November 1999

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Recommended Citation

Miller, Dan and Nees, Gary (1999) "Book Pricing Update-Economics of a Goofy Business," *Against the Grain*: Vol. 11: Iss. 5, Article 23.

DOI: <https://doi.org/10.7771/2380-176X.3697>

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Book Pricing Update — Economics of a Goofy Business

by **Gary Nees** (Chief Financial Officer, Blackwell's)

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Five years ago, I was recruited to be the Chief Financial Officer of Blackwell's Book Services. I came from outside the book industry, having spent the majority of my twenty-two years in financial positions in forest products. But, I figured accounting is accounting. How different can it be? Well, was I mistaken! Being a book wholesaler to libraries is the goofiest business I have ever seen. Why would anyone go into this business? Certainly not to make money!

To start, let's look at the economics of this business. Book wholesalers buy from a monopoly and we sell a commodity (i.e., a product with little differentiation). Each book I buy I can only get from one place, its publisher, who has a monopoly on that edition of the title. If I do not like the discount the publisher offers me, I cannot go to a competitor because none exists. On the other hand, the book in the wholesaler's hand has become a commodity. When I sell that book to a library, it is exactly the same book that all of my competitors sell. The library can play the academic suppliers against one another for higher discounts because we each must supply the identical book. We have no leverage on the publisher, nor on the buyer. What I remember from Econ 101 tells me this is not good.

Now, let's take a closer look at the product: academic books. We do not get to choose our product lines; rather, our customers tell us the exact title, edition, publisher, etc. that they want. In other wholesale businesses, the wholesaler decides what product lines to carry. For example, in my former life, if I wanted a D-9 Cat for the logging operation, I went to the local Caterpillar dealer. He had chosen to carry Caterpillar because of the margins he could earn in doing so. A full-service academic bookseller, on the other hand, cannot pick the books he wants to provide based on the margin he can earn. If he limits himself to only high margin books, the customer goes elsewhere. Consider also that as library budgets get squeezed, many libraries opt for low-cost paper editions. Even a high gross-margin

percentage on a twenty-dollar book will lose money for the wholesaler.

Now, let's consider cash inflows and outflows. Last year, over one hundred million dollars flowed through Blackwell's US book operation. Wow, a hundred million dollar business! But, wait a minute. Of every dollar that a customer pays to Blackwell's, at least eighty-two cents belongs to a publisher. We are not really a hundred million-dollar business; we are only an eighteen million dollar business. Nevertheless, we handled over one hundred million dollars worth of books. And, unlike big trade or textbook wholesalers, we have to order, receive, process, pick, ship and invoice them one at a time. While your textbook supplier can have the publisher send a thousand copies of the English 101 text directly to your campus book store without ever touching them, the library wholesaler must receive, process and re-send the one copy of the title that you order for your library. All of these book-by-book services must be covered out of a small percentage of the total revenue we receive from you. Think about the economics of that for awhile.

And what else are we expected to do with the eighteen cents left of each dollar after the publishers get their share? Well,

provide sophisticated electronic services is one market expectation. Wholesaling to academic libraries is now an information business in that we are expected to have state-of-the-art, Web-based tools for you to access all kinds of information for every book published or to be published, and all kinds of information regarding our specific relationship with your library. Each library operates differently from any other library (granted, this is a bit of an exaggeration), so we are expected to modify our electronic systems to accommodate various practices, and we try to

do so. Doing so means maintaining a formidable information technology staff.

As you know, in today's information age, IT skills are in high demand and competition for these skills has driven up salaries. Here in Portland, Oregon, **Intel Corporation** is the largest private employer, with over 10,000 employees in the metropolitan area. Intel competes for the same IT skills we need, and is willing and able to pay high wages because these IT wages are part of every chip they sell at fat profit margins (i.e., the wages are part of their cost of sales). On the other hand, consider the impact of IT costs on book wholesalers. Instead of being a cost of sale, IT costs are carried as an overhead cost since it does not produce a salable product. Why doesn't IT produce a salable product? Because the market only allows us to charge for books, and expects that all information tools and data will be provided at no additional charge, to the extent that it will play one vendor against another until its expectations are realized.

Another unusual and expensive aspect of book wholesaling to libraries (particularly for wholesalers offering Approval plans) is the right we give our customers to return books at full credit. Even when we receive full credit from the publisher for the returned book, this constant flow of returns adds significant costs to the business. A portion of our freight cost is doubled. Many books are handled twice, requiring more people in our distribution facilities than is the norm in wholesaling. And, perhaps worst of all, accounting for returned items, both on your statements and with our suppliers, is a highly complicated and expensive undertaking (many of you are only too aware of the intricacies of reconciling your account with us when returns are part of the mix). Staffing in our accounts payable and accounts receivable departments is probably one-third higher than in other industries in order to address complications caused by a constant flow of returns.

