SOUTH AFRICAN
BOOK DEVELOPMENT COUNCIL

# Factors influencing the cost of books in South Africa

arts and culture
Department:
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REPUBLIC OF SOUTH AFRICA

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TABLE OF CONTENTS

List of Figures iv

List of Tables iv

Executive Summary i

**1. INTRODUCTION 1**

**2. THE BOOK VALUE CHAIN 2**

2.1. Paper inputs 3

2.1.1. Market description 3
2.1.2. Market segments 5
2.1.3. Contribution to the cost of books 7

2.2. Printing 7

2.2.1. Market description 7
2.2.2. Participants and market shares 8
2.2.3. Finishing houses 9
2.2.4. Market segments 10
2.2.5. Cost drivers and the cost of books 10
2.2.6. Margins in the printing industry 15

2.3. Publishing 16

2.3.1. Market description 16
2.3.2. Participants and market shares 17
2.3.3. Cost drivers and the cost of books 18
2.3.4. Margins in the publishing industry 31

2.4. Distribution 33

2.4.1. Market description 33

Study conducted by Genesis Analytics (Pty) Ltd

2.4.2. Participants and market shares 33
2.4.3. Market segments 34
2.4.4. Cost drivers and the cost of books 36

2.5. Booksellers 37

2.5.1. Market description 37
2.5.2. Participants and market shares 37
2.5.3. Cost drivers and the cost of books 39
2.5.4. Margins in the bookselling industry 46

**3. PRICING OF IMPORTED BOOKS 47**

**4. FACTORS AFFECTING THE PRICE OF BOOKS 50**

4.1. General issues 50

4.1.1. Skills shortages 50
4.1.2. Coordination between publishers and printers 50
4.1.3. Implementation of new technology 51
4.1.4. Paper pricing 53
Box 1: Import parity pricing 54
4.1.5. Printing costs 56
4.1.6. Off-shoring of printing 57
4.1.7. VAT on books 60

4.2. The educational book market 62

4.2.1. Decentralised procurement 62
4.2.2. Uncertainty 63
4.2.3. Barriers to entry 64
4.2.4. Price insensitivity 66
4.2.5. Allegations of corruption 67
4.2.6. Government contracting 68

4.3. The trade book market 68

4.3.1. Size of the trade market 68
4.3.2. Limited distribution points 69
4.3.3. Library system 70

4.4. The academic book market 70

4.4.1. Size of the academic market 70
4.4.2. Limited sell-through of academic textbooks 71
4.4.3. Under-ordering by academic booksellers 71
4.4.4. Lack of coordination in the academic market 72
4.4.5. Potential concentration issues 72

**5. RECOMMENDATIONS AND CONCLUSION 74**

5.1. Policy recommendations 75

5.1.1. General issues 75
5.1.2. The educational market 76
5.1.3. The trade market 77
5.1.4. The academic market 78

Bibliography 79

Glossary 82

## LIST OF FIGURES

Figure 1: Origination costs, printing economies of scale and print runs iv
Figure 2: The book production cluster. 2
Figure 3: Vertical integration in the South African book industry 3
Figure 4: Printing economies of scale 14
Figure 5: Origination costs and print runs 20

## LIST OF TABLES

Table 1: Paper cost as percentage of total paper, printing and binding costs of a textbook. ii
Table 2: Breakdown of printer's costs ii
Table 3: Cost breakdown of the retail price of an educational book iii
Table 4: Educational publisher's overheads v
Table 5: Cost breakdown of the retail price (excluding VAT) of a trade book v
Table 6: Cost breakdown of the retail price (excluding VAT) of academic books vi
Table 7: Paper cost as percentage of total paper, printing and binding costs of a textbook. 7
Table 8: Breakdown of printer's costs 11
Table 9: Breakdown of the South African book market in 2005 16
Table 10: Cost breakdown of the retail price of an educational book 24
Table 11: Main origination costs 25
Table 12: Educational publisher's overheads 25
Table 13: Cost breakdown of the retail price (excluding VAT) of a trade book 27
Table 14: Main origination cost in the trade market 27
Table 15: Trade publisher's overheads 27
Table 16: Cost breakdown of the retail price (excluding VAT) of academic books 29
Table 17: Main origination cost in the academic market 30
Table 18: Academic publisher's overheads 31
Table 19: Economies of scale and retail prices in the academic market 31
Table 20: Sales distribution of a trade publisher 38
Table 21: Academic booksellers' market shares 39
Table 22: A particular trade bookseller's overheads 42
Table 23: Typical discounts received by local publishers in agency arrangements 47
Table 24: Recommended retail price of imported book 49
Table 25: Effect of 11% decrease in paper cost on retail price (excluding VAT) of an educational book and a trade book 55

# EXECUTIVE SUMMARY

This study comprises an investigation of the factors that affect the cost of books in South Africa, conducted in order to identify possible ways in which government, industry members and other stakeholders can work together to reduce the cost of books and make books more accessible.

The factors that affect the cost of books are dealt with by examining each of the five principal segments of the book value chain separately, namely paper, printing, publishing, distribution, and bookselling, and by furthermore investigating the sector-specific drivers of cost in the following three book market segments:

- **Educational books,** comprising books used in primary and secondary education, i.e. books for Grades 1 – 12.
- **Academic books**[1] aimed at the tertiary education sector.
- **Trade books,** which include both fiction and non-fiction books aimed at the general market.

## Paper inputs

Most trade, educational and academic books are printed on locally produced bond paper, with a minority of trade books printed on specialised imported paper. Industry role-players believe locally produced paper to be comparable to imported paper both in quality and price. While larger printers are able to negotiate directly with Sappi and Mondi (the local producers of paper), most printers buy their paper from paper merchants. These merchants source their paper from the cheapest source (be it local or offshore), and thus constrain the pricing power of local paper producers.

The high fixed cost involved in printing a book means that the cost contribution of paper can range from as little as 4% of the physical production cost of a book for small print runs, to about half the cost for bigger runs, as is shown by the table below.

[1] This category also includes books produced for the legal, accounting and similar professional industries.

| Print run | 250 | 500 | 750 | 3 000 | 5 000 | 10 000 |
|---|---|---|---|---|---|---|
| Paper cost as percent of total paper, printing and binding cost | 4.0% | 7.3% | 10.2% | 34.0% | 40.7% | 46.6% |

**Table 1: Paper cost as percentage of total paper, printing and binding costs of a textbook.**

*Source: Industry role-player, 2006 and Genesis Analytics calculations*

*Note: The three smaller print runs are for a teacher's guide and the three larger ones for a textbook. The teacher's guide is printed on less expensive paper and has fewer pages than the textbook. The increase in paper cost from 750 copies to 3000 copies is thus overemphasised. Nevertheless, the trend remains clear.*

## Printing

The collapse of educational spending in the late 1990s led to a drastic reduction in the number of South African printers that are able to produce a complete book. This contributed to increased concentration of this market: the two biggest dedicated book printers (CTP Books and Paarl Print) are at present believed to have a combined market share of 60%-80%. The distribution of a large printer's direct and overhead costs is shown in the Table 2.

| Cost item | Percentage of total cost |
|---|---|
| **Direct material costs** | **45%** |
| Paper | 30% |
| Ink | 3% |
| Plates | 6% |
| Other | 6% |
| **Overheads**[1] | **55%** |
| Folding and finishing[2] | 13.75% |
| Other overheads | 41.25% |

**Table 2: Breakdown of printer's costs**

*Source: Industry role-player, 2006*

*[1]Other overheads include labour, machine time and other general costs*

*[2]Percentage relates to softcover books - for hardcover books it could go up to 27,5%*

Possibly the biggest single factor driving the printing cost of a book is the size of the print run. The setup cost of a print run is high since the press needs to be calibrated (which is time-consuming and can use a large amount of paper) before use and thoroughly cleaned after use. The time needed for these processes is very expensive – machine time ranges from R500/hour to as high as R6 000 – R7 000/hour for new presses. Because overheads are so significant, the per-unit cost of a large print run drops sharply as the size of the run increases. This effect is illustrated in Figure 1 below.

The physical dimensions of the book, the number of colour pages and the size of the print run all affect printers' operating costs, as does the current shortage of

skilled labour in the printing industry. Gross margins in the book printing industry are fairly low, and are generally in the order of 17.5%-20%.

A number of factors contribute to making smaller printers less competitive. For example, printers without in-house binding facilities use finishing houses to bind and cover books, but finishing houses are increasingly diversifying away from book finishing. As a result, smaller printers must find the capital to make substantial investments in binding facilities. The cost of paper to smaller printers is also often higher than that of bigger printers, since they can typically not convince paper merchants to keep cheaper dedicated (indented) stock for them.

**Publishing**

The South African publishing industry is dominated by educational publishing, which accounts for 74% of locally published material and 60% of all books sold locally. Maskew Miller Longman is the largest local educational publisher, and is believed to have a market share of 34%-50%. Trade publishing accounts for 30% of books sold in South Africa, with more than half of these books being imported. Academic books make up the remaining 10% of the South African book market, with around a third of academic books being imported.

Cost drivers unique to the publishing industry include cost of content (i.e. author royalties), origination costs (typesetting, editing and so forth), the very real risk that the book will fail to sell, and cross-subsidisation costs (which are on occasion incurred in educational and academic markets, but which are very rare in the trade market). To put the contributions of the different segments of the book value chain into context, a typical cost breakdown of the recommended retail price of an educational book (excluding VAT) is provided in the table below.

| Cost breakdown of book retail price | Percentage |
|---|---|
| Printing, paper and binding | 11.5 |
| Origination | 13.5 |
| Royalties | 10.5 |
| Publisher's overheads | 29.0 |
| Distributor/ distribution | 5.5 |
| Bookseller | 30.0 |
| Total | 100.0 |

**Table 3: Cost breakdown of the retail price of an educational book**

*Source: Industry role-players, 2006 and Genesis Analytics calculations*

Factors like the prevalence of graphs and diagrams increase editing costs and thus origination costs. Royalties in the educational market range from 10% to 20%, and

are often controlled by either paying higher royalties on books that are cheaper to produce, or only paying royalties once a certain number of books have been sold.

Since origination is a fixed cost, its contribution to the cost of a book diminishes as the print run of the book increases. Origination costs, coupled with the fixed cost of printing, is the reason why the retail price of a book reduces sharply as the number of copies of a book printed increases. The effect of spreading the origination cost of a book and the setup cost of a print run over a large number of units printed is shown in Figure 1.

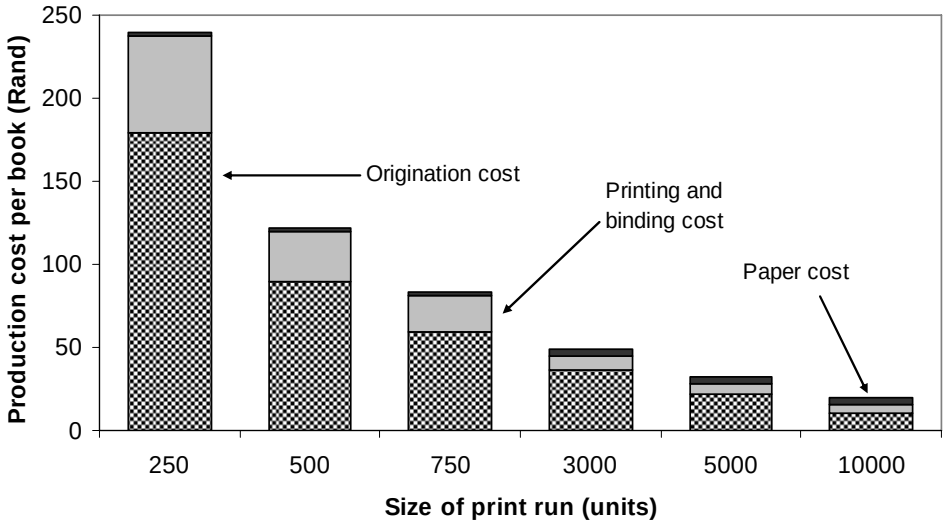


**Figure 1: Origination costs, printing economies of scale and print runs**

*Source: Genesis Analytics calculations based on Industry role-player discussions, 2006*

*Note: Print runs of 3000, 5000 and 10 000 are for books printed on more expensive paper. The economies of scale are thus slightly underestimated. The trend remains clear*.

Marketing and sales expenses make up the bulk of educational publishers' overheads. They distribute large numbers of free sample books to schools – for example, it is believed that the publishing industry gave away R80m in books in the run-up to the implementation of grades 8, 9 and 11. High marketing costs may reduce the profitability of educational publishing, but are also likely to increase the end price of books. In addition, small publishers which cannot afford the marketing expenditure required may be forced out of the market.

| Overhead cost item | Percentage |
|---|---|
| Human resource costs | 1 |
| Publishing costs | 18 |
| Warehousing and distribution | 15 |
| Administration | 23 |
| Marketing and sales expenses | 42 |
| Total | 100 |

**Table 4: Educational publisher's overheads**

*Source: Industry role-player, 2006*

For trade books, the relative cost of paper, printing and binding is much higher (roughly twice origination costs for example), due to the fact that they have much smaller print runs than the average educational book, and thus realise very little in the way of printing economies of scale. Origination costs for non-fiction trade books do however tend to be proportionally more similar to education books, as they often require specialised editing skills and additional costs for artwork, pictures and permissions and so forth. Royalties in the trade market are typically in the order of 10%- 15% of net receipts, and publishers manage their exposure to royalty costs by paying lower royalties on more risky titles and increasing royalties as sales rise. Royalties on academic books tend to be higher than on educational and trade books – the exception being scholarly books, which often carry no or low royalties.

| Cost breakdown of book retail price | Percentage |
|---|---|
| Printing, paper and binding | 12.7% |
| Origination | 6.5% |
| Royalties | 7.7% |
| Publisher's overheads (excluding distribution) | 20.8% |
| Distributor/ distribution | 5.6% |
| Bookseller | 46.7% |
| Total | 100 |

**Table 5: Cost breakdown of the retail price (excluding VAT) of a trade book**

*Source: Industry role-players, 2006 and Genesis Analytics calculations*

The relatively small print runs cause printing, paper and binding to make up a large proportion of the price of an academic books. Like non-fiction trade books, academic books have high origination fees, associated with factors such as their greater length, and the need for specialist editing skills. Royalties on academic books tend to be higher than on educational and trade books – the exception being scholarly books, which often carry no or low royalties.

| Cost breakdown of book retail price | Percentage | | |
|---|---|---|---|
| | Academic textbook | | Scholarly title |
| | 1st edition | 2nd edition | |
| Printing, paper and binding | 10.0% | 13.1% | 16.4% |
| Origination | 12.4% | 10.8% | 19.9% |
| Royalties | 12.6% | 10.5% | 6.3% |
| Publisher's overheads (excluding distribution) | 28.7% | 29.3% | 8.9% |
| Distributor/ distribution | 6.3% | 6.3% | 11.3% |
| Bookseller | 30.0% | 30.0% | 37.1% |
| Total | 100% | 100% | 100% |

**Table 6: Cost breakdown of the retail price (excluding VAT) of academic books**

*Source: Industry role-players, 2006 and Genesis Analytics calculations*

Gross margins for educational publishers are in the order of 35%-45%, and net margins are around 5%-15%. After book returns, trade publishers typically earn gross margins of about 44%, and the net return over a trade publisher's entire portfolio is typically less than 10%. Gross profits of 40%-50% are the norm for academic publishers, while net profits of 12%-15% are considered acceptable.

**Distribution**

Distributors in the book market typically also perform additional functions like invoicing and debt factoring. There are three main distributors of books in South Africa: On the Dot, Jonathan Ball Publishers and Booksite Africa. In the educational market, a variety of different distribution models are used by the provinces. While all three distributors mentioned above are active in the trade market, only On the Dot has a significant presence in the educational market, where publishers usually use couriers to distribute their own books. Distribution in the trade market is still mostly paper based, and electronic data interchange (EDI) – a system of electronic order transmission – has to date found limited application. Distribution in the academic market is relatively simple, since it usually involves bulk deliveries to tertiary institutions, and is often administered by the publishers themselves. The scholarly market, however, is mainly served by library suppliers.

