power of the consumer as well as the critical selection function that retailers play in determining what is most easily and prominently available to consumers. It is important to note, however, that all members of the book supply chain, including distributors, have an important role to play in shaping the array of titles available to Canadian readers.

5.2 THE SELECTION FUNCTION

The first of the various selection processes that contribute to the mix of titles available to consumers occurs at the production level, when a book publisher accepts, from the many manuscripts available to it, a particular manuscript or project that it will bring forward for publication. An equally important selection occurs at the retail level, when the bookseller (more precisely, when the proprietor or staff member with buying responsibility for the store or stores) selects the titles that will be (1) carried in inventory and (2) featured within the store's stock, either by virtue of prominent placement in the store and/or by inclusion in promotional programs.

Between these two major aspects of selection, a further significant decision is made by the distributor, in its choice of the publishing lines that it will handle, as well as the wholesaler, in its selection of the titles that it will hold in stock. Each of these decisions, at every stage of the supply chain, has a material effect on the books available to Canadians.

5.3 PUBLISHER SIZE AND NATIONALITY

Among the various factors that appear to influence a distributor's choice of which publishing lines to carry, there are two which are particularly relevant to our discussion of market access for Canadian-authored titles: publisher size and publisher nationality.

As we suggested earlier, smaller firms—with their lower sales volumes and more limited economies of scale—are generally less attractive to distributors than are larger publishing houses. In fact, a number of our study respondents indicated that $500,000 in annual sales was an important—albeit informal—benchmark in determining the range of distribution options for an individual firm. That is, firms with annual sales below this level will find relatively few options among distributors based in Canada, while those at or above this level of annual sales may be more attractive clients for a wider field of distributors.

In the Canadian market, with only a few exceptions, the largest firms are foreign-owned, while Canadian-owned firms are on average noticeably smaller. In its 2004 Survey of Book Publishers, Statistics Canada data identified a core group of 330 publishers operating in Canada. Of these, 311 were Canadian-owned and 19 were foreign-owned. Despite their smaller numbers, foreign-owned firms accounted for 59% of domestic book sales. [32] Consequently, when we examine the distribution arrangements and options of smaller publishers, these also describe generally the situation faced by Canadian-owned firms.

Foreign-owned publishing houses have a distinct role in the Canadian book market, where they are particularly active in the production of top-selling titles. These larger firms can often afford to invest more heavily in acquiring titles by high-profile authors and books with significant commercial potential. By virtue of their dominant market positions, they are generally better able to maximize the sales of these books when they come to market.

Many foreign-owned subsidiary firms operating in Canada also have well-established original publishing programs that produce Canadian-authored titles. Statistics Canada figures indicate that foreign-owned publishers produce roughly 23% of the Canadian-authored titles published each year. The majority of new Canadian-authored titles, however—the remaining 77% of the total—are produced by Canadian-owned publishing firms.

With these broad patterns in mind, we can imagine that the market access of a diverse selection of Canadian-authored titles is heavily influenced by the market access achieved by Canadian publishers, a factor that is very much influenced by the relatively small size of

[32] As noted earlier, these figures likely understate the share of market for foreign-owned firms, due to a Statistics Canada survey methodology that excludes companies focused entirely on distribution/exclusive agency sales (i.e. those without in-house publishing programs) many of who are very large, from the survey sample.

these publishers. We will use this publisher-title correlation as a device to further explore the question of market access for Canadian-authored titles over the balance of this chapter.

5.4 DISTRIBUTION ARRANGEMENTS FOR CANADIAN-OWNED PUBLISHERS

The Department of Canadian Heritage's Book Publishing Industry Development Program (BPIDP) has a mandate to ensure choice of and access to Canadian-authored books. The program works toward this objective through activities designed to foster "a strong and viable Canadian book industry that publishes and promotes Canadian-authored books."

BPIDP's Aid to Publishers component is a key aspect of the program, and provides targeted funding to enhance the competitiveness of eligible publishing firms. In 2007-08, there were 130 Canadian-owned, English-language publishing firms participating in Aid to Publishers[33]. These represent roughly two-thirds of the Canadian-owned, English-language publishers identified by Statistics Canada in 2004 and will serve here as foundation for a representative sample of Canadian-owned firms in the English-language market.

For the purposes of the breakdown in Figure 7 below, we have removed educational publishers from the sample, on the grounds that those publishers tend to rely less on contracting to exclusive distributors. English-language educational publishers can generally be classed as "self-distributing" but in practice their sales are often made through a combination of direct orders from schools and libraries as well as sales via one or more educational wholesalers. Twenty-seven educational publishers have been removed from the sample used in Figure 7, leaving a reduced sample of 103 English-language Canadian-owned firms.

