Straight Talk--Private Equity Firms and Their Influence in the Library Marketplace

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The recent announcement that Follett Corporation is buying long-time library supplier Baker & Taylor has been met with surprise and shock by many including comments about what is going to happen to the cats. I got calls and emails from many of my friends asking what is going on and what does it mean for the library community. What does this mean and why now? What is going on in our industry?

Well, for the most part nothing is going on! Yes nothing! There is no grand plan, no conspiracy, and no strategy. Yes, Follett Corporation is buying B&T. End of story. But why now? What is really going on? Is the library market in such disarray that all of our vendors are buying each other up?

The answer is fairly straightforward. The sale of Baker & Taylor Books is the final transaction, clean up and sale for Castle Harlan Partners IV, L.P, a New York-based private equity fund managed by the Castle Harlan, Inc. firm that acquired Baker & Taylor for $455 million in July 2006. That’s quite a jump in price as only three years earlier Willis Stein & Partners, LP paid only $255 million for the company. Someone told me that the high price paid was due to the expectation that Baker & Taylor would have a major role in Amazon’s distribution network, but in the end Amazon built their own distribution centers and bypassed B&T.

The Castle Harlan private equity firm has owned Baker & Taylor for ten years and I have reason to believe that they originally overpaid and have been looking for a way to get out of this situation for several years. I happen to know that Castle Harlan tried to sell YBP, a B&T business unit for about 18 months before EBSCO bought them in 2015. About the same time that YBP was sold to EBSCO, Baker & Taylor’s Marketing Services and Baker & Taylor’s Publishing Group were acquired by Readerlink Distribution Services LLC. So now, with two units of the Baker & Taylor group sold off, Castle Harlan only had the largest unit to sell.

Finally, after flogging Baker & Taylor to a number of venture firms and other potential buyers on both coasts for months, Castle Harlan finds a willing buyer and hopes that they have the unit all wrapped up, spit shined and ready for a new home. So the answer to everyone’s question: the sale of Baker & Taylor is a simple acquisition from a private equity owner that has been trying to sell this company for months. The timing is related to when they could find a buyer, plain and simple. I don’t think that Follett Corporation was planning on buying or seeking out this acquisition. But when the Castle Harlan sales pitch came they made Follett Corporation an offer too good to ignore. However, this not the first time that the Follett Corporation tried to buy Baker & Taylor, in 1994 there was a serious effort by Follett Corporation to buy Baker & Taylor from another private equity group, The Carlyle Group and after months of negotiations that deal fell through.

Private equity firms are a good way for companies to raise capital, and Baker & Taylor have had a long history of private equity owners starting back with the Carlyle Group that acquired Baker & Taylor from W.R. Grace in 1970. Each private equity firm for the most part has made a better than average return without making any significant investment. The Carlyle Group lucked out and left Baker & Taylor alone but did pay attention to the deal that B&T did with a new start-up in Seattle. Baker & Taylor licensed their title database and publisher files to Amazon for a modest upfront fee and B&T took a stock position which Carlyle later cashed in and made more money from the Amazon stock sale than they might have received from the sale of Baker & Taylor.

Baker & Taylor is not the only library services company that has private equity ownership or involvement. I am not here to judge whether private equity ownership is necessarily good or bad for the library industry but one thing is clear: the financial returns of the private equity firm are always maximized for the shareholders and not for the library clients and customers. As usual, library customers carry most of the cost of these deals in terms of higher prices, delayed development and diminished customer service. Too often, the private equity firm has no idea what they are buying, what business they are in, nor do they care about the market.

Some recent examples of private equity plays in the library marketplace would be in the ILS marketplace. Nearly everyone is aware of ProQuest’s acquisition of Ex Libris in 2015. I think many librarians are still shaking their heads at the whopping $500 million plus price that ProQuest paid a venture firm for Ex Libris. Yes, over $500 million, and most of that paid for by subordinated debt with a group of bond holders who are financing that debt. Ex Libris has had an interesting history with private equity ownership starting in the early days with Heaphean University and some other organizations that invested $4 million. From that small $4 million investment the growing company was able to find their next investor, Francisco Partners, who invested $62 million in June 2006. In August 2008, the next private equity firm, Leeds Equity Partners paid $150 million for Ex Libris which they sold to Golden Gate Capital for a little over $200 million. But wait there’s more... at the end of 2012, less than two years later, Golden Gate was able to flip Ex Libris for over $500 million. Not a bad payday for their investors!