**Booksellers**

The distinguishing feature of the South African book retailing sector is its high level of concentration. In every market segment there is one player that is noticeably bigger than its competitors. Afribooks is the largest retailer of learning and teaching support materials (LTSM) in South Africa, and the only retailer to be active in all nine provinces. Exclusive Books is the largest trade retailer and is believed to have a market share of 39%-43%. In the market for non-fiction books, however, its

market share is believed to be around 20%. Van Schaik Bookstores has a market share of around 50% in the academic market.

Booksellers generally buy books from publishers at a set discount on the publishers' recommended retail price, and then sell the books on to their customers at a price close or equal to this price. Educational booksellers receive a 30% discount, while trade discounts range from 35% - 68% and academic discounts from 30% and 40%. Scholarly works, however, are often sold in trade bookstores, and then trade discounts are applicable.

In the trade market, a number of factors increase the cost of retailing books. Books do not age well, and there are usually limits on the amount of unsold stock that can be returned to publishers. Bookstores need to be large in order to properly display their merchandise, and need to carry a large and diverse range of stock, in order to satisfy customer requirements and cope with the highly cyclical nature of bookselling.. The customer base prefers to shop in high-rent shopping centres, and requires the presence of knowledgeable staff. As a result, rent (41%) and salaries (35%) make up the bulk of booksellers' overheads.

Academic booksellers have cost structures similar to trade booksellers. Academic bookstores are mostly situated on or near the campuses of tertiary institutions. The textbook market is cyclical with the bulk of sales made in February to March. As a result, booksellers plan for most of their prescribed books to be in-store at the start of the academic year, which increases stockholding costs. It takes 6-8 weeks to import books via relatively cheap sea freight, but courses are often moved between semesters at short notice, resulting in a reliance on relatively expensive airfreight. Academic booksellers often face significant write-offs of stock due to unreliable lists of prescribed books from institutions. Most academic booksellers have moved away from carrying scholarly works.

Based on the discounts received, gross margins in bookselling are 30% for educational booksellers, 47% (on average) for trade booksellers, and 35% for academic booksellers. Unfortunately, net margins were not disclosed.

**Pricing of imported books**

The majority of books imported to South Africa are brought in by publishers or publishers' representatives. Imported books are priced to achieve margins similar to locally produced books, with the possible exception of obscure scholarly titles or textbooks, on which academic booksellers may look to make a small additional margin from time to time.

Imported books are either acquired at a discount in a foreign currency, or publishers negotiate an all-in price for the book in rand. An all-in price is used in special circumstances (particularly if the book is otherwise considered too expensive for the local market), where the local publisher is part of a larger publishing group, or where the book is co-published with a local publisher. Discounts on imported books are typically 60%-65% on educational books, 60%-75% on trade books, and 55%-60% on academic books. Where a rand price is not negotiated, the freight cost of the book is added to the foreign currency discounted price and converted to rand at the prevailing exchange rate, to derive the landed price of the book in rand. This landed price is then scaled up to account for the importers gross margin and the bookseller's discount, and thus to calculate the recommended retail price of the book.

**Specific factors increasing the cost of books**

A number of both general and sector-specific factors were identified as affecting the cost of books in South Africa, as follows:

General Issues

- *Skills shortages*. Across the value chain (with the exception of distributors), there are concerns about the availability of qualified staff. Competition for skilled staff may be increasing overheads.
- *Coordination between publishers and printers*. Without advance warning of orders from publishers, printers cannot source the cheapest available paper.
- *Implementation of new technology*. The potential of print on demand has not been fully investigated by the industry, and book distribution can be made more efficient by the adoption of EDI technologies (which would also provide small publishers and independent booksellers with easier access to larger booksellers and the lists of large publishers).
- *Off-shoring of printing*. As a result of lower capital and labour costs, printing in the East is about 30%-40% cheaper than in South Africa, and anecdotal evidence suggests that an increasing amount of South African book printing is being outsourced to the East.

*Other issues which are often flagged as affecting the cost of books are Paper pricing and VAT on books.* Paper is priced locally at import parity. This implies that the price of local paper is equal to the international price of paper plus all the cost associated with importing the paper. Since the cost of importing paper ranges from 4%-11%, local paper could be up to 11% more expensive than the world price of paper even if the paper is produced locally. This is likely to increase the cost of books. In practice, however, the impact of import parity pricing on the cost of books

is relatively small. An 11% reduction in the cost of paper would only reduce the cost of educational books by 2.53% and of trade books by 2.47%.The removal of VAT from books is often seen as a relatively simple way to reduce the cost of books. There are, however, important issues that need to be considered. If the gains from increased sales of books are to outweigh the increased administrative burden and loss of tax revenues, sales would need to increase significantly (i.e. books need to be relatively price elastic). A study of the price sensitivity of books is thus needed before a convincing argument can be made for the removal of VAT from books. It would also be difficult to justify a reduction of VAT on trade books on equity grounds; the type of books that do not carry VAT would thus have to be carefully specified. This creates administrative difficulties since the distinction between the different book market segments are often arbitrary.

The educational book market

- *Decentralised procurement.* The decentralised system of textbook procurement, where each provincial department of education is responsible for screening and ordering its own textbooks, introduces large operational inefficiencies to procurement, and increases the cost of schoolbooks. Multiple and differing submission processes are costly to publishers. The decentralised system also reduces economies of scale since the cut-off dates for orders in the different provinces are not synchronised and publishers are thus not able to pass on consolidated orders to printers. Orders are often relayed to publishers in drips and drabs and are often late, further increasing the cost of printing.
- *Uncertainty.* Publishers often receive requests to submit new textbooks for approval within unrealistic timeframes. This increases origination costs, as pressure is put on publishers' time resources, and authors need special incentives to work under extreme conditions. Rapid, unforeseen curriculum changes have also caused many publishers to rethink their pricing models, and they now look to make profit on a textbook from its first year in publication, as it may not make it to a reprint.
- *Barriers to entry.* High marketing costs in educational books act as a barrier to entry to new or small publishers, who are typically less able to afford the large expenditures required. The large amount of free sample books distributed to schools seems to be the greatest single driver of marketing costs. Other cost factors include the fact that grades are implemented at different dates throughout the year, necessitating multiple marketing trips to the same school, and the uncertainty surrounding the implementation of new grades, which drives the additional costs of unexpected curriculum changes and unrealistic book lead times.
- *Price insensitivity.* Educational departments currently do not use price as a criterion for judging textbooks submitted for approval.

- *Allegations of corruption.* There are widespread and consistent allegations of corruption in the educational market. In addition to the direct cost of bribes, lost sales and so forth, corruption reduces the ability of publishers to forecast sales and thus further increases uncertainty in the educational market.
- *Government contracting practices.* Concerns exist about the level of discretion given to certain private sector entities to purchase books on behalf of educational authorities, as this removes government oversight on public spending. It is believed that government contracts often do not adequately address potential conflicts of interests on the part of service provider.

The trade book market

- *Size of the trade market.* As the trade market is small, print runs are also small, and economies of scale in printing and publishing cannot be realised. Growing the market is thus critical – both via the long term goal of creating a reading culture, and via unearthing new sub-markets that may already exist.
- *Limited distribution points.* A lack of bookstores located outside wealthy urban areas constrains the growth of the trade market. As a result of the tender system in the educational market, many independent booksellers who used to serve rural areas have closed down; they could not survive without the educational business. The lack of a suitable distribution channel has to some extent constrained publishers from branching out into indigenous language publishing.
- *Library system.* The potential of the library system is under-utilised – it could serve as a distribution channel for indigenous language content, and help to increase print runs and reduce the risk associated with publishing new books.

The academic book market

- *Size of the academic market.* As in the trade market, the small size of academic book runs constrains cost.
- *Limited sell-through of academic textbooks.* The size of the academic market is further reduced by sell-through rates that are often as low as 50%. Illegal photocopying of books, lecturers not encouraging the purchasing of prescribed books, and a lack of a book-buying culture at certain institutions decrease sell-through rates.
- *Under-ordering by academic booksellers.* Academic booksellers do not have confidence in enrolment numbers because of low sell-through rates, and tend to under-order textbooks. This increases the sell-through problem, since there is a critical period at the start of the year when students both have money and are interested in buying textbooks.

- *Lack of coordination in the academic market.* Lists of prescribed books are given to the bookseller and/or the publisher late, or on an ad hoc basis by individual departments, which decreases the efficiency of ordering.
- *Potential concentration issues.* While not currently a problem, fears exists that the concentrated nature of the academic bookselling market may increase the price of academic books in future

**Conclusion and recommendations**

It was reassuring to find little evidence of excess profit-taking at any point in the book value chain. However, a number of cost-reducing initiatives should be considered by government and/or industry. Specific recommendations, ranked roughly according to importance in their given sector, are as follows:

Recommendations

General Issues

- Industry bodies should *research new technologies* like print on demand and EDI, and *champion their adoption* if potential cost savings are likely.
- Greater emphasis needs to be placed on *training*, across all segments of the book value chain, to alleviate a general skills shortage in the book industry.
- *Import tariffs on printing plates* should be dropped.

The educational market

- *Price should be included as a criterion* for judging educational material submitted for approval by publishers. This also implies that the over-specification of educational books should be dealt with, by imposing both *minimum and maximum quality* standards.
- Allegations of *corruption* should be investigated and dealt with.
- Opportunities to market books to schools should be structured so as *minimise marketing costs.*
- The *system of ordering* textbooks should be rationalised.
- Administrative and physical structures (like book storerooms) should be put in place to *enable effective book retention* at schools.
- *Government contracting* in the educational market should be made more transparent and efficient, by requiring firms to disclose conflicts of interest, and by specifying a set of verifiable criteria for book selection decisions.
- Procedures and guidelines for the approval of educational readers should be clearly specified to encourage an *overlap between trade and educational books*, and thus enable greater scale efficiencies to be reaped.

- The use of *own-buy markets for Section 21 schools* should be encouraged to stimulate the development of new general booksellers, particularly in poor and/or rural areas.

The trade market

- The *library market should act as a driver for growth* in the trade market through the use of dedicated funding for the purchase of local (and particularly indigenous language) books.
- An emphasis should be placed on growing the size of the trade market. Initiatives should include market research to identify untapped markets that may already exist.

The academic market

- *Up-to-date institution-wide adoption lists and enrolment figures* accessible both by academic booksellers and publishers and publishers' representatives are needed. Ideally, one central database for all tertiary institutions in South Africa should be created.
- *Closer interaction between publishers, publishers' representatives and academic booksellers* is necessary to reduce the problem of under-ordering of tertiary textbooks by booksellers.

# 1. INTRODUCTION

> *Children and adults – who are not good readers – will be lost in the information society of today because of the high level of literacy required in virtually every area of our lives; from street signs to automatic banking machines; from computers to newspapers and books [Thumbadoo, 2004:14].*
>
> *Books remain the most effective means of transmitting knowledge and recording, preserving and disseminating the cultural heritage of the South African people [PICC, 2005b:4].*

It is generally accepted that South Africa lacks a culture of reading. For example, only 14% of South Africans consider themselves "committed to reading" (PICC, 2007). The reasons for this state of affairs are varied and complex. The Research Report on Book Development, however, suggested that "the high purchase price of books discourages mass consumption" (BDCSA, 1997:11). Given the poverty of large proportions of the South African population, it seems reasonable to assert that lower book prices would increase access to books. Thus, while it is unlikely to be the only factor, the price of books plausibly acts as a barrier to accessing books for the poor. This study aims to unpack the factors that affect the cost of books in South Africa. By doing so, it is hoped that ways can be identified in which government, industry members and other stakeholders can work together to reduce the cost of books.

The report commences with an overview of the book value chain and proceeds, in sections 2 and 3, to describe the cost and market structures in each segment of the value chain. In each case, the net impact of the given factor on the cost of books is highlighted. In section 4, the factors that industry role-players signalled as unduly influencing the cost of books are discussed. The report ends with a brief conclusion, drawing together the insights gleaned, and making preliminary recommendations.

The purpose of this study is not to provide a detailed overview of the book industry in SA, but to investigate the factors that affect the price of books. Consequently, only a very high-level overview of the different segments of the book value chain is given, and descriptive measures are restricted to those relevant to the cost of books. The term publisher should be taken as referring to a book publisher unless otherwise specified. Please note that, where data was supplied by industry role players, it was not possible to independently verify such data and thus responsibility cannot be accepted for inaccuracies.

# 2. THE BOOK VALUE CHAIN

The factors that affect the cost of books will be dealt with by individually examining the industry clusters which ultimately supply booksellers. Figure 2 shows the major elements of the book production cluster. The paper market, as a major upstream supplier, will also be covered. In investigating each value chain segment, the focus will be on the cost of producing outputs along the value chain as pertaining to the book industry. A full overview of each industry will not be given.

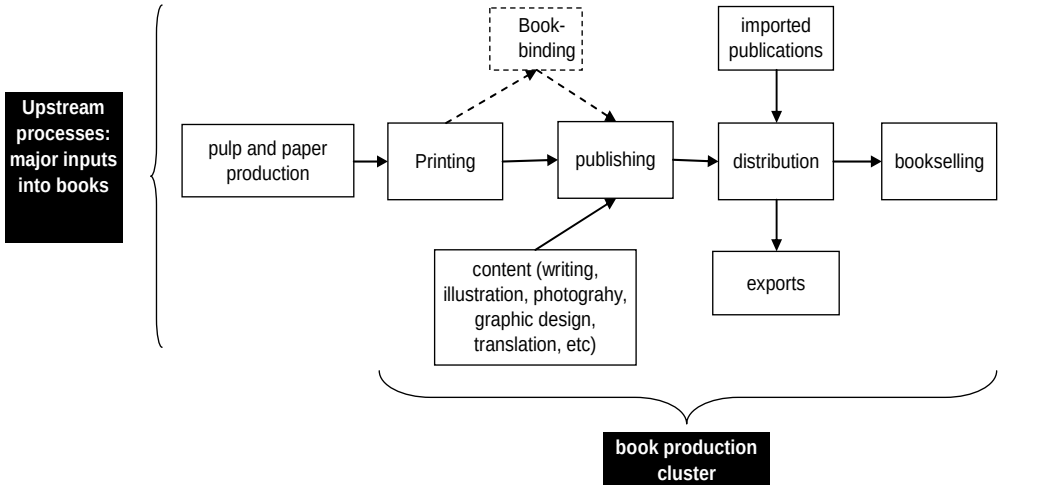


**Figure 2: The book production cluster.**
*Source: Genesis Analytics, based on PICC (2005)*

PICC (2005) identifies the following segments in the book market:

- **Educational books** include books used primary and secondary education, i.e. books for Grades 1 – 12.
- **Academic books**[2] are aimed at the tertiary education sector.
- **Trade books** include both fiction and non-fiction books aimed at the general public.

The operation of each segment of the value chain will be analysed from the perspective of each of the market segments noted above. This will insure that segment-specific factors influencing the cost of books are identified.

[2] This category also includes books produced for the legal, accounting and similar professional industries, which are referred to as scholarly books.

A high level of vertical integration between players in different segments of the book value chain is a feature of the South African book industry. Figure 3 details this vertical integration. The effect of high levels of vertical integration on the cost of books is unclear; the information in Figure 3 should be seen as background information to the rest of the study.