We should add two quick introductory notes before looking at Figure 7 more closely.

- The bar extending from each distributor in the figure shows the total number of BPIDP publishers distributed by each publisher-distributor or distributor.

- To be noted as a distinct option in the chart, a distributing firm had to distribute a minimum of two BPIDP firms (including its own books).

[33] See http://pch.gc.ca/progs/ac-ca/progs/padie-bpidp/recipients/recipients_e.cfm for a summary of Aid to Publishers participants.

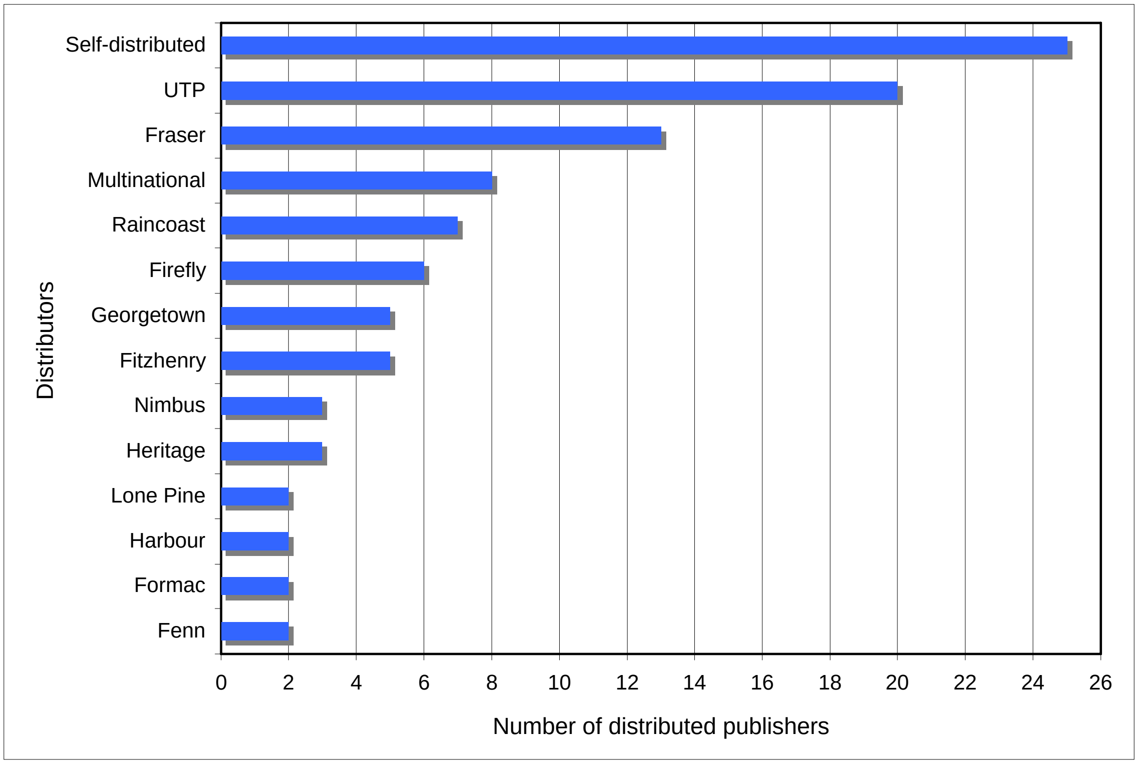

Figure 7. Distribution arrangements for English-language Aid to Publishers recipients.

There are a number of observations we can make based on the distribution in Figure 7.

1. Publishers in the “self-distributed” category represent the largest single group (24%) in the adjusted BPIDP sample described in the chart. As noted above, this category reflects 25 self-distributing publishers of varying sizes.

   We note as well that many of these self-distributed publishers have a geographic or market focus that makes self-distribution a more viable option than it might otherwise be. That is, the decision to self-distribute is likely more than just a reflection of the relative costs of self-distributing as opposed to contracting out and/or the range of choices of contracted distribution services available to the publisher.

   For example, Edmonton-based Company’s Coming distributes its books largely through non-traditional retail outlets, and via its national network of sales representatives and merchandisers. This full-service, direct-to-retail approach is a key business strategy for the firm. Similarly, the literary press New Star Books emphasizes an innovative consignment strategy to place its books in a network of participating independent booksellers.

