Penguin Three Year Plan 2009

We have prepared this plan against a backdrop that is economically clearer but strategically more opaque than a year ago. While we share the common anxiety about trends in consumer spending in 2010, the evidence of this year is that trade book publishing has experienced a soft landing, weakening in response to consumer and retailer pressures but sustaining its reputation as a safe harbour in a storm.

The evidence suggests that book volumes, and revenues, are running about [redacted] per cent below the levels of a year ago in the key US and UK markets. The picture elsewhere is mixed but even in India, which saw a dramatic fall in sales late last year, conditions are now more stable. It is a different story, of course, category by category and channel by channel. Demand for reference titles has collapsed while some areas of the market are even showing a little growth.

Two factors are distorting comparisons: sales of [redacted] titles are contributing [redacted] of growth to the market overall – shades of JK Rowling – and we see no direct benefit from that except in South Africa; and destocking by retailers has almost certainly caused sales by publishers to undershoot the trajectory of the retail market. We are presuming in the plan that this inventory adjustment has now run its course. Online channels – a euphemism for Amazon – have continued to grow, at about half the historic rate of 20 per cent a year, putting continuous pressure on bricks and mortar. We believe that we are now adequately provided against credit risks in physical channels but the collapse of Borders US, still a possibility, would turn that assumption on its head.

The softness in the market, and in particular the travails of DK, have slowed the progress of margin improvement but we are still moving in the right direction. We expect [redacted] margin to be restored next year and are projecting a further [redacted] margin improvement in each of the outer years. So this gets us to [redacted] margin in 2012, a year later than we had envisaged in the 2008 three year plan. There are two substantial risks, leaving the economy to one side, to this central assumption. The first, inevitably, is DK, which is being asked to manage a significant reduction in title output and a complex transition of publishing resources to India in a simply terrible economic environment. The second is the achievability of continued margin expansion in New York. The realisation of that target is predicated on continued rapid growth in e-book sales and, crucially, on our ability to generate more profit from those sales than we would from physical books. That is not a given, as we shall see.

We have attempted in this plan to address the rapid structural change in our industry, just as we did in the reorganisation of our London companies a month ago, but it is very difficult to read the pace and in a few cases the direction of that change. Earlier in the year we conducted a survey of our senior management, normally a cautious bunch, to establish their view of the likely shape of the industry in 2020. The conclusions were dramatic: digital content would represent between 30 and 50 per cent of our sales; territorial copyright would have disappeared; our publishing would be centrally directed; Amazon would dominate the retail landscape; emerging markets would be hugely more important to us; the warehouse would be an endangered species. We would all acknowledge that any vision of the publishing industry a decade from now is going to be highly imperfect but there was a general consensus about the direction in which we were heading and we need to be prepared. This is a snapshot of some key themes and of the actions that relate to them:

Competition and collaboration

Competition for the attention of readers will be most intense from digital companies whose objective may be to disintermediate traditional publishers altogether. This is not a new threat but we do appear to be on a collision course with Amazon, and possibly with Google as well. It will not be possible for any individual publisher to mount an effective response, because of both the resources necessary and the risk of retribution, so the industry needs to develop a common strategy. This is the context for the development of the Project Z initiatives in London and New York. We shall be prepared to discuss these, and the London project in particular, when we meet next month but there we will be significant costs and risks.

The supply chain

The growth of e-books, and of other digital formats, will certainly reduce the requirement for physical storage and transportation. We shall need to review our warehousing infrastructure, especially in the US, with the goal of reducing the number of warehouses we operate. Our planning in this area is still at an early stage. [redacted] despite the potential availability of profitable new agency clients, because of the uncertainty surrounding the growth of the physical book market and the possibility that Australia may move towards an open market during the life of this plan.

Global publishing

The present copyright model is under threat from readers, digital channels and, in the case of Australia, from Government. We therefore need to take a more global approach to our publishing in anticipation of the demise of the territorial copyright regime. The trend toward global publishing presents numerous threats, particularly in the area of piracy, but should work to the relative advantage of companies with international networks and recognised brands. We are making a start with a more co-ordinated approach to the publication of classics and business books, with more categories – children's publishing included - likely to follow in time. Our digital strategy, content management programme, international sales and workflow design are already managed on a global basis but we shall probably need to add other functions to the list during the next three years. [redacted] The reorganisation of the UK companies has brought a closer alignment with the US management structure and this should be helpful in realising our global objectives. Finally, we must continue to invest in emerging market opportunities and will introduce changes in management responsibility in October to give additional emphasis to these territories.

Free

Pricing will be a major preoccupation over the life of this plan. The emergence of a new generation of multi-purpose e-book readers, appealing to a younger audience, will require a more sophisticated approach to mobile technology and more creative pricing. We shall try to resist the momentum towards free content through the development of new pricing models. Bundling, micro-content, subscription and pay-per-view will all pay a role. This will, as we know, necessitate investment in our inadequate rights systems.

The list could go on. Its purpose is only to illustrate that strategic planning now looks more of an art than a science and will demand agility in responding to consumer and competitive pressures as they emerge.

The plan envisages compounds annual sales growth of [redacted] on a constant exchange basis, over the life of the plan. This objective may look a little more modest by the end of the year if, as we expect, Penguin US exceeds its current sales target but we are still counting on market share growth and a substantially greater contribution from digital sales to offset the inevitable decline in revenues from DK.

The key questions at the sales line are whether the US can generate just over [redacted] in annual revenue growth and whether DK [redacted] We shall discuss these risks in more depth when we meet.

Our margin targets will be achieved if these additional sales deliver [redacted] annual growth in profit. [redacted] Our working assumption is that the expected growth in e-book sales will generate nearly a point of margin expansion at Penguin USA. Pressures on pricing, higher royalty costs and substitution effects will mitigate the obvious manufacturing and supply chain benefits of the e-book, and our e-book profitability model is highly sensitive to small movements in any one of these variables. We shall see.

We are counting, as we so often do, on double digit profit growth from Pearson Australia Group. We have the Australian and New Zealand education companies to thank for some of this but the ANZ Penguin companies, our fantastic shared services organisation and the emerging market businesses should all play a role as well.

[redacted]

The market could throw a spanner into any of the moving parts of this plan but the greater risk [redacted]

John Makinson
August 4th, 2009