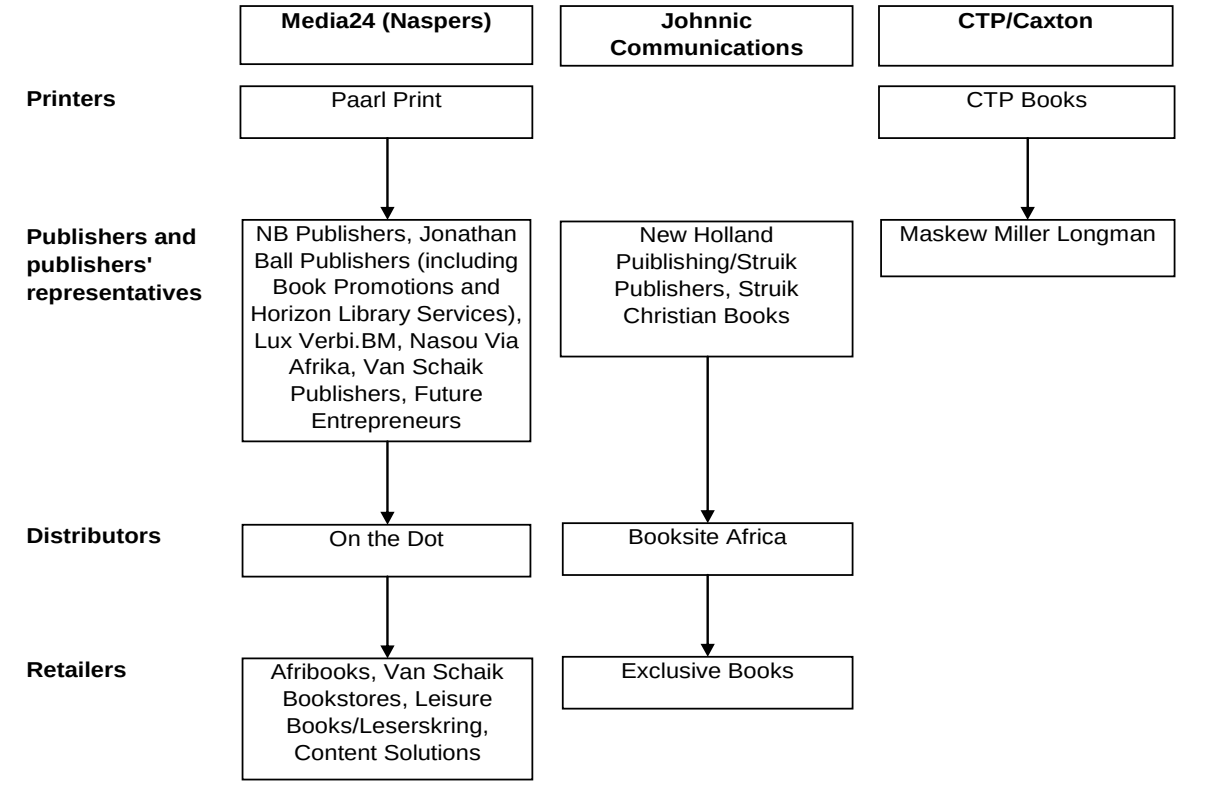


Figure 3: Vertical integration in the South African book industry

*Source: Company websites (http://www.naspers.com/Financials/annual2006/group_glance.htm; http://www.johncom.co.za/corpbusbooks.asp and http://www.caxton.co.za/), accessed 20/12/2006.*

*Note: The Naspers interests are grouped in their Media24 division. Paarl Print falls under the Paarl Media division of Media24, while all the other firms fall under the Via Afrika division of Media24.*

## 2.1. PAPER INPUTS

### 2.1.1. MARKET DESCRIPTION

For the purposes of the book industry, paper is classified according to whether it is coated or uncoated. Coated papers are better suited for colour printing than uncoated paper. Coated paper is mainly used for glossy “coffee table”-type publications, which tend to be toward the higher end of the book price continuum (although it is also sometimes used for illustrated children’s publications). These

types of publications tend to be more price inelastic[3] than the average book (industry role-player, 2006). Uncoated paper is classified according to the weight of the paper, specified as the number of grams per square meter of paper.

The majority of books in South Africa are printed on 60 to 80 g/m$^2$ white bond paper (industry role-players, 2006)[4]. Given that the majority of local books are printed on uncoated paper, the following analysis will thus focus on uncoated paper.

Uncoated woodfree paper is distinguished from uncoated wood-containing paper (newsprint) by the fact that it does not turn yellow with time. It can thus be regarded as a higher quality product than wood-containing paper. Uncoated woodfree paper is produced in a chemical process, while wood-containing paper is produced in a mechanical process and hence is known as mechanical paper.

#### 2.1.1.1. PAPER PRODUCERS

Based on the capacities of their respective uncoated woodfree paper mills, Mondi has a local market share of 75% and Sappi 25% (Genesis Analytics, 2005; updated with PAMSA data in 2006). These market shares, however, refer to all uncoated woodfree paper and not just that used in book production. It is estimated that the book trade uses 67 000t of paper a year (industry role-player, 2006). PAMSA 2006 data shows that there was 468 000t of uncoated paper produced in South Africa in 2005. The book market is thus of relatively little importance to local paper producers, particularly given that imported paper is often used to print local books (see next section). The book printing industry thus uses at most 14.3% of the uncoated paper produced locally.

#### 2.1.1.2. PAPER MERCHANTS

Only the bigger printers like Paarl Print, CTP Books and the other dedicated book printers (see Section 2.2.1) are able to deal directly with the local paper producers. These printers typically buy their paper in reels (industry role-player, 2006). It is very expensive to establish an in-house ability to convert paper in reels to sheets, and as a result printers need to have high volumes to offset the cost of buying paper in reels (industry role-player, 2006).

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[3] Price elasticity refers to the extent that the demand for a product reacts to a change in the price of the product. A product is said to be price "inelastic" if a certain percentage decrease (increase) in the price of a product leads to a less than proportional increase (decrease) in the quantity sold (e.g. a 5% decrease in prise results in a 1% increase in volume sold). In contrast, with a price elastic product, the quantity sold will increase (decrease) by a larger proportion than the percentage decrease (increase) in the price of the product.

[4] The quality of paper increases as its grammage increases. Higher grammage papers are less transparent and therefore better suited for colour printing (Industry role-player, 2006).

The bulk of printers purchase their paper from paper merchants like Antalis Paper, Paperlink and Peters Papers (industry role-players, 2006). The paper merchants will source their paper from the cheapest source, be it local or imported. One paper merchant indicated that they have traditionally never purchased more than 15% of their book paper offshore, while another paper merchant indicated that they are currently sourcing about half their book paper offshore. The proportion of paper imported is however not only a factor of the price of paper, but also the type of paper required by their clients. Bulky book paper (used extensively in trade publishing – see Section 2.1.2.2), for instance, is not produced locally and thus needs to be imported (industry role-player, 2006). Paper merchants also split their sales relatively evenly between the two local suppliers, with one paper merchant indicating that they currently have a 60/40 split between the two.

## 2.1.2. MARKET SEGMENTS

### 2.1.2.1. SCHOOLBOOKS AND ACADEMIC BOOKS

Schoolbooks are mostly printed on 60-80gsm white *bond* (an uncoated woodfree paper) (industry role-player, 2006). In recent times, improved newsprint[5] products like Sappi Super 60 have been increasingly used.[6] Academic books are usually printed on 80-90gsm white bond (industry role-players, 2006).

Industry role-players interviewed indicated that the price and quality of local bond paper is competitive with imports.[7] The price of local bond paper is generally slightly lower than the landed cost of imported bond paper (industry role-players, 2006). Bond paper is however imported at lower cost from time to time when special deals are brokered with foreign suppliers (industry role-players, 2006). Locally produced 60gsm improved newsprint paper is however significantly cheaper than imported alternatives (industry role-player, 2006).

### 2.1.2.2. TRADE

Trade publishers favour imported cream *bulky book paper* for paperback novels (industry role-player, 2006). Bulky book paper is a mechanical paper that is produced specifically for the trade book market (industry role-player, 2006). As the name suggests, bulky book paper creates a book that looks thicker, given a similar

[5] Whereas newsprint usually has a grammage of 48gms, Sappi Super 60 has a grammage of 60gsm. Sappi super 60 is also brighter (whiter) than normal newsprint (Industry role-player, 2006).

[6] Sappi Super 60 is being discontinued and Sappi is looking into replacing it with a product that is manufactured on their uncoated woodfree machines as the demand for newsprint locally is currently very strong (industry role-player, 2006).

[7] One industry role-player consulted did, however, mention that there had been some quality issues with local paper in the past.

grammage, than bond paper (industry role-player, 2006). Bulky book paper, like all mechanical paper, turns yellow over time. In order to disguise this yellowing, bulky book paper has a calcium coating (industry role-player, 2006). Currently bulky book paper is about 40% more expensive than bond paper (industry role-player, 2006).

Although bulky paper is more expensive, one industry role-player suggested that it can be more cost effective than bond paper. For example, 50-55gsm bulky book paper will cost slightly less than 70-75gsm white bond, but will create a slightly better quality book (industry role-players, 2006).[8] Bulky book paper also reduces ink consumption as the ink "sticks" better to bulky paper than bond paper (industry role-player, 2006).

Trade publishers seem to prefer bulky book paper with a grammage of at least 70 gsm (industry role-player, 2006). Highly illustrated books are often printed on up to 180 gsm white bond paper (industry role-player, 2006).

Producing bulky book paper is a specialised procedure, and as a result the local market has to rely on imports (industry role-player, 2006). Bulky book paper is mostly imported from Scandinavia (industry role-players, 2006). Sappi is currently experimenting with the production of bulky book paper and true bulky book paper may thus be produced locally in future[9] (industry role-player, 2006). Based on Mondi's stated objective of rationalising its product line in order to increase its global competitiveness, it is unlikely that Mondi would consider the production of bulky book paper (industry role-player, 2006).

Bulky book paper currently accounts for only a small percentage of the paper used in the local book industry. A paper merchant mentioned that bulky book paper makes up only about 5% of their imports of book paper. A large local printer stated that although the amount of bulky book paper they are using is steadily increasing, only about 3.6% of their book printing is done on bulky book paper. Given that trade publishing made up 16.23% of local publishing in 2005, this lends credence to the printer's assertion that trade publishers mostly prefer to use cheaper bond paper for most of their trade publishing (Genesis Analytics calculation based on Galloway et al, 2006).

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[8] Based on pulp usage, a 55gsm bond paper will be 21% cheaper than a 70gsm bond paper to produce. A paper machine producing a 55gsm paper runs at a slower rate than a machine producing 70gsm paper to avoid tears (Industry role-player, 2006). Up to 50% of the cost saving in pulp can thus be negated by reduced economies of scale (Industry role-player, 2006). It is also costly to increase the opacity and bulkiness of bulky book paper (Industry role-player, 2006). As a result, a 55gsm bulky book paper will be less than 21% cheaper than 70gsm bond paper (Industry role-player, 2006).

[9] As mentioned earlier, Sappi Super 60 was never intended to be a substitute for bulky book paper, but rather a cheaper alternative to bond paper aimed at the educational market (Industry role-player, 2006). Sappi Super 60 is an improved newsprint. While bulky book paper is also a mechanical paper, it is technically not newsprint (Industry role-player, 2006).

### 2.1.3. CONTRIBUTION TO THE COST OF BOOKS

There was a general consensus among industry role-players consulted that material costs make up about 45% of printer's costs. Paper contributes about 67% of this cost (or 30% of printers' total costs). As a print run increases, the proportion of printing costs made up by paper also increases, since the paper cost remains constant per book, while printing costs decline as a result of economies of scale. Table 7 shows paper cost as a percentage of total paper, printing and binding (ie: physical production)[10] costs, as print run sizes increase. Given the high fixed costs of printing (see next section), paper costs can be as little as 4% of total printing costs for very small print runs. For larger print runs, paper cost becomes more important, as upfront printing costs are spread over more book units and their impact per book is reduced.

| Print run | 250 | 500 | 750 | 3 000 | 5 000 | 10 000 |
|---|---|---|---|---|---|---|
| Paper cost as percent of total paper, printing and binding cost | 4.0% | 7.3% | 10.2% | 34.0% | 40.7% | 46.6% |

**Table 7: Paper cost as percentage of total paper, printing and binding costs of a textbook.**

*Source: Industry role-player, 2006 and Genesis Analytics calculations*

*Note: The three smaller print runs are for a teacher's guide and the three larger ones for a textbook. The teacher's guide is printed on less expensive paper and has fewer pages than the textbook. The increase in paper cost from 750 copies to 3000 copies is thus overemphasised. Nevertheless, the trend remains clear.*

## 2.2. PRINTING

### 2.2.1. MARKET DESCRIPTION

In theory, any printer can produce books. The bulk of book printing in South Africa, however, is done by dedicated book printers. A dedicated[11] book printer is able to produce a finished book that is bound and ready to be sold to consumers (industry role-player, 2006). 10 years ago there were about 20 dedicated book printers in South Africa: the collapse of educational spending on schoolbooks in the late 1990's, however, caused a number of dedicated book printers to either close down, merge with other printers or diversify away from book printing (industry role-player, 2006). At present there are only six dedicated book printers left (see next section). Smaller printers do also produce books, but use finishing houses to cut, fold and bind books (industry role-player, 2006).

The printing industry is very capital intensive and new printing presses can be as expensive as R60m (industry role-player, 2006). Even if cheaper machines are

[10] This excludes a range of additional costs incurred in book production that will be dealt with later in this report.

[11] The term "dedicated" is somewhat ambiguous in this context since none of the dedicated book printers consulted exclusively print books. In general they also print magazines, brochures, annual reports and other commercial printing.

used, it is unlikely that a dedicated book printer could begin operation with an investment of less than R90m (industry role-player, 2006). While some printers are equipped to do some forms of binding in-house, i.e. perfect binding[12] and saddle stitching,[13] the capital outlay required to install facilities for more complicated forms of binding, like thread sewing and PUR binding,[14] are beyond the reach of most small printers (industry role-players, 2006). Of the R90m estimate for outfitting a new dedicated book printer mentioned above, about R30m of the total would be allocated to investments in binding facilities (industry role-player, 2006).

A binding unit is needed for each printing press installed. Only one new PUR binding unit, consisting of a folding, cutting and gathering machine and a PUR glue unit, costs about R8.8m, while a thread sewing facility costs about R7m (industry role-player, 2006). Thread sewing is however a more labour intensive process than PUR, since while the PUR process is in-line, the gathered book sections need to be manually taken to the thread sewing machine and then back to the binder (which also does the initial cutting, folding and gathering) to have the cover drawn on (industry role-player, 2006).

### 2.2.2. PARTICIPANTS AND MARKET SHARES

Currently there are six dedicated printers in South Africa: ABC Press, Creda Communications, CTP Books, Paarl Print, Sancino Litho and Ultra Litho (industry role-player, 2006). Of these six, only Ultra Litho (which is in Johannesburg) is not based in Cape Town or the surrounding area.

Ownership of book printing facilities in South Africa is highly concentrated. Estimates of the combined market shares of the two biggest book printers, namely Paarl Print and CTP Books, range from 60-80% (industry role-players, 2006). Furthermore, these big printers are vertically integrated with publishers. Paarl Print is part of Paarl Media Holdings, in which Media24 (part of the Naspers group) is a majority shareholder, while the CTP/Caxton group (which incorporates CTP Books) owns 50% of Maskew Miller Longman (the remaining 50% is owned by the international group Pearson PLC via its Pearson Education company)[15] (PICC, 2005).

[12] Gluing books together
[13] A manual binding process
[14] A type of glue binding that is more durable than perfect binding and is seen as an alternative to thread sewing
[15] Maskew Miller Longman website: http://www.mml.co.za/about_maskew_miller_longman.htm. Accessed on 1 November 2006.

### 2.2.3. FINISHING HOUSES

The rationalisation in the book printing industry in the wake of the decline in textbook spending in the late nineties also affected finishing houses, with many of them either closing down or diversifying away from book finishing. Of the four finishing houses approached for the purposes of the current study, two indicated that they are not in the book market anymore and one indicated that it only does specialised binding work, like binding journal editions into single volumes and repairs to antique books. The fourth stated that it was downsizing its finishing shop to concentrate on specialised jobs like repairs to antique books and leather covers for diaries. Bookbinding is a very labour intensive business, and high labour costs were one of the reasons quoted for finishing houses exiting the general book market and moving towards more specialised work (industry role-player, 2006).