   In addition to these strategic considerations, there appears to be a geographic aspect to the decision to self-distribute as 68% of the self-distributing firms in our sample are based outside of Ontario, and so outside of the geographic centre of Canada's English-language book supply chain.

2. Beyond these self-distributing publishers, there are a relatively small number—15 in total—of distributors or publisher-distributors handling these Canadian-owned firms. Five of these—Nimbus, Heritage, Harbour, Formac, and Fenn—distribute their own titles, the titles of one or more wholly owned (or partially owned) affiliates, and (in the case of Nimbus and Fenn) the lines of foreign publishing firms as well. They do not, however, currently handle any other Canadian-owned publishers.

3. Setting these five firms aside, the distribution landscape for Canadian-owned publishers is composed of University of Toronto Press's (UTP) distribution division, Raincoast Books/Publishers Group Canada, Georgetown Terminal Warehouse, Fraser Direct, Firefly, Fitzhenry & Whiteside, and H.B. Fenn. The "multinational" category in the chart includes the foreign-owned HarperCollins Canada, Random House Canada, and Pearson Canada.

Another lens through which we can examine the distribution options of Canadian-owned publishers is to consider which of the larger distribution firms carry the titles of Canadian-owned firm, and to what degree. Many of the major book distributors currently operating in Canada carry a relatively small number of Canadian publishers among the lines they distribute. The business model of these firms appears to emphasize instead distribution of imported lines that require full-service distribution (e.g., warehouse and fulfillment, sales representation, and marketing), and that offer higher sales volumes and greater profitability.

The following table illustrates the import-domestic mix, by publisher line (i.e., where each line is a distinct publisher or imprint) for Canada's largest book distributors. Of these, BookNet Canada reports[34] that select lines distributed by Pearson Canada, Simon & Schuster Canada, Random House Canada, HarperCollins Canada, and H.B. Fenn accounted for roughly 37% of tracked retail book sales in Canada 2006[35].

Distributor	Total lines	Canadian	Foreign
Pearson Canada	163	3	160
Simon & Schuster Canada	53	0	53
Random House Canada	167	3	164
HarperCollins Canada	107	7	100
H.B. Fenn*	74	3	71
Raincoast Books*	204	11	193
Thomas Allen & Son*	25	1	24
UTP Distribution*	78	37	41

Table 6. Canadian-owned and foreign-owned lines carried by the largest book distributors in Canada's English-language market.
Source: *The Book Trade in Canada, 2007 Edition*. Note: The asterisks (*) indicate those firms that are Canadian-owned.

[34] Source: *The Canadian Book Market 2006*, BookNet Canada, 2007.
[35] The term "tracked" is significant here as the BookNet system tracks sales for approximately 70% of the retail trade in Canada's English-language market.

As the table suggests, much of Canada's domestic book distribution capacity is dedicated to imported books, whether titles published by the parent company of a foreign-owned Canadian subsidiary or other foreign lines. Because of the considerable pressures on book distributors to achieve the greatest possible economies of scale—and the greatest efficiency and operating margins—this capacity is unlikely to shift to accommodate Canadian-owned publishers to a greater degree (particularly given the smaller size of most Canadian-owned publishers relative to foreign firms).

There are a relatively small number of distributors in the Canadian market that represent viable options for Canadian-owned publishers. The country's largest distributors by sales volume, such as Fenn, Random House, and Raincoast, tend to carry larger BPIDP publishers. As a result, many publishers—particularly smaller firms (that is, those with $500,000 or less in annual sales)—reported in our interviews that they feel they have relatively few choices with respect to contracting for distribution services. In fact, absent a small sample of distributors currently active in Canada—notably UTP and Fraser Direct—they appear to have very few options indeed. This limits competitiveness in the Canadian-owned sector which may, in turn, limit efficiency in the distribution of Canadian-authored books.

5.5 THE SITUATION FOR CANADA'S SMALLEST PUBLISHERS

This pattern appears to reinforce an earlier observation regarding the inverse relationship between sales volume and distribution cost. Smaller publishers are more expensive to serve for distributors, and so less profitable, than are higher-volume clients. As a result, smaller firms are less attractive to many distributors and have fewer viable distribution choices within the supply chain.

This issue becomes more pronounced when we consider that--beyond the sample of Canadian-owned firms we have explored in this chapter--there are a number of very small book publishing firms operating in Canada (that is, publishers with less than $200,000 in annual sales). Outside of self-distribution or industry collectives such as LitDistCo, there are few available or affordable options for these smaller firms, and these options lack the capacity and efficiency that large-scale, national distribution can bring. As a result, it remains difficult for smaller Canadian-owned publishers to effectively place their books within the "book system"—the mainstream sales channels for books throughout the country—and/or to achieve more widespread distribution. Similarly, distribution remains expensive (on a percentage-of-sales basis) for smaller firms and so the ability of these publishers to invest in new titles and new markets—in short, to improve their competitiveness—is in turn constrained.

