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TO: David Shanks, Susan Petersen Kennedy, John Makinson

FROM: John Schline

SUBJECT: Ebooks talking points

Please let me know if you have any comments or want any clarifications or additions.

Ebooks Talking Points: Answers to Potentially Awkward Questions

1. With all of the saving in paper, printing and binding surely there must be some savings that can be passed on to authors in the form of higher royalties on ebooks.

ANSWER: Most ebooks are sold at the paperback price point, and whether the royalty is 25% of net or 15% of retail it is still roughly double the normal royalty rate for paper editions. The cost of paper, printing and binding is between 7 and 9% of the cost of a physical book, so, in short, we have already passed along the savings of paper printing and binding to the authors.

2. But what about reduced warehousing and distribution costs?

ANSWER: Those costs have not gone down. We still have to do all of the things we always did for physical books, which for the foreseeable future will still be the core of our business. Of course, at the same time, we have to invest in digital warehousing and distribution. Since we are talking about costs, this might be the time to point out that author advances are still the biggest cost we have.

3. Why can the "independent" ebook publishers afford to pay such high royalties, but traditional publishers refuse?

ANSWER: Those companies basically ride the coattails of the marketing we have invested in and the brands we have helped build. These companies provide not one tenth of the services we provide in terms of editorial, distribution, design, production, publicity and marketing. Our online marketing group alone has more staff than these entire companies. Their royalty is higher but for only a fraction of the services, so our royalty is more than fair.

4. So why shouldn't authors sell physical books to you and sell the e-editions to the people who pay them 50% royalties?

ANSWER: Many reasons, but I will name 3 very important ones..
First, authors and publishers want rational coordinated pricing to protect the value of books and prevent them from being commoditized. An e only publisher would probably substantially undercut the physical book price.

Second, there should be coordinated market timing and packaging. Different covers from different publishers, published on odd dates is frustrating and confusing to retailers and customers alike and usually leads to lost sales.

Third, separating e revenue from traditional publishing would lead to lower advances and greater uncertainty in the publishing industry. The book business invests billions of dollars a year in author advances and anything that creates uncertainty slows or lowers that investment, which is money out of author's pockets.

5. I just feel like there must be more money somewhere--even if we can't see it right now--so I only want to agree to an ebook royalty for a short time and then revisit this.

ANSWER: Of course there is always a degree of uncertainty in evolving businesses. I would say that because of the way that publishing works, with publishers competing with one another to buy books, we are all encouraged to take risks on authors even though we don't really know what the market will look like when the book is actually delivered. The good news for authors, of course, is that whether we are right or wrong, and whether or not the market has evolved in a way that is good or bad for a book, the author still has their advance! In that way, publishers are accepting an even greater level of risk.

6. Even if I accept that the royalty rate is fair, I am losing a lot of money because the prices of new releases in ebook are substantially lower than their physical counterparts. On a $30 hardcover I make $4.50 as a royalty and assuming the agency model and a $14.99 ebook I make only $2.62, That is a big reduction, and most agents will tell you that most of their revenue comes from hardcover sales. How is this fair?

ANSWER: Like authors and agent, we care very much about keeping prices for books as close to physical books as we can. Publishers and authors have a shared interest books having a high perceived value. But this isn't 5 years ago. There are strong forces at work which would have no hesitation about "commoditizing" books if it were left up to them. We have fought to protect high prices; we have taken hits in the media and allowed ourselves to be called "greedy" because we fought against $9.99 pricing. Yes $14.99 is a lot less than $30, but it is better than $9.99. And who knows, it is $14.99 this year, but in a few years it may be $16.99 or $19.99. We are paying attention and we are on the same side in this regard. Remember, it is a lot less revenue for us too!

7. Penguin has been very inflexible of late with regard to your so called "micro-transaction royalty"; not only have you not agreed to be flexible about the rate, but you also are resistant to giving authors approvals over the kind of programs they can put their book in. Many authors are uncomfortable about their books being "sliced and diced" in this manner and feel like you are usurping too much control. Why are you doing this?

ANSWER: Just because an author writes a book in a particular manner and just because we publish it in a particular manner, does not mean that all consumers will use it in the same way.

Right now any consumer can grab a book at Barnes and Noble or other superstore, and read some or all of it in the coffee bar without paying...sometimes that coffee stained book will be returned to the publisher for full credit...Likewise a student doing research can go to the library and make photocopies of certain sections of books for a paper he is writing. In both cases the author and publisher get zero compensation.

If I can charge a student 25 cents a page or make some revenue from Google or Safari for this kind of use because people can now do it from home, isn't some money better than no money? I think we would rather have them brew their coffee at home and give us their $2. Plus, by raising the profile of these books we also create the possibility of more sales.

Now approvals. Because our industry had no ebook royalties negotiated for so many titles we wasted a lot of time and lost a lot of sales during the past 2 years when ebooks sales started growing. As a publicly traded company that invests hundreds of millions of dollars in books, it would be irresponsible of us to not be prepared to seize whatever opportunities for us and our authors that the evolving market presents. After all, we pay advances, so authors already have their money and we have to make it back. Marketing managers will have to make decisions for hundreds if not thousands of titles as these opportunities present themselves. We can not proceed at the leisurely 19th century pace authors and publishers were accustomed to 10 years ago.

What we have done, is created a negative option. If an author really feels that a program we have placed a book in is bad for sales or misrepresents the book we will remove it from that program within a relatively shot time span upon their request.

8. But why isn't this paid like a license at a 50-50 or better split for the author?

ANSWER: Because it is not a license. First, there is no advance. No one is making a determination of risk for a particular title; we are negotiating terms of digital distribution like we would with an ebook account. Second, this is not a licensed edition; it is our edition published under our imprint. Finally, there is no third party licensee setting a new retail price.