Printers are increasingly doing their own finishing, with only specialised finishing like UV binding on covers outsourced (industry role-players, 2006). This is most likely a result of the consolidation in the book printing industry; one industry role-player mentioned that you need to produce high volumes of books to justify an investment in the more complicated forms of binding. Large printers increasingly tend to invest in bookbinding as part of their growth strategy, and are also cutting their margins on finishing as a way to compete for print jobs (industry role-players, 2006). One printer mentioned that they believe that the dedicated printers are at most charging a 10% mark-up on their finishing. Given that finishing houses typically charge margins of 15-20%, printers without bookbinding facilities are finding it hard to compete with printers that have these facilities (industry role-player, 2008). As a result, printers are starting to invest more heavily in bookbinding equipment and most local book finishing is now being done by printers (industry role-players, 2006). PUR binding, in particular, is being favoured by local printers at present. Despite the cost premium paid for PUR facilities as opposed to thread sewing facilities, it is considered more cost effective in the long run as a result of the lower labour costs (industry role-player, 2006)[16].

Because finishing houses are focusing more and more on specialised binding jobs, their role in book production is expected to decline in future. In the production of coffee table books, however, finishing houses may play a larger role. Binding a coffee table book is a very complicated process, involving 13 separate stages as opposed to 2 for normal perfect binding (industry role-player, 2006). As a result, finishing houses can charge higher margins on coffee table books, since it is not cost effective for printers to do it in-house (industry role-player, 2006).

[16] One industry role-player, however, pointed out that PUR technology is largely unproven and that international experience with this type of binding is not encouraging. It was also mentioned that there are environmental concerns related to the use of PUR binding.

It is likely that the decline in the finishing house industry will make it more difficult for small printers to enter into the book market. They would now have to invest in binding as well as printing equipment when setting up a new book-printing operation.

### 2.2.4. MARKET SEGMENTS

Printers only distinguish between educational and other books. The distinguishing feature of educational books in the eyes of a printer is the size of print runs (industry role-player, 2006). General and academic books usually have print runs of around 3 000 copies, whereas the print run for educational books can run into tens of thousands for textbooks in large languages like English or isiXhosa (industry role-players, 2006).

### 2.2.5. COST DRIVERS AND THE COST OF BOOKS

The factors that affect a printer's production costs, and therefore also the cost of books, can be broken down into direct and overhead costs, and product-related factors. The first category of cost drivers are wide-ranging, and affect book printing in general, while the second category relates to factors that influence the printing cost of a particular book.

### 2.2.5.1. DIRECT AND OVERHEAD COST DRIVERS

A typical breakdown of a large book printer's input costs across all its book-printing operations is shown in Table 8.

| Cost item | Percentage of total cost |
|---|---|
| **Direct material costs** | **45%** |
| Paper | 30% |
| Ink | 3% |
| Plates | 6% |
| Other | 6% |
| **Overheads**[1] | **55%** |
| Folding and finishing[2] | 13.75% |
| Other overheads | 41.25% |

**Table 8: Breakdown of printer's costs**

*Source: Industry role-player, 2006*

*[1]Other overheads include labour, machine time and other general costs*

*[2]Percentage relates to softcover books - for hardcover books it could go up to 27,5%*

As evident from Table 8, **paper** constitutes 30% of printers' input costs. This percentage is however reflective of the paper costs faced by larger printers. Printers who buy relatively small amounts of paper can typically not convince paper merchants to indent paper for them (i.e. cut the paper to their size specifications and keep a limited supply for them); this increases their paper input costs as paper "off the shelf" is typically more expensive than indented stock (industry role-player, 2006). In such circumstances, paper input costs may range to as high as 40-45% of total cost (industry role-player, 2006).

**Ink and plates** contribute another 9% to printers' costs. Plates cost about R300 each and form part of the fixed cost of a printing job (industry role-player, 2006). Depending on its specifications, a 100 page book would typically require 16 plates at a cost of R4 800 (industry role-player, 2006). Ink and plates are imported, and as a result exchange rate movements influence their costs. Inks do not carry an import tariff, but plates carry a 10% duty from the EU and 15% from the rest of the world.[17]

The most significant component of the overhead cost of operating a printing press is **machine time**. Machine time includes repayment cost of capital, pro rata rent for the space a printing press and the workspace around it occupies, and other factory and company overheads (industry role-player, 2006). Machine time ranges from

[17] Tariff headings **3701.30.25** and **3701.30.60** carry a 10% tariff from the EU and 15% from the rest of the world (Information from Jacobsens Customs and Excise Tariff Book provided by PIFSA).

R500/hour to R6 000/hour or even R7 000/hour for new presses (industry role-player, 2006). The cost of machine time for colour presses is higher than black-and-white presses, and as a result the number of colour pages a book contains affects its printing cost. This issue will be addressed under the product-related cost drivers to follow.

There is currently a shortage of skilled **labour** in the printing industry (industry role-players, 2006). In order to get access to the needed skills, printers often have to resort to poaching staff from one another, driving up wages in this sector as they do so (industry role-player, 2006). A skilled tradesman can now earn up to R3 000 a week in the printing industry (industry role-player, 2006). Many of the printers consulted indicated that they are now training their staff in-house – further increasing labour costs (industry role-player, 2006).

While one printer mentioned that the Cross Media Training Centre (CMTC) run by the Printing Industries Federation of South Africa (PIFSA) did an admirable job of equipping individuals for a career in printing, the printer felt that CMTC graduates are mostly scooped up by the big printers in Johannesburg. CMTC graduates who specialise in electronic origination are also increasingly being employed in fields outside of the printing industry like media and advertising (industry role-player, 2006). There is also a shortage developing in people who are able to use the latest printing software programs and, more importantly, a lack of trainers to impart this knowledge (industry role-player, 2006). The task of providing trained staff to the printing industry is complicated by the wide range of skills needed in this sector; MAPPP SETA (2004a), for example, identified 24 distinct trades within the printing and packaging sector.

#### 2.2.5.2. PRODUCT-RELATED COST DRIVERS

##### 2.2.5.2.1. Physical dimensions

The physical dimensions of a book affect the number of pages that a printer can fit onto a sheet of paper and the amount of wastage. The significance of physical dimensions on printing cost is, however, questionable. One of the printers consulted felt that while it would bring down folding and binding costs, the cost saving would be relatively small. They factor the physical dimensions of the book in when they quote for a project and then set up their factory in a way that minimises the folding and binding costs. Another printer indicated that their electronic quotation system was so sophisticated that it factored in the optimal size sheets to purchase given the dimensions of a book.

#### 2.2.5.2.2. Number of colour pages

Apart from the total number of pages (length) of a book, the number of colour pages in a book also significantly increases the cost of printing a book. Each colour needs to be set up individually, and this increases the setup cost of a print run. Historically, the make ready time for a colour printing press was much higher than for a black and white press, but is increasingly comparable (industry role-player, 2006). Technology has reduced the amount of time that it takes to perfect the colour balance (or “registration”), and on new printing presses it could be as little as twenty minutes (down from four hours in the past). Given that the hourly rates for printing presses can be as high as R7 000/hour, the use of colour pages can significantly increase the cost of printing a book (industry role-player, 2006).

Colour printing involves a more complicated colour registration process than black and white printing and this requires more skilled machine operators – increasing the labour cost of operating colour printing machines (industry role-player, 2006). The machine time of a colour press is also much more expensive that a black and white press, given the fact that while new one colour presses start at about R1m, it will be difficult to obtain a new four colour machine for under R9-R10m (industry role-player, 2006). One printer mentioned that they recently spent R28m to upgrade just one of their machines to eight colours.

#### 2.2.5.2.3. Size of the print run

Typically, the biggest single factor driving the printing cost of a book is the size of the print run. The setup cost for a print run is the same no matter what the size of the print run. This means that the per unit setup cost is much higher for smaller print runs (industry role-player, 2006). Not only is the time used to set up the machine expensive, but depending on whether the book has colour pages, it generally takes 200 – 400 A1 sheets of paper to calibrate the press for every section in a book (industry role-player, 2006). In extreme cases, however, it can take up to 1 000 A1 pages (industry role-player, 2006). The wash-up time after a printing run has been completed should also be counted as part of the setup cost (industry role-player, 2006).

The effect of the size of a print run on the unit cost of the books produced is shown in Figure 4. Figure 4 builds on Table 7 by showing the actual reproduction cost of a teacher’s guide (for print runs of 250, 500 and 750)) and a typical learner’s textbook (for print runs of 3 000, 5 000 and 10 000). The graphic illustrates that the reason why the percentage of paper, printing and binding cost comprised by paper increases with the size of the print run in Table 7, is that the actual cost of printing

and binding per book decreases as the print run increases, while the paper cost per book remains constant.

As a result, the reproduction cost of the books shown decreases from R60.65 for a print run of 250 (of which R2.40 - or just 4% - is paper) to R9.20 for a print run of 10 000 (of which paper is just under half the cost). It should be noted that the teacher's guide and the textbook are printed on different types of paper, leading to a jump in the paper cost between print runs of 750 units and 3 000 units. The trend with respect to the reduction of printing costs as a proportion of reproduction cost however remains clear.

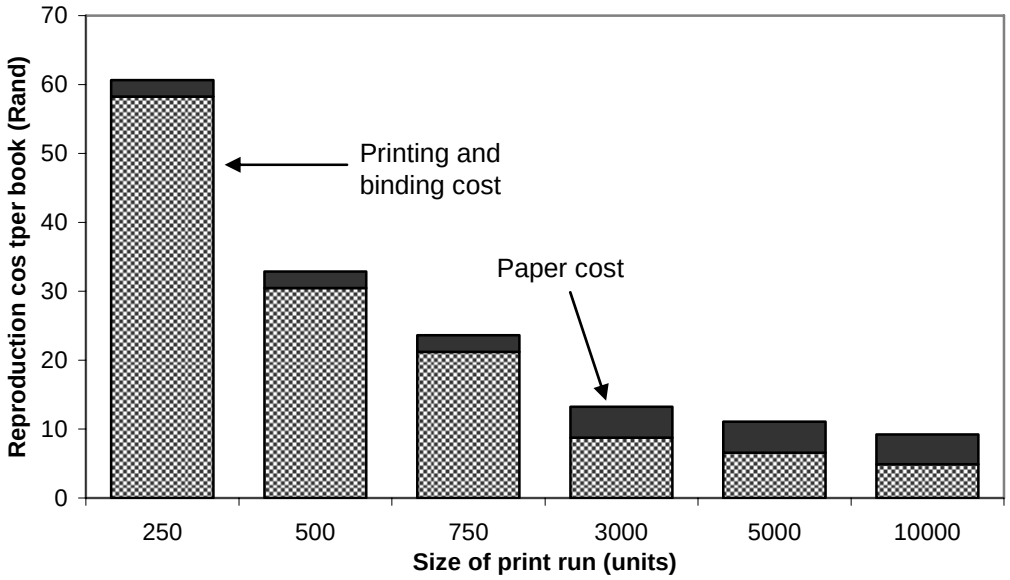


**Figure 4: Printing economies of scale**

*Source: Genesis Analytics calculations based on Industry role-player, 2006*

The figure also somewhat underestimates the cost effect of increasing print run size, since while both books are in black and white and have the same format (physical dimensions), the textbook contains 208 pages while the teacher's guide only contains 144 pages, and the textbook is printed on a slightly better quality paper (70 gsm bond as opposed to 60 gsm).

The gains from increasing print run size decrease as the size of the print run increases – in other words, the production activity exhibits decreasing returns to scale. At a certain size of run, economies of scale gains are outweighed by an increase in the cost of holding a larger inventory of stocks. One of the publishers consulted suggested that printing economies of scale plateau after 20 000 copies,

while another publisher believed that economies of scale are exhausted at 44 000 copies.

### 2.2.6. MARGINS IN THE PRINTING INDUSTRY

One industry role-player (2006) stated that gross margins in the printing industry are generally in the order of 17.5% to 20%, while net profits are about 3% to 5%. For smaller printers, these numbers seem to be even smaller. A smaller printer mentioned that while they used to be able to put a 20% mark-up on printing, they are now having difficulty achieving double figures.

## 2.3. PUBLISHING

### 2.3.1. MARKET DESCRIPTION

The South African publishing industry is relatively small in international terms. In 2005, about 6 177 new and revised books were published in South Africa and the estimated total turnover of the South African publishing industry was R2.2bn[18] (Galloway et al, 2006). The bulk of this is made up by educational books (see Table 9 below). In 2007, the local educational market alone is expected to be in the order of R1.4bn (industry role-player, 2006). In contrast, according to the UK Publishers Association, UK publishers generated £2,7bn in revenues and 161 000 new and revised books were published there in 2005.[19]

| | Locally produced (rand) | % produced locally | Imported (rand) | % imported | Total (rand) |
|---|---|---|---|---|---|
| Trade (rand) | 246,857,225.00 | 40.83% | 357,788,797.00 | 59.17% | 604,646,022.00 |
| % of locally produced/ imported/total | 16.23% | | 71.27% | | 29.89% |
| Education (rand) | 1,124,694,646.00 | 93.20% | 82,010,522.00 | 6.80% | 1,206,705,168.00 |
| % of locally produced/ imported/ total | 73.94% | | 16.34% | | 59.65% |
| Academic (rand) | 149,484,599.00 | 70.61% | 62,234,461.00 | 29.39% | 211,719,060.00 |
| % of locally produced/ imported/ total | 9.83% | | 12.40% | | 10.47% |
| Total (rand) | 1,521,036,470.00 | | 502,033,780.00 | | 2,023,070,250.00 |

**Table 9: Breakdown of the South African book market in 2005**

*Source: Galloway et al, 2006 and Genesis Analytics calculations*

*Note: The total in the table is slightly lower than the total quoted above since the table excluded published electronic products, non-book products and non-publishing activities of publishers (like warehousing, rights sales and remainder sales, for example).*

Table 9 shows a breakdown of the South African book market in 2005 by segment and origin of books (i.e.: whether books were imported or locally produced). The table indicates that educational books make up the bulk of locally produced books. In contrast to academic and trade books, educational books do not seem to experience much competition from imports.

[18] R2 233 947 837 is the total estimated turnover of the 80 PASA members included in the survey. The actual turnover of publishers who participated in the survey, is R2 123 150 837. The survey thus covered approximately 95.04% of the turnover of the identified PASA members. This is an underestimation of the overall publishing market since not all publishers belong to PASA; this underestimation is however likely to be relatively small (Industry Role-player, 2006).

[19] Data obtained from the UK Publishers Association website in November 2006 (http://www.publishers.org.uk/paweb/paweb.nsf/pubframe!Open). They cite Nielson Bookdata as the source of the number of new and revised titles, and their 2006 publication *UK book publishing industry statistics yearbook 2005* as the source of the revenue figures.

### 2.3.2. PARTICIPANTS AND MARKET SHARES[20]

The PASA Annual Industry Survey Report, the main source of information on the publishing industry, indicated that there were about 80 companies involved in publishing or publishing-related services in South Africa in 2005 (Galloway et al, 2006). The report split these 80 companies into small, large and medium firms, based on the PASA membership fee turnover bands (Galloway et al, 2006). Companies with a turnover of less than R5m per annum were classified as "small", companies with annual turnovers of R5m or more but less than R50m were classified as "medium", and companies with turnovers of R50m or more were classified as "large". 58 companies were classified as small (of which 8 participated in the survey), 11 companies were classified as medium (of which 8 participated in the survey, and 11 companies were classified as large (of which all 11 participated in the study).

The large companies accounted for 91,2% of the total net turnover of the South African publishing industry, while the medium-sized companies accounted for 8,13% and the small companies for the remaining 0,64% (Galloway et al, 2006). The 2005 report unfortunately did not provided a breakdown of the number of titles produced by publisher category, but information from the PASA Snapshot Industry Survey 2003 Report suggests that the number of titles produced will be broadly in line with the turnover shares of the different classes of publishers (Galloway et al 2005, 2006 and Genesis Analytics calculations).

It was not possible to get verifiable data on market shares in publishing. The PASA Annual Industry Survey only presents market data in a consolidated form, due to confidentiality concerns by the publishers (Galloway et al, 2006). The following discussion of market shares is thus largely based on anecdotal evidence.