The challenge of finding affordable and effective distribution is therefore particularly acute for these very small publishers. However, as we have explored throughout this chapter, all but the largest Canadian publishing houses face a relatively limited field of distribution options in today's book market.

5.6 SUMMARY

In this chapter, we have explored some of the challenges for Canadian-owned publishers—particularly those with $500,000 or less in annual sales—in securing affordable and effective distribution. We have observed that these smaller firms have a relatively limited field of potential distributors to choose from, and that their ability to access effective distribution has a significant bearing on the ease with which the books they publish can be discovered by Canadian consumers.

Given that Canadian-owned firms are responsible for publishing a majority of Canadian-authored titles, this in turn indicates that the wide availability of a diverse selection of Canadian titles is heavily dependent on the ability of Canadian publishers to access effective distribution.

We can note as well that Canadian-owned firms have demonstrated a willingness and ability to create new distribution platforms for their books through collective efforts, such as the well-established LitDistCo model, emerging regional cooperatives of smaller firms, and recent national initiatives towards effective digital distribution undertaken by the Association of Canadian Publishers.

6.0 DIGITAL DISTRIBUTION

The past several years have seen the emergence of a parallel supply chain in the book trade—a digital supply chain—that moves digital content from publishers to retailers and other aggregators. As social and consumer behaviour, and reading behaviour in particular, continues to shift online, these new models and platforms for digital content distribution bear on the distribution of print books in a couple of interesting ways.

First, the channels by which different kinds of digital and print content are sold are becoming increasingly intertwined. The leading online retailer, Amazon, sells not only print editions but also e-books and print-on-demand books. Other major book retailers are following suit, including the following.

- In March 2008, the lead book retailer in the US, Barnes & Noble, launched an e-book website to exclusively sell digital content published by Barnes & Noble.

- Also in 2008, the #2 book chain in the US, Borders, launched a new "digital center" within its concept store in Ann Arbor, Michigan. The digital center allows in-store customers to download music (for transfer to an MP3 player or CD), download audiobooks, access a self-publishing/print-on-demand service, and buy e-books and e-book readers.

Of course, many other retailers carry some measure of digital content as well. As digital content gains a larger share of consumer purchases, it is likely that the unit sales volumes and economies of scale in the print distribution system will come under pressure. In a market such as the book business, where profit margins are generally slim throughout the value chain, it would not take a great shift—likely even a 5–10% change towards digital content—for this change to have a noticeable effect on the market structure and terms of trade in book distribution.

As a second point, some of the market-leading firms in print distribution, notably Ingram, HarperCollins, and Random House, have begun to invest heavily in digital distribution as well. As these firms adapt and extend their services to include a wide range of digitization and digital distribution capabilities, it seems likely that the move to digital represents both a new revenue source and a defensive move against an erosion of print market share. For both of these reasons, the decision to expand into digital distribution is a significant strategic step on the part of these market leaders.

In addition to what these investments represent for the individual firms making them, the active participation of these market leading firms in the digital marketplace is likely to fuel further growth in digital content sales and digital distribution generally. In February 2008, in an apparent acknowledgement of this trend, the Association of Canadian Publishers announced a broad initiative to explore collaborative opportunities for digitization and digital marketing for its member publishers.

Finally, as we see below, there are many parallels to be drawn between the market dynamics of digital distribution and those of print distribution. These include the importance of economies of scale, the natural competitive advantages of market leaders, and the presence of powerful gatekeeping effects in the marketplace. These parallels are important if we are to understand how print distribution may change in the coming years as a result of developments in the digital realm.

6.1 EMERGING DIGITAL DISTRIBUTION SYSTEMS

To date, the digital distribution of books has consisted largely of different services and platforms—such as Google Book Search or the EbscoHost online research databases—each of which has been designed to serve a specific purpose or market.