In recent years, a new economic pressure has been introduced into the library book wholesaling business: consortium buying. The consortia's contention is that, by associating together, libraries can offer a single supplier a very large volume of business and, therefore,

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should receive a higher discount than the individual libraries might otherwise obtain—an economies-of-scale argument. However, there are no economies of scale. If ten libraries form a buying consortium, they generally still want their books delivered separately to at least ten different locations. Each generally wants to be billed individually. Each generally has different processing and handling requirements. And, because the goal of the consortium is to reduce or eliminate duplicate copies of the same title across consortium members, the wholesaler's volume is actually less than if the ten libraries contracted for services individually. There are essentially no cost savings to the wholesaler in dealing with a consortium. Indeed, the higher discount means there is less money to cover the same costs as selling to the libraries individually.

So, what do we see here? We see a business that offers each wholesaler little opportunity to differentiate the products for which customers pay. We see a business where services that offer opportunities for differentiation (i.e., IT-based services) are in high demand in the market, are very expensive to develop, but are expected at no additional charge. We see a business that is a one-at-time business with little real opportunity to take advantage of economies-of-scale, even when consortium buying is involved. We see a business that offers unusual, yet complicated and expensive, features such as liberal returns privileges. We see a business where there is constant pressure to reduce prices through raising discounts. We see a business that, over the last decade, has lost a significant number of players, which has translated into a loss of options for the library market!

So, next time you are negotiating a contract with your book wholesaler, bear in mind the economics under which the wholesaler operates, and realize that we—the library and the wholesaler—must, together, develop working relationships that sustain the services that libraries desire.

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on Stanford in the mid-1970s. Don passed away several years ago but Fred is alive and well as the owner of **Gull's Nest Books** in Portland, Oregon. Don and Fred were founts of information about publishing and bookselling and willing to share all they knew. They were great teachers, and they represented small book jobbers who wanted as much business as they could handle. They were willing and able to provide customized services in order to get their fair share of business. When they heard my special request, both Don and Fred set up accounts with me and immediately began shipping books to libraries in the USSR and sending the invoices to me. The arrangements, based on trust, worked well, and from that experience, I learned a valuable lesson about working with book jobbers as colleagues.

When I had the opportunity to deliver the keynote address, "The Business

of Acquisitions," at the first ALA/RTSD Preconference on Acquisitions, July 4-5, 1985 (befittingly delivered in the Windy City), I wanted to share my enthusiasm for library acquisitions and also pay tribute to friends and colleagues, both vendors and librarians who had taught me so much. I especially wanted to share my belief that the library community needed large, medium-sized, and small vendors, each with its own mission, each with its own niche. Part of my theory about this family of jobbers was that when small and medium-sized book jobbers got so big they could no longer provide customized service, one or more employees, wanting to do more, would leave and form a small company in order to be closer to customers and their needs. There was evidence then to support my thesis. I had seen it happen and had seen it work. But that was then and this is now.

So what do we make of the most recent mergers that, while not new in the library supplier world, have come as a shock and surprise to many of us? The big have become bigger. **Blackwell's** buys **Academic Book Center** and hires **Dan Halloran** (AcBC's president) to run what is essentially a new company with an old, respected British name. **Baker and Taylor** buys **YBP** (a.k.a. Yankee Book Peddler) and moves its academic accounts to YBP, hiring (retaining) **John Secor** to continue his leadership under the business name that he stands for and behind.

There are good reasons for these mergers. The one I am most familiar with seems to be going smoothly. Longtime friends and colleagues, with a few exceptions, have kept their

jobs. For those who did not, I hope that they land on their feet and find satisfying work elsewhere. They have my sympathies and those of others with whom they worked for a full score of years. Change is not always pleasant or easy.

I wonder what these events portend? Are librarians demanding so many services and such high discounts, with one-sided loyalty, that it is no longer possible to survive without the big becoming bigger? Can experienced booksellers still split off and start their own small, service-oriented companies? Or will the technology that has enabled at least some large companies to provide at least a modicum of customization also allow smaller outfits to survive if not thrive? What has technology wrought? What have we all gained from it all and at what cost? Are the most recent mergers harbingers of more and perhaps even bigger mergers, acquisitions, food chain reactions?

I don't pretend to know the answers but I am not idly asking these questions, either. I wonder what will happen to the world of acquisitions that I grew up in. It has changed but it is still recognizable. If I had fallen asleep in 1980 and just woke up, though, I would look

at my old, familiar world and say, my how you have grown, much like a seldom seen relative comments on those nieces, nephews, and grandchildren who have gone from two years old to twenty with no sightings in between. But some things have not changed. The good companies, regardless of size, still provide excellent service

that is reflected in the representatives who are sent into our libraries to work with us, get to know us and our needs, and establish a base of trust without which I would not want work, without which no decent business relationships can be forged, much less sustained.

I am not critical of recent changes. They make sense and seem, in retrospect, logical and overdue. And there are still some small and medium-sized jobbers out there trying to make a living by doing some things for customers that the larger companies cannot or do not want to do. I hope we all understand the value of such a diverse community and also understand that there are real costs associated with services, and that if we do not pay for true customized service, through additional charges or through loyalty, we may not be able to get those services in the future. Or we will have reduced our choice of vendors to one or two at the expense of competition. Costs will rise as services are unbundled. We will pay for what we get and we will be poorer in more ways than one. Support your local bookseller.

"... if we do not pay for true customized service, through additional charges or through loyalty, we may not be able to get those services in the future."