#### 2.3.2.1. EDUCATIONAL PUBLISHING

In the education market, the main players are Maskew Miller Longman and MacMillan, followed by Via Africa (MAPPP SETA, 2004b). Maskew Miller Longman is believed to currently have a market share of between 34% and 50% in the educational market, and is by far the biggest player in this market (industry role-players, 2006). Imports are relatively unimportant in educational publishing, comprising far less than 10% of turnover in 2005 (Galloway et al, 2006). This is largely due to time constraints imposed and local curriculum requirements.

[20] Co-publications between imported and local publishers were excluded from this analysis because due to their limited extend, amounting to 0,69% in the trade market, 1,83% in the educational market and none in the Academic market in 2003 (based on turnover) (Galloway et al, 2005).

#### 2.3.2.2. TRADE PUBLISHING

The big international players in the trade market, according to MAPPP SETA (2004b), are Random House, Pan MacMillan and Penguin. Given that these firms predominantly provide imported content, and that imported content accounted for 59.2% of turnover in the market for trade books in 2005 (Galloway et al, 2006), it is unlikely that any one of these three firms will have a large enough market share to influence prices in this market.. The bulk of local content publishing is accounted for by the Via Afrika group of companies (part of Naspers' Media24 division) and Struik New Holland publishers (industry role-player, 2006).

#### 2.3.2.3. ACADEMIC PUBLISHING

The largest academic publishers in South Africa are believed to be Butterworths, Juta and Oxford University Press (industry role-player, 2006). The first two firms are estimated to each have academic book turnovers in the vicinity of R42m per annum, while Oxford University Press annual turnover is estimated at about R28m (industry role-player, 2006). The 2003 PASA Snapshot Industry Survey estimated that total turnover for academic publishing was about R119m and that imports constituted 37.5% of the total turnover. This import number is likely to be an under estimate, given that some overseas publishers are not members of PASA but supply quite a large amount of books to the South African academic market (industry role-player, 2006). Examples of such companies are Butterworths and McGraw-Hill (industry role-player, 2006). The relatively large import penetration into the South African academic market, coupled with the estimated market shares of the big three local publishers that are of a similar order of magnitude, makes it unlikely that any one publisher would have a large enough market share to undermine the competitive dynamics of this market.

### 2.3.3. COST DRIVERS AND THE COST OF BOOKS

Since publishing is a specialised industry, this section starts with an introductory sub-section that explains some of the unique cost drivers in the publishing industry. The subsequent sections then deal with cost drivers in the various publishing market segments, and their effect on the cost of books.

These cost drivers, and their influence on the cost of books, are dealt with differently with respect to publishers than the other components of the value chain. Since publishers have an important coordination function in the book value chain, a cost breakdown of the recommended retail price of books in each of the different market segments is provided to show how costs are apportioned across the value chain. An important point to highlight here is that the "publishers' overheads"

components in these breakdowns also include publishers' gross profits, in order to simplify the analysis. The issue of publishers' profits will be addressed separately in Section 2.3.4.

#### 2.3.3.1. PUBLISHING-SPECIFIC COST DRIVERS

**Cost of content**

The main driver of cost of content is the royalty rates that authors receive. Royalty rates will be addressed as a cost driver in each of the individual market segments. The reason for this is that royalty rates differ markedly between the different market segments, and sometimes even within the same segment based on the bargaining position of the authors, the target market for the book and so forth.

**Origination costs**

Origination costs refer to the fixed costs that a publisher has to incur to create a book. Origination costs include costs like typesetting, editing, cover and book design, project management, proof reading, obtaining permissions to use copyrighted material and all other once-off costs that are linked to developing a book (industry role-player, 2006). Origination costs are mainly influenced by the length of the book (since many of these costs – like editing and proof-reading – are a function of the number of words or pages in the book) and editorial complexity (diagrams and other graphics increase typesetting and layout costs) (industry role-player, 2006).

Since the origination cost of a book is a fixed cost, its impact on the price of a book diminishes as the size of the print run increases, and the origination cost can be apportioned across an increasing number of copies.

Figure 5 again builds on the data used in Figure 4, by including origination costs in the production cost of a book. Figure 5 shows how the actual production cost per book produced decreases as the size of the print run increases, and illustrates that a significant proportion of the decrease in the production cost per book as print run size increases is due to a reduction in per-book origination cost. It should be noted that Figure 5 is based on the same information as Figure 4 and Table 7, namely the production cost of a teacher's guide (for print runs of 250, 500 and 750) and an educational textbook (for print runs of 3 000, 5 000, 10 000), and thus the decrease in production and origination cost is again underestimated, given that the textbook was longer, printed on more expensive paper, and had a higher total origination cost than the teacher's guide.

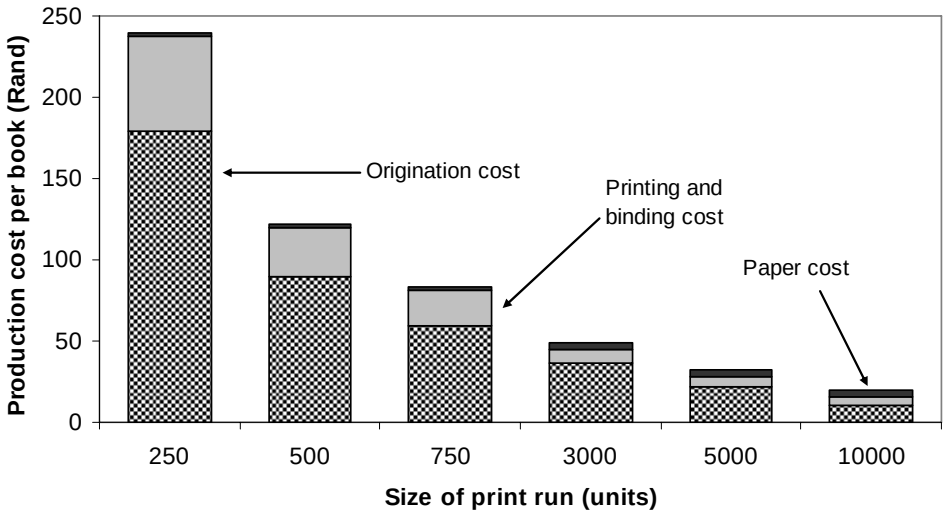


**Figure 5: Origination costs and print runs**

*Source: Genesis Analytics calculations based on Industry role-player discussions, 2006*

Since origination costs are once-off upfront costs, they are not incurred when a book goes to reprint. This drastically reduces the production cost of reprinting a book. Thus, while publishers mostly aim to recoup their origination costs in the initial printing of a book (and maybe make a small profit), it is when books go to reprint that they make most of their profit (industry role-player, 2006).

Trade and scholarly books, however, are an exception to this rule. Trade publishers consulted mentioned that only 30-50% of their locally published titles go to reprint. As a result, they typically aim to make a reasonable profit on the first printing of a book (industry role-players, 2006). Reprints are also not equally profitable. In trade publishing the print run for a reprint may be as low as 1 000 copies (industry role-player, 2006). This implies that a part of the saving on origination cost made by the reprint will be eroded by its higher printing costs (see Section 2.2.5.2).

While academic textbooks are usually prescribed for more than one year, and thus lend themselves to reprinting (one academic publisher mentioned that they usually printed such textbooks in three-year cycles), only about a third of scholarly titles go to reprint (industry role-player, 2006). In the scholarly market, in contrast to the trade market, reprints are usually of a similar order of magnitude to the initial print run (industry role-player, 2006).

**Risk premium**

MAPPP SETA (2004b:12) describes publishing as a "low-margin high-risk business". Many books that are published fail to sell the entire print run. While the average print run on a new fiction title in South Africa is in the region of 2 000-3 000 books, the average sell through is only about 1 500 (industry role-players, 2006).[21] One trade publisher consulted mentioned that their experience has shown that on average:

- 20% of books they publish in a year will do well;
- 40% will make a small profit;
- 20% will break even;
- 20% will make a loss.

The losses on the 20% of books that do not break even may be quite large, as books have been known to "bomb" from time to time. The upshot of this is that before this publishing company can turn a profit, the 60% of books that make a profit must recoup the losses on the 20% of books that are expected to lose money.

Another trade publisher mentioned that:

- 17% of the books they published last year made more than R100 000 profit;
- 48% of books made a profit of R10 000 – R100 000;
- 9% of books made a profit of less than R10 000;
- 26% of books made a loss.

In the academic market, the risk is somewhat less as publishers usually have a good indication of the number of books that are going to be sold. Publishers tend to wait until a book has been adopted[22] at an institution before they print: in situations where they do print a book without having achieved an adoption, they tend to print conservatively (industry role-player, 2006). Despite this higher degree of certainty, some books still fail to break even. One academic publisher mentioned that about 5% of their books do not break even. Given the higher origination costs associated with academic books (see Section 2.3.3.4), losses can be significant on books that do not sell as well as expected.

[21] The riskiness of publishing was emphasised by one trade publisher who described it as "a horse race".

[22] When a book is "adopted" in terms of the academic market, it means that the book has been prescribed for a course at a tertiary institution and is thus on the list of books that the tertiary institution will send to booksellers to order (see Footnote 60 on page 58 for an explanation of the meaning of "adopted" in the educational market).

An academic publisher that specialises in tertiary textbooks mentioned that in order for them to remain in the market:

- 50% of their books need to make a profit; and
- 40% need to at least break even.

They can thus safely carry losses on only 10% of the titles they publish.

The **scholarly market**[23] is much riskier than the academic market as a whole. An academic publisher that specialises in scholarly works mentioned that on average about:

- 25% of their books make a profit;
- 50% break even;
- 25% make a loss.

Publishers are aware of this state of affairs, and while they generally do not include an explicit risk premium in their costing, the need to recoup the cost of books that fail to break even influences the gross margins they aim to achieve.[24] Thus, in theory, as the risk in a segment of the book market increases, for example due to limited sell-through of academic textbooks to students, gross margins in that segment will tend to increase.

**Cross-subsidisation**

Related to the risk premium in the previous section, but not technically the same concept, is the idea of cross-subsidisation in the book market. Whereas the risk premium deals with the need to insulate the company against unforeseen losses (while they know that traditionally a certain proportion of their books won't do well, they are hoping that they all do well), cross-subsidisation refers to the conscious decision to publish a book that will in all likelihood never break even – knowing that they can offset the losses against another book that is expected to do well.

[23] Scholarly books refer to "university press"-type books aimed at academics and other more technical readers rather than students (Gray, 2000). These books are unlikely to be prescribed as tertiary textbooks and as a result tend to sell in smaller quantities than academic textbooks.

[24] Some of the publishers interviewed mentioned that the gross margin on a book is often dictated by the price they expect consumers to be willing to pay for the book. One publisher mentioned that they try and keep the price of local books as low as possible. It is thus not always possible to include a gross margin on a book that includes an implicit risk premium. As a result, publishers prefer to deal with the problem of books that "bomb" by screening manuscripts as thoroughly as possible. This said – the nature of publishing is such that it will never be possible to completely screen out books that do not break even. At the very least, the idea of a "risk premium" should be kept in mind when evaluating the margins that publishers make.

Cross-subsidisation is prevalent in the **educational market**. The clearest example is where textbooks are used to cross subsidise accompanying teacher's guides. Teachers' guides are generally sold in quantities that are too small to recoup their origination costs, given the high print cost associated with small print runs (industry role-player, 2006). The guide is thus typically subsidised by profits on the accompanying textbook. Also, one of the educational publishers mentioned that the only reason they are able to publish readers in some of the smaller indigenous languages (which typically sell in smaller number than language text books), is that they can cross-subsidise the readers with language textbooks.

The provincial education departments do not allow publishers to charge different prices for different language versions of the same textbook (industry role-player, 2006). While translating textbooks can greatly reduce origination costs in small languages, translating can still be very expensive – depending on the length of the textbook and the time limit the publisher is operating under (industry role-player, 2006). The much smaller print runs of the translated small language books imply that the translated books are often more expensive than the original larger language book (industry role-player, 2006). As a result, the textbook in all its language variants is priced at a level higher than would have been charged for the larger language textbook in isolation, but lower than a stand-alone small language textbook would be priced. In effect, the higher enrolment language cross-subsidises the small language.

Cross-subsidisation is also practiced in the **academic book market**. In the general academic (or scholarly) market publishers often publish books which are unlikely to break even, but are considered worthy of publication based on broader social aims (industry role-player, 2006). Academic textbooks prescribed for high enrolment courses also cross-subsidise books aimed at courses with lower enrolment (industry role-player, 2006). One academic publisher, however, mentioned that they only occasionally explicitly cross-subsidise between titles and do not regard it as a business practice. They believe cross-subsidisation to be a dangerous game as it leads to unpredictability in returns. Another academic publisher mentioned that 20% of their titles account for 80% of their revenues, which points to at least some level of cross subsidisation, since it seems clear that not only books that are expected to be wildly successful are published.

In the **trade market**, however, cross-subsidisation is much rarer, as a result of the higher risk of failure in trade publishing and a lower willingness to pay for trade titles on the part of consumers (industry role-player, 2006). Trade publishers will publish books they do not expect to break even only in exceptional circumstances. More often than not the publisher will only publish a book that is not expected to break even if they believe the following book (or books) by the same author will do

well – this may refer to new authors or pet projects of established authors that are not considered economically viable by publishers.

Since cross subsidisation will lead to an increase in the diversity of books printed, the cross subsidisation of higher-risk books by blockbusters can be welfare enhancing (Canoy et al, 2004).

#### 2.3.3.2. THE EDUCATIONAL MARKET

Table 10 provides a breakdown of the contribution of the different segments of the value chain to the retail price of an educational book (excluding VAT). These numbers should be seen as loose estimates, since they are based on a small number of data points. The make up of the cost of an individual book can vary widely based on factors like the length of the book; the use of colour; the size of the print run etc. (see Section 2.2.5.2). The proportion of the price of a book attributable to factors like printing and paper cost, and origination cost can also be quite a bit higher for books with smaller print runs (industry role-player, 2006).

| Cost breakdown of book retail price | Percentage |
|---|---|
| Printing, paper and binding | 11.5 |
| Origination | 13.5 |
| Royalties | 10.5 |
| Publisher's overheads | 29.0 |
| Distributor/ distribution | 5.5 |
| Bookseller | 30.0 |
| Total | 100.0 |

**Table 10: Cost breakdown of the retail price of an educational book**

*Source: Industry role-players, 2006 and Genesis Analytics calculations*

The main components of origination costs are book design and layout (including typesetting, artwork and editing). Table 11 shows the main origination costs of a particular educational publisher for all their grade 7 and grade 10 titles. The editing cost in this table refers to freelance editing. The cost of artwork is often shared between the publisher and the author (industry role-player, 2006) although in this case the publisher seems to have borne all the costs.

| Cost item | Percentage of total origination cost | |
|---|---|---|
| | *All grade 7 titles* | *All grade 10 titles* |
| Editing | 29% | 47% |
| Artwork[a] | 30% | 22% |
| Design and lay-out[b] | 34% | 25% |
| Other | 7% | 6% |
| Combined total | 100% | 100% |

**Table 11: Main origination costs**

*Source: Industry role-player, 2006 and Genesis Analytics calculations*

[a]*Includes permission costs*

[b]*Includes typesetting costs*

The effect of factors like graphs and diagrams on origination costs (and possibly the effect of the size of print runs) is illustrated by the fact that an educational publisher mentioned that while they are able to make a gross margin of about 55% on life orientation textbooks, high-graphic maths textbooks generally only deliver a gross margin of around 21%.

Royalties in the educational market range from 10% to 20% on net receipts[25] (industry role-players, 2006). Only one publisher mentioned that they still pay royalties on the retail price of books (excluding VAT), but this practice seems to be used less and less. Most publishers pay higher royalties on books that are cheaper to produce. One publisher mentioned that they pay higher royalties on black and white books. Another publisher mentioned that they only pay royalties on teachers' guides once a certain number of books have been sold, and even then the royalty rate is less than that offered on textbooks. The information provided by industry role-players with respect to educational royalties is consistent with the results from the *PASA Annual Industry Survey 2005 Report*, which indicated that small educational publishers on average paid royalties of 13,8% on net receipts, medium education publishers 13.5%, and large publishers 11.46% (Galloway et al, 2006).

| Overhead cost item | Percentage |
|---|---|
| Human resource costs | 1 |
| Publishing costs | 18 |
| Warehousing and distribution | 15 |
| Administration | 23 |
| Marketing and sales expenses | 42 |
| Total | 100 |

**Table 12: Educational publisher's overheads**

*Source: Industry role-player, 2006*

[25] "Net receipts" is a publishing industry term for the recommended retail price of a book minus the bookseller's discount.