Aside from managing content workflows and the delivery of digital files to printers, there are basically three main ways in which publishers can make use of digital content today:

- The sale of e-books (or other sale or licensing of electronic content)
- Production of print-on-demand editions
- Online marketing

These three basic applications of digital content can take many forms. A recent article in the American trade magazine *Book Business* summarizes the current digital marketplace for book publishers:

> "For some years now, various technology vendors have enabled publishers to deliver electronically formatted versions of their titles for special purposes. These have included applications such as conversions to XML formats (e.g., Publishing Dimensions), proprietary e-book reader formats (Mobipocket), sight-impaired applications (National Instructional Materials Accessibility Standard/NIMAS), archiving and storing electronic versions of titles for other uses (OverDrive Inc.), PDF archives to drive on-demand printing (Lightning Source Inc.), licensing content to be sold in turn by subscription or sale for limited use (NetLibrary), browse-inside applications by e-tailers (Amazon) and specially targeted online libraries for education, training and business (ebrary Inc., Books24x7 Inc.).[36]"

The investment required to trade digital assets can be significant. The publisher's archive has to be catalogued and organized, and then it—or some portion of it—must be digitized, structured, and stored for delivery in various formats, and to various platforms and vendors. Most Canadian firms, however, have been understandably reluctant to invest either dollars or staff time in digital content delivery.

Book publishers in Canada spent most of the 1990s hearing that book sales would soon be surpassed by electronic reading, and that they should invest in new formats and systems in order to keep up with the new economy. These assertions seemed to fade with the dot-com collapse in the early part of this decade and the drastically slower-than-predicted growth of e-book markets. As industry consultant Mike Shatzkin has observed, "That time around, in

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[36] Eugene Schwartz in "Distribution Goes Digital," *Book Business*, August 2007.

many ways, the less cyber-minded the publisher, the more money they didn't waste…And the many publishers who did very little investing in fancy web sites or ebook conversions saved themselves a bunch of money.[37]"

That said, there is no question that publishing markets are evolving in ways that are creating new opportunities and market imperatives with respect to digital content. In particular, the following market factors are drawing publishers' attention back to broad questions of digital content management and distribution:

1. E-book sales, while growing slower than expected, are certainly growing steadily[38]. Initially, competing devices and formats slowed consumer adoption, but it appears that breakthrough Internet-enabled PDAs—such as the ubiquitous Blackberry and the iPod-iPhone family of products from Apple—are boosting consumers' interest in e-books.

2. Major print-on-demand (POD) providers—such as the Amazon subsidiary BookSurge, Lulu.com, and Ingram's Lightning Source—provide targeted services to book publishers. Thanks to technology and systems improvements in this area, production standards are improving and print-on-demand unit costs are falling, making POD a more viable format for professional publishing firms. In fact, POD providers, many of which offer fulfillment services as well, arguably constitute an additional category of distributor in the book trade.

3. There is increasing evidence that distributing publishers' content online is good for book sales. Book buyers increasingly use the Internet to learn about books and authors; mass marketing in the book trade is shifting to niche marketing on the web; the online retail channel is claiming a greater share of the book market; and major digitization initiatives from Google (Book Search) and Amazon ("Look Inside/Search Inside" and "Upgrade") represent new platforms for sharing book information and monetizing book content.

With these points in mind, the issue for publishers is not only how best to digitize and structure book content, but increasingly, how best to store their content, manage it effectively, and serve it in multiple formats to a variety of platforms.

The accompanying challenge is the cost of building a digital infrastructure that can serve an adequate volume of files. Server and bandwidth requirements are part of that expense, but the larger issue is the cost of engineering and maintaining a system that can adapt to keep up with the changing formats, standards, and delivery requirements of the rapidly changing digital landscape.

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[37] "Publishing and Digital Change: What's Next?" Mike Shatzkin, from a speech to the Association of Book Publishers of British Columbia, February 2006.

[38] The American Association of Publishers and the International Digital Publishing Forum have reported a 400% increase in wholesale e-book sales in the US from 2002 to 2007, though the $67M in e-book sales reported in 2007 represented less than 1% of the $25B US book market. This pattern is reflected in library expenditures as well. In 2002, Canada's public libraries spent 82% of their materials budgets on print resources in 2002, but by 2006 the share of budget for print resources had fallen to 74%.

A related issue that has emerged for publishers is that of how to retain control over digital content. The examples of Google Book Search and Amazon Upgrade mentioned above have each attracted their fair share of controversy, not least of all because they raise important questions about the security and online use of copyrighted content. By allowing Google and Amazon to hold digitized copies of their books, publishers are in effect allowing these powerful trading partners control of their content and the opportunity to create new business models on the strength of the aggregated book archives.

Recently, the growing interest among publishers in controlling their own digital assets and increasing awareness of the related systems costs have led to a greater role for publishers' consortiums and specialist firms in the digital supply chain.