ProQuest must now meet certain performance goals in terms of sales, etc. in order to satisfy the bond holders. Any time your company takes on debt, that debt always comes with someone looking over your shoulder on a quarterly basis. If you are unable to meet the performance criteria then you possibly end up like Cengage. Again the library community may be indirectly involved in helping to manage that debt by paying rising database prices and/or higher maintenance prices.

Another example of a private equity acquisition is Innovative Interfaces, Inc. where Huntsman Gay Global Capital and JMI Equity made a strategic investment in Innovative in March 2012. Innovative was founded in 1978 and had long been one of the libraries’ favorite companies with a broad base of support and a huge customer base. Innovative was in serious need of a technological engineering overhaul. They chose to raise capital from the private equity community. In the end, Jerry Kline decided to sell out to a venture group and let someone else deal with the task of reengineering the various systems and platforms into the next generation systems. As an outsider observer, it was interesting to note that one of the first tasks that the private equity firm undertook was a reduction of a number of well-known and highly respected library vendors that had worked for years at Innovative who understood the unique aspects of the academic and research library marketplace. It will be interesting to follow the developments in Emeryville, CA.

While several of the ILS vendors are owned by private equity firms, there are other examples of venture ownership in our industry. High Wire Press, a hosting service founded by Stanford University as an auxiliary unit of Stanford University Libraries in May 2014, received a significant equity investment to support its strategic growth from Accel-KKR, another private equity firm. High Wire Press received a much needed investment that will enable HWP to develop the next generation hosting service. High Wire Press had been under pressure from a number of their publisher partners to reengineer their services. This investment will enable them to remain competitive in this niche market. Recently, High Wire Press announced the opening of a new European Office in Belfast, Northern Ireland and the addition of 74 new positions over the next three years. I cannot help but wonder if this is the first step to moving all the software development to a much lower cost area. Maintaining a software development team in

continued on page 38
Redwood City, one of the most competitive and high cost locations where software engineers are constantly looking for the next opportunity is a challenge.

My final example of a private equity play is OverDrive, the Cleveland based company supplying digital content to libraries, primarily schools, public libraries, and public library systems. OverDrive caught the wave of the shift from print to electronic formats and experienced a dramatic growth spurt. It needed a cash infusion to help pay for expansion and for a new headquarters. In 2010 Insight Venture Partners, a private equity firm provided the necessary cash investment and became the primary shareholder and majority owner. In five years with continued growth OverDrive became a hot target and in 2015 Insight Venture Partners sold OverDrive to Japan’s Rakuten, Inc. for $410 million. The OverDrive example is another great payday for a venture firm. Anytime you can turn $30 million into $410 million is an impressive win.

Back to my original question: Are private equity firms in the library marketplace good or bad for our industry? One thing is certain, a number of private equity firms have made investments in ILS, Book supply, and e-books that have yielded impressive returns. We can expect that private equity firms will remain players in our marketplace. In addition, private equity firms allow library service companies to raise much needed capital for expansion or for buying other companies.

On the other hand, private equity firms are focused on maximizing their profit potential and have little to no interest in growing, developing or understanding our market place. A private equity firm most likely will have ownership positions in ten or more companies often in a variety of businesses. The library company they invested in is just a balance sheet to watch over and make sure that the profits grow. In some cases, the venture firm makes a wrong investment and after attempting and failing to find an exit strategy is left with the option of stripping the company of all its cash and/or other assets and simply walking away and leaving the company to fail. Recent examples of this type of venture play include both Swets and Faxon.

My money is on vendors that are long term players in the marketplace, who are conservative and who have a deep understanding of the marketplace. Libraries should avoid companies that are saddled with huge debt and pay attention to what is going on in the marketplace. The Swets situation is a prime example of too many people ignoring the warning signs. Investment banks were having second thoughts about Swets and in the end they stripped out all the cash, protected their investment and pocketed many libraries’ prepayment payments. Several major U.S. libraries each lost more than a million dollars.

My final thought… All of these private equity firms are investing enormous amounts of money chasing deals all over the world. When you stop and think about it, the money they are using is mostly from retirement funds. Your state, university, or other retirement program is supplying the cash for the various private equity funds. I guess we can all sleep well at night knowing that someone is using our money creatively… or not!