Table 12 shows the distribution of an educational publisher's overhead costs. Human resource costs mainly refer to staff training and development costs. Publishing costs include publishers' salaries, transport, accommodation and other overheads that are directly related to book production. Administration costs relate to general overheads like debtors' charges, water and lights and so forth. One educational publisher mentioned that while salaries constitute about 38% of their overheads in normal times, they are currently about 56%. This is due to the need to bring in additional freelancers to cope with the pressure of developing new content given the current curriculum implementation (industry role-player, 2006).

According to Table 12, staff and marketing costs contribute the bulk of educational publishers' overhead costs. Marketing costs in particular are very large. In the education market, publishers feel obliged to provide a large number of free books in order to generate a large volume of orders from teachers (industry role-players, 2006). One publisher mentioned that their experience has shown that you need to give away about R6m worth of free books in order to generate about R17m worth of sales. The publisher also mentioned that they believe the publishing industry to have collectively given away R80m in books in the run-up to the implementation of grades 8, 9 and 11. One of the smaller publishers mentioned that they typically give away 3 000 promotional copies per textbook and pointed out that this number is considerably larger for the bigger publishers. The high marketing costs in the educational market not only reduces the profitability of educational publishing, but also serves as a barrier to entry for small publishers wanting to enter this market. These issues are addressed in Section 4.2.3.

#### 2.3.3.3. THE TRADE MARKET

Information from various trade publishers was used to calculate the portion of the retail price of a book (excluding VAT) that is attributable to the different segments of the value chain. The relatively small print runs in the trade market (the three books on which Table 13 is based all have print runs of between 2 700 and 3 100 copies) cause printing costs to contribute a larger proportion of the final price of a trade book than is the case in the education market. Table 13 shows that the cost of paper, printing and binding is roughly twice origination costs. This is however not always the case, particularly when dealing with non-fiction books. One publisher that does a lot of non-fiction work mentioned that origination and paper, printing and binding costs are often of a similar magnitude. Non-fiction books often require specialised editing skills and additional costs for artwork, pictures and permissions (industry role-player, 2006). Also, when autobiographies are published, publishers usually budget for legal fees of between R5 000 and R25 000.

| Cost breakdown of book retail price | Percentage |
|---|---|
| Printing, paper and binding | 12.7% |
| Origination | 6.5% |
| Royalties | 7.7% |
| Publisher's overheads (excluding distribution) | 20.8% |
| Distributor/ distribution | 5.6% |
| Bookseller | 46.7% |
| Total | 100 |

**Table 13: Cost breakdown of the retail price (excluding VAT) of a trade book**

*Source: Industry role-players, 2006 and Genesis Analytics calculations*

Table 14 highlights the main origination costs in the trade market. Where artwork is an important cost in the education market, the design of covers is a major origination cost in the trade market. Table 14 also shows that freelancers play an important role in the trade market. While no freelancing costs were explicitly included in the book budget for the second trade title in the table, the difference in the magnitudes of editing and cover design costs between the two titles suggests that the cost of freelancers may be included in these two cost items.

| Cost item | % of total origination cost | |
|---|---|---|
| | *Book 1* | *Book 2* |
| Editing | 11.1% | 50.2% |
| Cover design | 18.8% | 40.2% |
| Design and lay-out | 33.4% | 7.6% |
| Freelancers | 30.4% | 0.0% |
| Other | 6.3% | 2% |
| Combined total | 100% | 100% |

**Table 14: Main origination cost in the trade market**

*Source: Industry role-players, 2006 and Genesis Analytics calculations. -*

Table 15 shows that a trade publisher's overheads are dominated by staff and distribution costs. For the publisher in question, freelance costs made up 8% of staff costs (or 3% of total overheads).

| Overhead cost item | Percentage |
|---|---|
| Staff costs | 39 |
| Distribution | 36 |
| Marketing | 7 |
| General overheads | 18 |
| Total | 100 |

**Table 15: Trade publisher's overheads**

*Source: Industry role-players, 2006 and Genesis Analytics calculations*

In contrast to educational publishers, trade publishers are much more frugal when it comes to promotion and marketing. Of the two books shown in Table 13, one had

a promotional budget equal to 4.9% of net receipts and the other 7.3% (industry role-players, 2006 and Genesis Analytics calculations). The latter number of 7.3% may overestimate the actual amount spent on marketing and promotion, since it includes stock provisions (industry role-player, 2006). Average marketing costs in trade seem to be in the region of 2-7% of net receipts (industry role-players, 2006).

Royalties in the trade market generally range from 10% to 15% of net receipts (industry role-players, 2005). Although royalties are still sometimes paid on the recommended retail price of a book in the trade market, this practice is becoming rare (industry role-player, 2006). Royalties can range as high as 25% of net receipts for well-known authors (industry role-player, 2006). The opposite is however also true, and lower royalties (sometimes as low as 5%) are paid on books which are considered more risky than usual (industry role-player, 2006). Rising royalties are also sometimes used; an author may receive 15% royalties on the first impression of a book and 18% on reprints, for example (industry role-player, 2006). These numbers are consistent with the *PASA Annual Industry Survey 2005 Report* where small trade publishers indicated they pay royalties of 15.67% on net receipts on average, while medium trade publishers they pay 13% and large trade publishers pay 13.42% (Galloway et al, 2006).

Advances are a relatively new development for local publishers, and currently only established authors can expect to receive advances (industry role-players, 2006). The local market for trade books would need to grow substantially before advances would start to play an important role in the dynamics of the local publishing industry (industry role-player, 2006).

#### 2.3.3.4. THE ACADEMIC BOOK MARKET

The cost breakdowns for typical academic titles are given in Table 16. The textbooks shown had print runs of 2 000, and royalties of 18% on net receipts were paid on the first edition and 15% on the second edition.[26] The second edition had 472 pages as opposed to the first edition's 352. The numbers for the two books are thus not directly comparable. The scholarly title (i.e.a general academic book – see footnote 23 on page 22) had a print run of 1 200, and a royalty rate of 10% on net receipts.

[26] Second editions usually require much less time and effort on the author's part than originating a book from scratch (first edition), and it is on this grounds that publishers are able to justify lower royalties on revised editions.

| Cost breakdown of book retail price | Percentage | | |
|---|---|---|---|
| | Academic textbook | | Scholarly title |
| | 1st edition | 2nd edition | |
| Printing, paper and binding | 10.0% | 13.1% | 16.4% |
| Origination | 12.4% | 10.8% | 19.9% |
| Royalties | 12.6% | 10.5% | 6.3% |
| Publisher's overheads (excluding distribution) | 28.7% | 29.3% | 8.9% |
| Distributor/ distribution | 6.3% | 6.3% | 11.3% |
| Bookseller | 30.0% | 30.0% | 37.1% |
| Total | 100% | 100% | 100% |

**Table 16: Cost breakdown of the retail price (excluding VAT) of academic books**

*Source: Industry role-players, 2006 and Genesis Analytics calculations*

As was the case with trade books, the small print run causes printing, paper and binding to make up a larger proportion of the price of an academic book than an educational book. One academic publisher mentioned that they often print 1 000 copies or less of a book in 18 months. This is particularly the case for the second edition and the scholarly title. Despite being more than 100 pages longer than the first edition, the origination cost of the second edition was 31% less than that of the first edition – leading to printing, paper and binding contributing a bigger portion of the cost of the book than origination.

Origination costs for academic books are generally higher than for education or trade books.[27] Firstly, academic textbooks tend to be longer than educational books. Whereas educational textbooks are 180 pages at most, it is not unheard of for tertiary textbooks to be up to 600 pages long (industry role-player, 2006). Since many origination costs (i.e. editing, proofreading, and type-setting) are charged either by the page or number of words, the length of tertiary textbooks increases their origination costs (industry role-player, 2006).

Secondly, editing tertiary textbooks usually requires specialised skills, and many academic editors only edit academic books (industry role-player, 2006). Subjects like medicine also require a level of attention to detail not found in other types of books, and this further increases origination costs (industry role-player, 2006).

Thirdly, subjects like science and medicine usually require a large number of diagrams and graphs; these are often hand originated and this is very costly (industry role-player, 2006). The main origination costs involved in creating an academic textbook are shown in Table 17. The origination costs of the scholastic

[27] This fact is not evident when comparing the tables in this section. The reason for this is that the educational textbook on which the information in this section is based included a number of illustrations and photographs. The tertiary textbook was for a management title and thus had lower origination costs that would be the case for say a tertiary science textbook.

title were collapsed into costs related to text (i.e. proofreading, editing etc.) and typesetting and reproduction costs. The ratio between these costs is 56% text versus 44% typesetting and reproduction costs.

| Cost item | Percentage of total origination cost | |
|---|---|---|
| | *First edition* | *Second edition* |
| Editing | 21.03% | 17.65% |
| Proofreading | 18.55% | 23.06% |
| Cover design and illustrations | 6.50% | 8.20% |
| Typesetting | 28.68% | 29.93% |
| Corrections | 16.44% | 21.16% |
| Other | 8.8% | 0% |
| Total | 100% | 100% |

**Table 17: Main origination cost in the academic market**

*Source: Industry role-player, 2006 and Genesis Analytics calculations*

Royalties for academic titles also tend to be higher than for other types of books.[28] The reason for this is that these titles are usually written by academics, who have less time to devote to writing than for example a teacher (industry role-player, 2006). Since tertiary textbooks tend to sell fewer copies than educational textbooks, authors require higher royalties per book to make it worth their while to write books (industry role-player, 2006). Lecturers also tend to be more business savvy, and may be in a stronger bargaining position than other authors, since it is often implied that their textbooks will be prescribed at the institutions where they teach (industry role-players, 2006). Gray (2000) mentions that historically, authors of mainstream books likely to be prescribed to large distance education classes have been able to negotiate royalties as high as 25% of net receipts. In contrast to academic textbooks, authors of scholarly works have much less bargaining power, as a result of the more limited nature of this market. Royalties on scholarly works are typically 10% or less and some publishers do not pay any royalties at all on these types of works (industry role-players, 2006).

The royalty numbers shown in Table 16 seem consistent with the information provided by the *PASA Annual Industry Survey 2005 Report,* where 2 medium trade publishers indicated that they pay 12% royalties on net receipts on average, and four large academic publishers indicated that they pay an average royalty of 14.25% (Galloway et al, 2006).

[28] This is not the case for all publishers interviewed, though.

| Overhead cost item | Percentage |
|---|---|
| Staff costs | 40.4 |
| Distribution | 21.3 |
| Marketing | 8.5 |
| Travel | 6.4 |
| Other costs | 23.4 |
| Total | 100.0 |

**Table 18: Academic publisher's overheads**

*Source: Industry role-player, 2006 and Genesis Analytics calculations*

Table 18 shows that the bulk of academic publishers' overheads are staff costs and distribution. Marketing is also relatively high since academic publishers, rather than booksellers, typically need to interact with institutions to get their books prescribed (industry role-player, 2006). Table 19 shows the reduction in retail price and production cost for the first and second edition of the academic textbook as the print run increases.

| Size of print run | Reduction in retail prices | | Reduction in production costs | |
|---|---|---|---|---|
| | First edition | Second edition | First edition | Second edition |
| 2 000 | Base price | Base price | Base price | Base price |
| 2 500 | 10% | 14% | 12% | 14% |
| 3 000 | 17% | 24% | 21% | 23% |

**Table 19: Economies of scale and retail prices in the academic market**

*Source: Genesis Analytics calculations based on Industry role-player, 2006*

The table shows that cost-savings seem to be passed on to consumers in their entirety. The scholarly book is priced the same irrespective of print run, but this is probably the result of the book already being priced as low as the publisher can profitably go. The gross profit (after distribution and marketing costs) is 6% for a print run of 1 000, 17% for a print run of 1 200 (the actual print run used) and 30% for 1 500.

### 2.3.4. MARGINS IN THE PUBLISHING INDUSTRY[29]

In the educational market, anecdotal evidence suggests that publishers' gross margins are in the order of 35%-45%. One education publisher mentioned that promotional and marketing costs are about 15%-20% of net receipts (a term which is equivalent to gross profit – see footnote 25 on page 25). If the middle point of this range is taken (17.5%) and combined with the information in Table 12, educational publishers' overheads are roughly 30% of net receipts. Given this rough estimate of total overheads, educational publishers' net margins can be approximated as being in the order of 5%-15%.

[29] The information is based on information from industry role-players and Genesis Analytics calculations.

Before returns of unsold books and promotional costs, trade publishers look to make a gross profit of about 50%. After book returns, which are on average 14% of books sent to booksellers, the gross profit margin drops to about 44%.[30] Only one book budget provided by trade publishers provided sufficiently detailed information to calculate a net profit. This book was budgeted to make a net profit of 11%. Given that not all trade books break even, this lends credence to the statement by another trade publisher that it is very difficult to get a net return of above 8% on a trade publisher's entire portfolio of titles.

In the academic market gross profit margins of 50-60% are aimed for, while 40-50% seems to be the norm. One publisher mentioned that they aim to make 50% gross profit on first impressions and 60% on reprints. Another publisher mentioned that they make about 10-15% net on books that are profitable; but that only about a quarter of their books are profitable. Yet another academic publisher mentioned that they generally make about 55% gross profit on their overall portfolio and about 18-19% net before taking into consideration book returns of 15-18%. These numbers are consistent with the assertion by an academic publisher that their research indicated that publishing overheads in the academic market are 30-35%, and that net profits of 12%-15% are considered acceptable.

[30] Note: 44% is not precisely 86% of 60% since royalties are slightly reduced as a result of returns, while other expenses remain constant.

## 2.4. DISTRIBUTION

### 2.4.1. MARKET DESCRIPTION

Distributors in the book market typically also perform additional functions like invoicing, debt factoring and so forth. For example, the Booksite Africa website[31] lists their services as:

- Order processing, e-commerce and EDI (electronic data interchange) capability and order tracking services;
- Warehousing and physical distribution;
- Credit risk management;
- IT services, including a real-time link between publishers and their supply change management systems, transactional and management information reporting and secure information systems that include daily backups and disaster recovery capabilities.

In some instances publishers distribute their own books, using couriers (industry role-players, 2006). The distinction between distributors and publishers' representatives can also be a bit murky. While publishers' representatives offer distribution services as part of their bouquet of services, many of them outsource their distribution to specialist distributors (industry role-player, 2006).

### 2.4.2. PARTICIPANTS AND MARKET SHARES

The major distributors of books in South Africa are On the Dot (which is part of Naspers' Via Africa division), Booksite Africa (which is part of the Johnnic Communications group) and Jonathan Ball Publishers (which incorporates the publisher's agent Book Promotions and its library supply arm, and is also part of Via Africa). Jonathan Ball has recently entered into a joint venture with On the Dot (industry role-player, 2006). On the Dot is estimated to have a share of 35-45% of the South African book distribution market as a whole[32] (industry role-player, 2006). Booksite Africa and Jonathan Ball are estimated to have 45% and 20-22% of the trade market (industry role-players, 2006). The academic market is mainly served by library suppliers[33] and publisher's agents; while some of the larger academic publishers manage their own distribution (industry role-players, 2006). On the Dot does limited academic distribution, with the bulk of its business

[31] Booksite Africa website: http://www.struiknews.co.za/booksitenew/services.html accessed 6 November 2006.

[32] It is unclear whether Jonathan Ball's market share is included in the estimate of On the Dot's market share, as a result the numbers of the two entities are shown separately to avoid possible double-counting.

[33] Firms active in this filed include Exclusive Books' library division, Hargraves Library Service and Book Promotions (Industry role-player, 2006).

distributed between the educational and trade markets (industry role-player, 2006). Apart from these large players, there are also a number of smaller players, mostly courier firms and publishers' representatives (industry role-player, 2006).