Mike Shatzkin's Idea Logical Company had led some of the early research in this area, and has documented some of the early moves by industry consortia in college and professional publishing, a sector that leads many other categories of book publishing in digitization and digital content distribution.

> "In the US, Pearson, Thomson, McGraw-Hill, Wiley, Houghton Mifflin, and Holtzbrinck—which comprise 85% of the US market—are organizing a consortium 'to generate efficiencies and promote electronic demand for electronic content within higher education institutions.' In other words, they're sharing the cost of creating the infrastructure for what they expect will be an explosion of digital delivery.
>
> Oh, and by inference, they'll control that infrastructure so the newer or smaller publishers trying to reach this market will have to gain access to their road. Real anti-trust concerns will limit abuse, but one has to believe that this step will consolidate power for the existing market leaders.[39]"

In this sense, we can imagine that these early moves of market-leading firms in digital distribution are driven in part by a recognition of changing consumer behaviour, but also by the interest of these category leaders in asserting or protecting their position in the marketplace.

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[39] "Publishing and Digital Change: What's Next?" Mike Shatzkin, from a speech to the Association of Book Publishers of British Columbia, February 2006.

6.2 THE DIGITAL ASSET DISTRIBUTOR

Shatzkin has also described the emergence of several new digital distribution firms in America and Europe, and provided a glossary of terms that illustrate the roles played by major participants in the digital supply chain. In the Idea Logical lexicon, the market is composed of Digital Asset Producers (DAPs), Digital Asset Distributors (DADs), and Digital Asset Recipients (DARs). This conception of the supply chain is illustrated in the figure below.

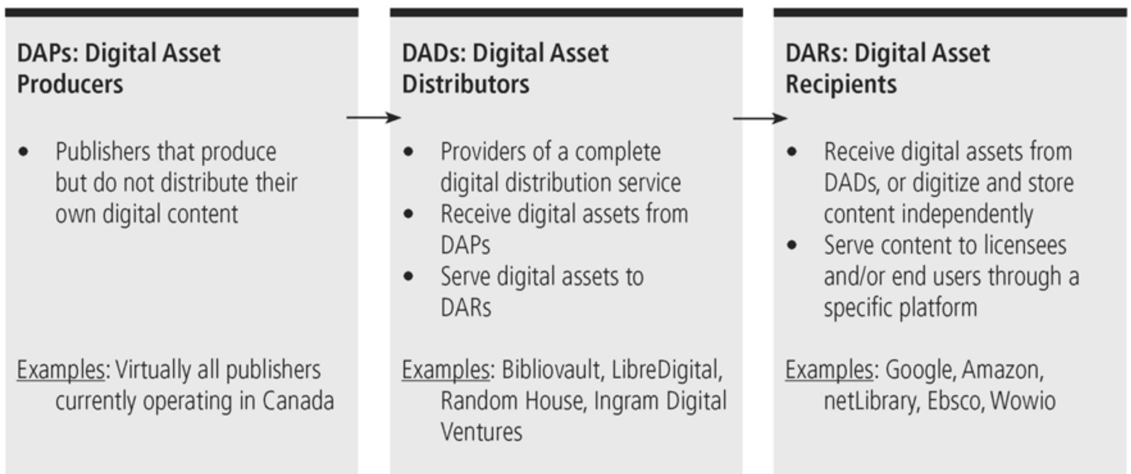

Figure 8. The digital supply chain for books.

In this model, the Digital Asset Distributor, or DAD, is a specialist firm that provides a comprehensive service, including storing DAPs' digital assets; converting them into various formats; serving them to DARs of all types (who then deliver them to end user/consumer); and providing digital rights management and transactional services. The early indication is that there are no more than 10–12 such firms operating, or soon to be operating, at any scale in North America or Europe. All of these DADs or DADs-to-be are major firms with an existing role in book publishing.

The current North American-based entrants in this category are: (1) Accenture, a global consulting and technology services firm, (2) codeMantra, a US-based DAD with a production facility in Chennai, India, (3) LibreDigital, a division of Newsstand Inc that is partially owned by HarperCollins Publishers, (4) Random House Inc, one of the world's leading trade publishers, (5) RR Donnelly, and (6) Ingram Digital Ventures, a wholly owned subsidiary of the leading US book wholesaler[40]. We note that all of these firms are US-based, and that both the infrastructure and practice of digital content distribution is more developed in the US than it is in Canada.

As an example of the range of digitization and digital distribution services offered by a DAD, the following graphic illustrates the relationship, and synergies, between Ingram

[40] Educational publishers have a further option through Bibliovault, a digital repository, conversion, and asset delivery service operated by the University of Chicago Press.