### 2.4.3. MARKET SEGMENTS

#### 2.4.3.1. EDUCATION

Despite the fact that On the Dot has a strong presence in the educational market, publishers often distribute their own books, either through courier companies or with their own vehicles (industry role-players, 2006). The distribution models employed in the various provinces vary widely. Publishers are usually either required to deliver their books to central warehouses, or to individual bookshops (industry role-players, 2006). The way the books are distributed to schools, however, varies from province to province (industry role-players, 2006):

- In some provinces (like the Eastern Cape, for instance) publishers are required to **use local SMME's as distributors** to deliver books to schools in order to facilitate local empowerment (industry role-player, 2006). In order to deal with the fact that many of the local subcontractors in the Eastern Cape did not have credit histories (and often did not fulfil their contractual obligations), a local firm was sub-contracted to administer the central warehouse (LSM Logistics) and an accounting firm was brought in to oversee the payment process (industry role-players, 2006). Currently the publishers sell books to the Eastern Cape Department of Education at a discount of 15% (as opposed to the standard discount in the educational market of 30%) and then also pay LSM logistics, the accounting firm and the local distributors – which amounts to an additional 17% (industry role-player, 2006). The distribution model thus effectively reduces publishers' net receipts by 2 percentage points.
- In other provinces, like Mpumalanga and Limpopo, the local **Department of Education is responsible** for the distribution of books to schools through the use of **local sub-contractors**.
- In Gauteng and KZN **one player (a company called EduSolutions)** is responsible for the distribution of books. In Gauteng EduSolutions delivers books to Section 20 schools, while in KZN it delivers books to both Section 20 and 21 schools (industry role-player, 2006).
- In provinces like the Northern and Western Cape, **schools buy their books from booksellers**, and educational books are thus delivered to bookstores.

This is not an exhaustive list of the distribution arrangements in the educational market, but illustrates that distribution models vary widely between provinces. In general, the distribution of books once they have been delivered to central

warehouses does not influence educational publishers' costs; except in the Eastern Cape. The publishers interviewed who participated in the Eastern Cape arrangement, however, were quite happy to forego this revenue, since the model has decreased bad debts significantly.

While the different arrangements do not seem to influence the recommended retail price of books, many industry role-players did not believe that the different educational departments were striving to minimise the distribution cost of educational books. The efficient provision of learner and teaching support materials (LTSM) is an issue that is currently being addressed by the National Learning and Teaching Support Materials Consultative Forum, which was established by the National Department of Education and on which various members of the PICC sit.[34]

The National Learning and Teaching Support Materials Consultative Forum was appointed by the Minister of Education to:

> *[C]o-ordinate the activities of the Department of Education and the private sector agencies in the development of the learning and teaching support material industry of South Africa to the end that quality learning and teaching support materials of all kinds may be available at the lowest possible costs to all learners throughout the country [DOE, 2005:2].*

It is an objective of the Forum to make recommendations relating to the supply of LTSM to the Minister of Education (DOE, 2005).

#### 2.4.3.2. TRADE

In the trade market, bookstores' orders are either relayed directly to the distributor who then dispatches the books to the stores, or to the publishers who then relay the orders to the distributors (industry role-players, 2006). Electronic data interchange (EDI), a system whereby orders are electronically transmitted between retailers, distributors and publishers, and which allows detailed tracking of transactions between these parties, has yet to be implemented on a large scale in South Africa, and most orders are still relayed by fax (see discussion in Section 4) (industry role-player, 2006, MAPPP SETA, 2004b).

[34] PICC website: http://www.picc.org.za/programmes.q. Accessed on 10 November 2006.

#### 2.4.3.3. ACADEMIC

Publishers often handle their own distribution in the academic market (industry role-player, 2006). The distribution of academic books is less complicated than the distribution of other books, since it usually involves the bulk deliveries of textbooks to a limited number of bookstores or tertiary institutions (industry role-player, 2006). The scholarly market, however, is more complicated because of the small number of books typically sold to each customer (industry role-player, 2006). The distribution of scholarly titles is predominantly done via publishers' representatives and library suppliers (industry role-players, 2006). Library suppliers typically do their own distribution; they usually have warehouses and use couriers to deliver the books (industry role-players, 2006).

### 2.4.4. COST DRIVERS AND THE COST OF BOOKS

The **main cost drivers** in book distribution were identified as: freight costs, staff costs, packaging, rent, IT costs and insurance (industry role-players, 2006). Of these, one distributor mentioned that freight is by far the biggest expense. No further detail was obtainable at this time.

In the **educational market** distribution costs are in the order of 6-7.5% of net receipts (industry role-players, 2006). Given the standard 30% discount offered by publishers in the educational market, distribution costs make up about 4.2-5.3% of the retail price of an educational book. Educational publishers did not indicate that this percentage is influenced by the way books are delivered to schools in the different provinces.[35] Any increase in distribution cost as a result of inefficiencies in the delivery of educational books is thus likely to be borne by the respective departments of education.

In the **academic market** distribution cost varies widely based on the number of books delivered, which in turn depends on whether it is a mainstream academic textbook or a specialised postgraduate textbook or scholarly title. In the case of bulk textbook orders, distribution costs can be as low as 3% of net receipts (industry role-player, 2006). When one or two copies of highly specialised titles are distributed, the cost can be as high as 9.5% of net receipts. At a publishers' discount of 35%, this would imply that between 1.95% and 6.2% of the retail price of an academic book is distribution costs.

[35] In cases where costs are increase as a result of local distribution methods (for example the Eastern Cape), the effect seems to be negligible.

Distribution cost in the **trade market** is about 10% of net receipts. At a discount of 46%, this implies that about 5.4% of the retail price of a trade book is comprised by distribution costs.

Books distributed through publishers' representatives are usually sold to the publishers' representative at a discount of 17.5% to 35% on net receipts (i.e. a discount on the retail price of the book minus the booksellers discount) depending on whether promotional services are included in the agreement (industry role-players, 2006). Publishers' representatives usually look to make a gross margin of 20%-25% (industry role-players, 2006 and Genesis Analytics calculations).

## 2.5. BOOKSELLERS

### 2.5.1. MARKET DESCRIPTION

Although there are variations on the theme (which will be highlighted in the discussions of the relevant markets), most booksellers generally buy books from publishers at a set discount on the publishers' recommended retail price, and then sell the books on to their customers at a price close or equal to this recommended retail price. The gross margin of booksellers is thus determined to a large extent by the discount they get from the publishers (industry role-player, 2006).

The distinguishing feature of the South African book retailing sector is the high levels of concentration. In every market segment there is one player that is noticeably bigger than its competitors.

### 2.5.2. PARTICIPANTS AND MARKET SHARES

#### 2.5.2.1. EDUCATIONAL MARKET

Afribooks (part of Via Africa) is the largest retailer of learning and teaching support materials (LTSM) in South Africa, and the only retailer to be active in all nine provinces.[36]

#### 2.5.2.2. TRADE MARKET

Exclusive Books (part of the Johnnic Communications group) is the largest retailer of trade books in South Africa. Although Exclusive Books has fewer stores than CNA[37] (39 as opposed to 195),[38] the former is a dedicated bookshop while the

[36] Via Africa website, http://www.viaafrika.com/afribooks.asp. Accessed 6 November 2006.
[37] Which is now owned by Edcon.

latter is a retailer of "reading, writing, listening, learning and communication consumables."[39] There was consensus among the industry role-players consulted that Exclusive Books currently sell significantly more books than CNA. In terms of bookstores, CNA and Exclusive Books are followed by Fascination Books with 24 stores and Wordsworth with 8 stores.[40] As an indication of the relative market shares of the larger retailers in the trade market, Table 20 shows the distribution of two trade publisher's sales by retailer. These particular trade publishers, however, do not deal extensively with book clubs. It is believed that Leserskring/Leisure Books (a book club) has a market share which is marginally higher than Wordsworths' market share (industry role-player, 2006).

| Retailer | Percentage of total sales |
|---|---|
| Exclusive Books | 39% - 43% |
| CNA | 16% - 18% |
| Fascination Books | 4.7 - 6% |
| Estoril * | approx 3.4% |
| Wordsworth | 2.3% - 3% |
| Kalahari.net | 1% - 3% |
| Adams & Co | 1.1% - 2% |
| Hargraves * | approx 2.5% |
| Airport Retail * | approx 2% |
| Other retailers | 26% - 27% |

**Table 20: Sales distribution of a trade publisher**

*Source: Industry role-players, 2006*

** Estimation only supplied by one trade publisher*

In the non-fiction segment of the trade market, however, the market seems to be less concentrated. A trade publisher who specialises in non-fiction books mentioned that Exclusive Books accounts for 20% of their sales and CNA for 15%, and that no other group accounts for more than 4% of their sales.

South African supermarkets have also recently begun stocking trade books. While this development is likely to increase access and hopefully reduce prices, Canoy et al (2004) mention that potentially welfare-enhancing cross-subsidisation between popular mass-market titles and more idiosyncratic books may be threatened by non-booksellers (like supermarkets) that use books as sale items. This view was echoed by an industry role-player that mentioned that booksellers that aim to cater

[38] CNA website: http://www.cna.co.za/CNA/Help/About%20Us. Accessed 6 November 2006; Exclusive Books website: http://www.exclusivebooks.com/stores.php?PHPSESSID=f4714bd3d0e012530581285879396926. Accessed on 6 November 2006.

[39] Edcon website. http://www.edcon.co.za/Edcon/Divisions/Department+store/CNA.htm. Accessed 6 November, 2006.

[40] Fascination Books website, http://www.fascinationbooks.co.za/AboutUs.htm. Accessed 7 November, 2006; SABA membership directory provided by SABA.

to a wide range of tastes and thus carry a wide range of books will never be able to compete on price with supermarkets, which may use books as “loss-leaders”.

#### 2.5.2.3. ACADEMIC MARKET

Van Schaik Bookstore (also part of Via Africa) is the largest retailer of academic books in South Africa, with an estimated market share of between 40% and 50% (industry role-players, 2006). Van Schaik currently has 42 outlets nationwide, while its closest competitors (in terms of outlets) are Adams & Company with 8 stores (of which only one store does not stock academic books) and Juta & Company with 4 outlets[41] (industry role-player, 2006). In terms of sales, Table 21 shows the market shares of the largest academic booksellers in South Africa.

| Retailer | Percentage of total sales |
|---|---|
| Van Schaik Bookstores | 50% |
| Juta & Company | 13% |
| Adams & Company | 12% |
| Brainbooks | 8% |
| Protea Bookshops | 7% |
| LJ Armstrong Booksellers | 6% |
| Other retailers | 4% |

**Table 21: Academic booksellers’ market shares**

*Source: Industry role-player, 2006*

### 2.5.3. COST DRIVERS AND THE COST OF BOOKS

#### 2.5.3.1. THE EDUCATIONAL MARKET

**Cost drivers**

Educational booksellers differ markedly depending on the province in which they operate. In the Western Cape with its “own buy” market structure, for example, educational books are sold by general bookstores (industry role-player, 2006). In provinces where a tender system is used to distribute books to schools, educational booksellers do not resemble traditional bookstores in any way, shape or form. These entities effectively act as distributors, and their business can be viewed as “cartage” rather than bookselling (BDSA, 1997). It is therefore difficult to make any general statements about educational booksellers.

[41] Van Schaik Website. http://www.vanschaik.com/books/index.asp?lang=eng. Accessed 6 November 2006, Juta website: http://www.tmza.co.za/juta/aboutus.asp. Accessed 6 November 2006.

Sales of educational books are usually confined to the month or so before the new school year starts. Some Section 21[42] schools, however, do tend to order books more than once a year (industry role-player, 2006).

**The cost of books**

Educational books are sold to educational booksellers, or the provincial departments of education (depending on which distribution model is used), at an average discount of 30% on the recommended retail price (industry role-players, 2006). As shown in Table 10, this 30% is the largest single contributor to the retail price of a book in the educational book value chain.

In provinces where educational books are distributed through traditional bookstores,[43] schools are usually able to negotiate a discount from the bookseller. Generally the discounts passed on to schools are in the order of 10%, but due to intense competition these discounts can be as high as 22.5-25% in market sectors such as supplying Section 21 schools in provinces like KwaZulu Natal[44] (industry role-players, 2006). This situation may however not be sustainable, as SABA has calculated that any discount above 12% will cause booksellers to cut back on the quality of service they offer as stock-holding bookshops (industry role-player, 2006).

In provinces where the education department buys and distributes books, or where tenders are put out for firms to supply books to schools, the actual price at which books are purchased differs. In the Free State, for instance, grade 9 and 11 books are purchased directly by the provincial department of education (at the 30% discount) and the books are then delivered by the Social Services Department (industry role-player, 2006). In the Eastern Cape, as mentioned in Section 2.4.3.2, books are sold to the provincial education department at a discount of 15%, and distribution costs are borne by the publishers.

In provinces where the administration of the distribution of educational books is contracted to one firm, less data is available and it is unclear whether any discount is passed on to schools.

To summarise:

[42] Section 21 schools are schools with relative strong administrative capabilities where expenditures and management issues are overseen by governing bodies, rather than the provincial department of education.
[43] Traditional bookstores refer to business that's major business is the sale as opposed to distribution of schoolbooks. This would include stockholding bookstores and educational book retailers like Afribooks.
[44] The supply of books to Section 20 schools is handled by Edusolutions.

- Educational booksellers receive books from publishers at an average 30% discount on the retail price
- Where schools buy from booksellers, they are able to negotiate discounts of around 10%. These discounts can be significantly higher where there is strong competition between booksellers.
- In provinces where educational departments buy and distribute books, or where tenders are put out to supply books to schools, the actual price at which books are bought varies.

#### 2.5.3.2. THE TRADE MARKET

### Cost drivers

A number of factors increase the cost of retailing trade books, as follows:

- A retail display of books takes up a relatively *large amount of space*; this fact, coupled with the fact that every title is unique, means that bookstores are generally quite large (BDCSA & industry role-player, 2006). One trade bookseller mentioned that they believe the minimum size for a successful bookstore to be about 300m$^2$.
- The South African book-buying public seems to require trade retailers to be *located in shopping centres,* where shop rental prices are fairly high (industry role-players, 2006). In addition, book retailing is a very *cyclical business,* and particularly so in South Africa, where Christmas falls in the traditional annual holiday period (industry role-player, 2006). One trade publisher mentioned that more of their books are sold over the Christmas period than during the rest of the year combined. This increases booksellers' overheads, since they must invest in premises and systems that can accommodate this rush in November and December, but will not be fully utilised during the rest of the year. Given these factors, it is no surprise that rent is generally a trade bookseller's main expense (industry role-players, 2006).
- Consumers expect a bookseller's staff to be knowledgeable about the books sold and literature in general (industry role-player, 2006). Booksellers thus tend to employ people with a cultural background suitable to book retailing (industry role-player, 2006). Employees who fit this profile are in short supply and this drives up booksellers' *staff costs* (Industry role-player, 2006).
- Given the uniqueness of books, booksellers need to keep a large amount of stock to be able to offer a wide selection of books. As a result, *stock turn* in the trade market is only about 3 times a year (industry role-players, 2006).
- Trade books do not age well, and after about 18 months of fluorescent lighting and customer handling in a bookstore they usually need to be *written off* (industry role-player, 2006). Because of the high rents in shopping malls, it is

important that trade booksellers move their stock and old stock is often written off before 18 months in order to make way for new stock with a higher probability of being sold.

- While trade books are often sold on a "sale-or-return" basis, the percentage of *books that can be returned* is typically specified at around 50% (however, this differs between retailers, and often special deals are made where 100% of a certain order may be sale-or-return) (industry role-players, 2006). Trade publishers consulted indicated that about 10-15% of trade books are usually returned by booksellers.