Digital Ventures and other major operating divisions at Ingram, including Ingram Book (a wholesaler of print books) and Ingram Lightning Source (a POD provider).

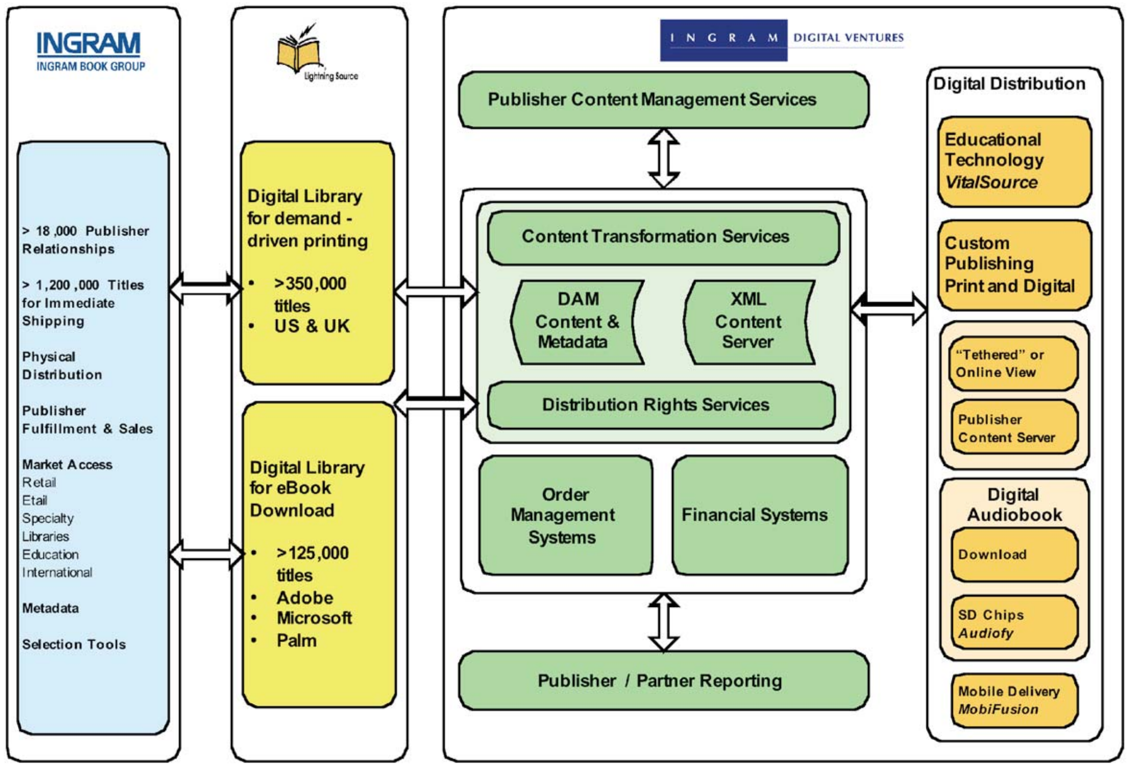

Figure 9. The comprehensive range of services provided by Ingram Book, Ingram Lightning Source, and Ingram Digital Ventures.

Figure 9 is best read starting from the middle, with the green panels of Ingram Digital Ventures. Having processed publishers' content through its conversion, storage, and management services, Ingram is able to serve content to various DARs, or to serve the content as an e-book (sold through Ingram Book or otherwise), or to send the digital asset for print-on-demand production at Ingram Lightning Source.

This example shows how multi-faceted and integrated a digital distribution system can be, and highlights the advantages of a dominant market position in the digital marketplace—an issue that will be further explored in the following section.

6.3 THE INFLUENCE OF MARKET LEADERS

There are some remarkable parallels between this emerging digital distribution marketplace and the supply chain for print books. Most notably, the digital channel also favours larger players. There are powerful gatekeepers emerging in the digital content marketplace—with every bit, or more, of the market power attributed to category leaders in print distribution.

Further, there is considerable momentum—mainly because of the level of investment required to build a comprehensive digital infrastructure and the resulting drive for economies of scale—toward consolidation of the distribution function in the hands of a relatively small number of companies.

In an interesting example of how this phenomenon can play out in the digital marketplace, Amazon announced in March 2008 that print-on-demand publishers and self-published authors with titles for sale on Amazon must use the Amazon-owned BookSurge print-on-demand printer to print their titles. In other words, authors or publishers who choose not to print with BookSurge will effectively not be able to sell through the market's leading online retailer.

Also as in the print supply chain, the market's largest publishers/content owners have opted to invest in their own DAD services, either by acquiring a related company (as in the case of HarperCollins) or by building a proprietary system from scratch as Random House has done. These firms operate on a scale that supports their direct participation in digital asset distribution in this way.

Similarly, the market dynamic favours the market leaders in distribution, such as Ingram. These companies can accommodate the investment required to build infrastructure for digital distribution. They have additional advantages in (1) their expertise in content markets, and (2) established business relationships with both publishers and DARs.

In all cases, these large firms can achieve the economies of scale required for long-term success in the digital supply chain. These scale effects allow a market-leading firm to deliver digital distribution services on a cost-effective basis for publishers, and also to support the ongoing development and systems improvements required in the dynamic marketplace for digital content.

In contrast, this also means that most publishing houses will find contracting digital distribution to a DAD to be the most effective approach—as opposed to managing this function in-house.

This last point underscores a pattern that we have seen throughout this chapter in that there are a number of important relationships between the print and digital distribution environments. While the digital marketplace is still taking shape, these parallels provide a basis for some broad observations of how the market for digital content is likely to develop.

In general, we expect the following:

- continued integration of print and digitized book content with respect to their sales and distribution;
- increased market share for digitized book content, and increased availability of digitized book content generally; and
- continued strength and market-shaping influence of category-leading firms—both in terms of the activities of larger trade and educational publishers as well as way in which dominant internet-based firms such as Amazon or Google are exerting an increasing control over digital book content.

7.0 CONCLUSION

This study has described a system of book distribution in Canada's English-language market that, while it has been reasonably stable, has experienced a general tightening in recent years—particularly in the wake of the collapse of General Distribution Services in 2002 and the increasing concentration in Canada's book retail channels.

In a marketplace with relatively little overall sales growth, downward pressure on book prices, and rising costs, the emphasis has ever more been placed on controlling costs and on achieving the greatest possible efficiency and economies of scale throughout the book supply chain.

These factors have shaped a book distribution system in Canada's English-language market that has achieved some real performance and efficiency gains in recent years. At the same time, they have influenced a system that has been characterized by rising distribution costs for publishers and more rigorous inventory management, and where the majority of the country's distribution capacity is devoted to the relatively more profitable lines of the largest domestic and imported publishing lines.

For the moment, the end result is that the larger publishers in the marketplace—particularly those with annual sales above the $500,000 threshold—have relatively effective access to the mainstream channels for book sales in the country. These channels include bookstores, online booksellers, and a small number of established mass market accounts, such as Costco. Those below the half-million-dollar threshold have fewer distribution options, and may have limited access to this "book system"—that is, to the prominent sales channels through which the majority of books are currently sold in Canada.

Looking forward, we expect that the mainstream book market in Canada will continue to concentrate market share among the nation's largest retailers, both large chain bookstores, online booksellers, and mass market retail outside of the bookstore category. This concentration of consumer book sales among a relatively small field of major retail chains will in turn continue to reinforce the very important role that large-scale distributors play in the supply chain.

The country's largest publishers will continue to have a dominant position in these channels, and smaller firms will likely increasingly collaborate through distribution collectives in order to achieve an operating scale that allows effective access to nation-wide distribution.

We also expect, however, that the conventional understanding of Canada's mainstream book system will expand in the near future due to the following:

1. Given the limited growth available in established sales channels, larger publishers and distributors will pursue sales growth through alternate channels, including a greater emphasis on non-traditional retail accounts, direct-to-consumer sales, and digital distribution.

2. Due to the persistent challenge of accessing mainstream national sales channels, smaller publishers will be compelled to pursue sales growth in many of these same alternate outlets in order to better capitalize on some of their natural strategic advantages, such as a focus on a particular region of the country or editorial niche.

In this sense, the book market is likely to become increasingly diffused outside of the traditional retail channel as Canada's book supply chain expands to serve these new customer accounts. The additional diversity that this shift suggests will bring new challenges for publishers and distributors alike. It may also provide an opportunity for a greater selection of Canadian-authored titles to reach a wider audience, and, in so doing, may represent an important counterpoint to the structural advantages that books published by large, foreign-owned publishers currently enjoy in the Canadian marketplace.

Regardless of how the supply chain develops in the years ahead, it is clear that the establishment and management of effective, affordable sales and distribution systems will remain a critical aspect of publishing in Canada, and a key function in ensuring a diverse selection of books for readers throughout the country.