The typical distribution of the overhead costs for a trade bookseller is shown in Table 22.

| Overhead cost item | Percentage |
|---|---|
| Rent | 41% |
| Salaries | 35% |
| Other expenses | 24% |
| Total | 100% |

**Table 22: A particular trade bookseller's overheads**

*Source: Industry role-player, 2006*

### The cost of books

Publishers' discounts (and thus booksellers' gross margins) in the trade market range from 35% to 68%, and average about 47% (industry role-players, 2006). New customers would typically start out towards the lower end of the scale, while the Leserskring/Leisure Books[45] book club receives a discount of 68% (industry role-players, 2006). Various trade publishers indicated that as a result of this large discount, they only deal with Leisure Books in circumstances where they believe it will increase their sales to such an extent that they can increase their print runs. The general view was that only publishers who publish a lot of Afrikaans works, and have a longstanding relationship with Leisure Books (typically including using them as an advertising channel), deal extensively with Leisure Books (industry role-players, 2006).

Table 13 in Section 2.3.3.3 shows that the booksellers' margin accounts for the biggest portion of the total retail price of a trade book. It is however not known what

[45] Leserskring/Leisure Books was established as a response to the lack of distribution channels for Afrikaans books – at the time only 20 out of 300 CNA branches stocked Afrikaans books – and not only grew the market for Afrikaans fiction, but effectively opened up a market for Afrikaans non-fiction (BDCSA, 1997). According to the Leisure Books website they have been operating for 25 years and have 240 000 members (http://www.leisurebooks.com/join.asp?user=%96%8Fcuyb%7Bh%5C%8FO%7Ey%80%60%8Ak%80y%7Em%96uQ%87%90%83lqa%81%8EspzDnjl%7E%8E%81%5E%7Ep%9Ff%97i%84Zkgr%5DhWuac%5B%89. Accessed 9 November 2006).

net returns trade booksellers make. Trade bookselling does seem to be a relatively expensive endeavour, as discussed in Section 2.5.3.2. The lower rates of stock turnover in trade bookselling as opposed to in the academic market suggest that a higher discount is warranted in trade than in academic (see Section 2.5.3.3).

While most trade booksellers tend to price their books at about the publisher's recommended retail price, Exclusive Books tends to mark their prices up by R5 – R10 per title (industry role-players, 2006). The rationale for this is that they are offering a wider range of books (and thus a superior service) to most other booksellers (industry role-players, 2006). Given that their flagship store, for example, stocks up to 70 000 titles,[46] this small premium is probably warranted.

A trade bookseller mentioned that trade booksellers generally cannot afford to sell books at less than the recommended retail price when they are located in shopping malls, as a result of high rent costs. Leisure Books, on the other hand, sell books to their customers at a discount of "up to 20%" on the recommended retail price.[47] The consensus view among the industry role-players consulted was that Kalahari.net, the largest internet retailer of books in South Africa and part of Naspers' Via Africa division, on average sells books at a price that is roughly equal to the recommended retail price, once freight costs, which are borne by the consumer, are taken into consideration.

To summarise:

- Trade booksellers receive average discounts of about 47% from publishers
- Most booksellers tend to sell books at close to the publishers' recommended price. Where prices are set above the recommended retail price, the premium is typically relatively small.
- High rent costs imply that booksellers who are located in shopping centres generally cannot afford to sell trade books at below the recommended retail price.
- Booksellers' margins account for the bulk of the cost of trade books. Trade retailing is however an expensive endeavour. It was not possible to ascertain what net returns trade booksellers make

[46] Exclusive Books website: http://www.exclusivebooks.com/about.php?PHPSESSID=501673b1581234e844f2cb004b481487. Accessed 6 November 2006.
[47] Leisure Books website: http://www.leisurebooks.com. Accessed on 6 November 2006.

### 2.5.3.3. THE ACADEMIC MARKET

#### Cost drivers

The cost structures of academic bookstores are very similar to those of trade booksellers (industry role-player, 2006). Many academic bookstores, however, are situated on or near the campuses of tertiary institutions. An academic bookseller mentioned that *rents* on tertiary campuses are typically marginally cheaper than in shopping centres. The academic textbook market is *cyclical* and most textbooks are purchased at the start of the semester. The bulk of sales are however made in February to March, since books prescribed both for first semester and year-long courses are sold then (industry role-player, 2006).

Since academic booksellers predominantly sell prescribed tertiary textbooks, they should in theory be able to *move these books relatively quickly* when a new semester starts. One academic bookseller mentioned that they turn stock over up to 5 times a year (the bookseller did however mention that that figure was based on their stock level in May – which is significantly less than at the start of the year) (industry role-player, 2006). In general, however, academic booksellers find it hard to get their stock turnover above 3.5 times a year (industry role-player, 2006). This is a result of the fact that many institutions have now moved to a system of courses being offered in four blocks (two per semester), and the fact that booksellers are often not informed which courses are going to be offered in which block (or at least not in time to stagger their purchases throughout the year) (industry role-player, 2006). Institutions also have a history of moving courses between blocks without informing bookstores (industry role-player, 2006). Given that it takes 6 to 8 weeks to import books to South Africa with sea freight, academic booksellers tend to plan their purchases in such a way that most of the prescribed books are in-store at the start of the academic year, which obviously increases *stockholding costs* (industry role-player, 2006).

While academic booksellers indicated that they stock more scholarly work outside of peak periods, scholarly books are believed to account for only 10% of academic booksellers' turnover (industry role-players, 2006). Half of this 10% is believed to be special orders by customers (industry role-player, 2006). This has caused some industry role-players to question whether the majority of academic booksellers in South Africa can be classified as stock-carrying bookshops. An academic bookseller, however, mentioned that the decision to scale back on scholarly works was the result of a very high write-off rate. They mentioned that academics mostly buy their books on-line. The bookseller now mainly stocks scholarly works aimed at conferences held in the area.

**The cost of books**

Academic booksellers typically receive a discount of between 30% and 40% from publishers (industry role-players, 2006). Scholarly titles, however, are often sold to trade booksellers, in which case a higher discount is applicable (industry role-player, 2006).

Academic booksellers generally stick close to publishers' recommended retail prices on local books (industry role-players, 2006). One academic bookseller mentioned that they try and maintain a 35% gross margin on the books they sell. In situations where they receive a discount of below 35%, they mark up the book slightly so that the purchase price of the book is effectively a 35% discount on the selling price of the book. In general, most of the bigger international publishers allow South African booksellers to return unsold books for a refund (although the booksellers carry the return freight cost) (industry role-player, 2006). Local academic books, however, are mostly on a "firm sale" basis and cannot be returned (this does vary from publisher to publisher and some publishers do allow a percentage of orders to be returned) (industry role-player, 2006).

Academic booksellers on average write off stock to the value of 2-3% of sales annually (industry role-player, 2006). This number can be considerably higher in cases where institutions do not provide them with accurate booklists (industry role-player, 2006). While this may look like a relatively small amount of books, it must be kept in consideration that a history of large write-offs has created a system where academic booksellers tend to under order stock (industry role-player, 2006).

Academic booksellers may from time to time look to make additional margins on imported books (industry role-players, 2006). This is usually the case with obscure scholarly titles, or textbooks imported in very small quantities (industry role-player, 2006). Given the high cost of importing a small number of books, it is unlikely that academic booksellers would be able to increase their margins on these books by much and still be able to price them at competitive levels.

To summarise:

- Academic booksellers receive discounts of 30-40% on books from publishers. Scholarly titles, however, are often sold through trade bookstores, and then trade discounts apply.
- Academic booksellers tend to stick close to publishers' recommended retail prices, but may look to make additional margins on obscure imported titles. The premium charged on these titles are however relatively small.

- Big international publishers allow booksellers to return unsold books, while locally published academic books mostly cannot be returned.
- Academic booksellers on average write off stock to the value of 2%-3% of sales annually. This number can be considerably higher where accurate booklists are not supplied by academic institutions.

### 2.5.4. MARGINS IN THE BOOKSELLING INDUSTRY

Gross margins in the bookselling industry are determined by the discount a bookseller receives from publishers, since most booksellers tend to keep quite close to the recommended retail prices provided by publishers. These gross margins should however be seen as indicative only, since booksellers do sometimes deviate from the publishers' recommended retail prices; these deviations are however usually relatively small (industry role-players, 2006).

Based on the average discounts received by booksellers from publishers in the different market segments (given in Section 392.5.3), gross margins in the bookselling industry are as follows:

- Educational booksellers: 30%
- Trade booksellers: 47% (on average)
- Academic booksellers: 35% (on average)

# 3. PRICING OF IMPORTED BOOKS

The majority of imported books are brought into South Africa by publishers or publishers' representatives who own agencies to distribute the books of foreign publishers (industry role-players, 2006). Imported books are either acquired at a discount to the domestic price of the book in a foreign market, or publishers negotiate an all-in price for the book in rand (industry role-players, 2006). The second method is predominantly followed where there are special circumstances (i.e. the book is considered too expensive for the local market based on the discount model and freight costs), where the local publisher is part of a larger publishing group, or where the book is co-published[48] by a local and foreign publisher (industry role-players, 2006). The only difference in the pricing dynamics between these two methods is the way in which the landed price of imports is calculated.

The discounts received from offshore publishers differ between market segments, and this influences the landed price of imports and thus the gross profit margins achieved. The discounts in the different market segments are shown in Table 23. Publishers typically try and make a similar margin on imported books to that achieved on local publications, although this is dependent on the price they purchase the books at and whether the imported books will be competitively priced if the full margin is included (industry role-players, 2006). Because of these similarities, the pricing of imported books will be illustrated using the trade market as an example.

| Market segment | Discount on foreign retail price |
|---|---|
| Education | 60% - 65% |
| Trade | 60% - 75% |
| Academic | 55% - 60% |

**Table 23: Typical discounts received by local publishers in agency arrangements**

*Source: Industry role-players, 2003*

[48] Co-publication refers to the practice of releasing a book published overseas locally under a local publisher's imprint (Industry role-players, 2006). Typically, the local publisher would spot a book published overseas that they consider relevant to the local market. They would then buy the rights to distribute the book locally and negotiate a foreign currency price for the book. All origination costs are borne by the overseas publisher. The local publisher's imprint would appear on the cover and title page of the book. The transaction would typically call for the local publisher to purchase 500 – 1000 copies of the book. Co-publications usually relate to specialised academic books or non-fiction trade books. In the academic market the local author often adopt the book for local conditions (industry role-player, 2006). One trade publisher mentioned that they typically price books at a multiple of 5 of the price they purchase the book at (converted to rand). The publisher did however point out that this is a very rough rule of thumb and that they would typically adjust the price downward if they do not feel it would be competitive at full price.

**Imported trade books.** Books are usually purchased at a discount of between 60% and 75% on the retail price of the book in the foreign market (industry role-players, 2006). In order to get a rand price for the book, the foreign currency price of the book will be converted at the prevailing exchange rate at the time of the transaction (industry role-players, 2006). Freight cost will then be added to the rand cost of the book to calculate the landed price of the imported book (industry role-players, 2006). The freight cost may also be foreign currency-denominated, in which case the exchange rate will be applied to the sum of the discounted price and the freight cost in order to obtain the landed price in rand (industry role-player, 2006).

Freight costs are usually about 8%-15% of the landed price of the book (industry role-players, 2006). If sea freight is used, freight costs are in the region of 4% to 7%, depending on whether the publisher is able to bring in full container loads (industry role-players, 2006). Airfreight, however, averages about 25% of the landed cost of the books and can range as high as 30-40% if books need to be moved at very short notice (industry role-players, 2006). The landed cost of the book is then scaled up in order to allow the local publisher to add its margin to the landed price.

Local publishers usually look to make a margin of about 40% to 45% on imported books (industry role-players, 2006).[49] The price of the book at this stage is then scaled up again in order to be able to offer retailers the customary discount and still receive the amount needed to make the margin decided upon. As is the case with local trade books, the average discount to bookstores is around 46% (industry role-players, 2006). The bookseller's discount ranges from 35% to new customers, up to 52.5% in some instances (industry role-player, 2006).

An example of the pricing of an imported trade book is provided in Table 24. The example was provided by a trade publisher and is consistent with the process detailed above. The example refers to the recommended retail price of an imported book, and not the actual price the book is sold at by a bookseller. Booksellers, however, tend to stick quite close to the recommended retail price provided by publishers (industry role-players, 2006). The exception is academic booksellers, who may from time to time look to make additional margins on obscure scholarly titles or textbooks of which only a few are imported (see Section 2.5.3.3).

[49] In order to ensure a 40% margin on net receipts, the landed price of an imported book will be times by a factor of 1,67.

| | Cost |
|---|---|
| UK Retail Price | £6.99 |
| Less Discount (70%) | £4.89 |
| Purchase Price | £2.10 |
| Freight Cost (7%) | £0.15 |
| **Landed Cost of Book** | **£2.24** |
| | |
| R/£ Exchange Rate | 13.5 |
| **Landed Cost of Book in Rand** | **R 30.29** |
| | |
| Required Margin | 40% |
| Inflated price to earn 40% margin | R 50.00 |
| Average Trade Discount | 46% |
| **Inflated price to account for trade discount** | **R 93.49** |
| Price including VAT (14%) | R 106.58 |
| **Recommended Retail Price Rounded** | **R 107.00** |

**Table 24: Recommended retail price of imported book**

**Source: industry role-player, 2006.**

# 4. FACTORS AFFECTING THE PRICE OF BOOKS

This section will take a closer look at the factors that are seen by industry role-players as increasing the cost of books. The section will start by highlighting factors important across the different segments of the book market. It will then go on to highlight specific problems highlighted in each of the three market segments.

## 4.1. GENERAL ISSUES

### 4.1.1. SKILLS SHORTAGES

In all three market segments in the book industry (educational, trade and academic books), and across all segments of the value chain, role-players expressed concern about the availability of qualified staff. While some role-players expected this to lead to an increase in their costs in future, most indicated that competition for skilled staff was already increasing their overheads. A lack of suitable staff was highlighted as an issue by players in all segments of the book value chain, with the exception of book distribution.

Smaller players, in particular, felt that a lack of skills is a serious concern. They mentioned that they are spending significant resources to train staff in-house, only to almost inevitably see them being poached by larger players. In the printing industry, for instance, a lack of skilled workers was mentioned as a factor serving as a barrier to entry into book printing by smaller printers.

Industry role-players differed in their opinion of whether this was increasing the retail price of books. Everyone consulted agreed that higher staff costs were eroding their margins. Indirectly, at least, it seems that plausible that a lack of skilled staff may increase the price of books in future.

### 4.1.2. COORDINATION BETWEEN PUBLISHERS AND PRINTERS

Printers and paper merchants consulted felt that paper cost was increased by the fact that they usually did not get enough advance warning of when orders would be forthcoming from publishers. As previously mentioned, local bond paper prices are generally slightly lower than the landed price of imports (industry role-players, 2006). Industry role-players however mentioned that this is not always the case, and that innovative sourcing of paper may sometimes make it possible to bring in paper at lower cost. One paper merchant felt that if printers got sufficient warning

about upcoming projects, that would give paper merchants the opportunity to source the cheapest paper available internationally at any given time.

Currently publishers usually require that orders be fulfilled within one month (industry role-player, 2006). International paper producers, however, usually require a month to make and a month to ship when exporting paper to South Africa (industry role-player, 2006). One industry role-player mentioned that lead times in their paper imports are usually 90-110 days, while local supply is available in 30-45 days. To compensate for this, paper merchants do sometimes pre-purchase paper when they are able to negotiate special deals, and then keep it in stock (industry role-player, 2006). If they had a better idea of future demand, however, this could be done on a much larger scale (industry role-player, 2006).

Typically, only the larger printers have the kind of certainty about future projects that allows them to purchase large amounts of paper far enough into the future so that paper merchants can indent paper for them (i.e. cut paper to their specifications) (industry role-player, 2006). Purchasing indented paper is much cheaper than buying paper "off the shelf" (industry role-player, 2006). The reason for this lack of certainty amongst smaller printers is that they typically get the overflow the larger printers cannot accommodate (industry role-player, 2006).

### 4.1.3. IMPLEMENTATION OF NEW TECHNOLOGY

**Publishing and printing**. Many industry role-players were of the opinion that printers and publishers could work together more closely to maximise efficiency gains through the use of technology. It was felt that some publishers have yet to break through the "digital barrier" – for example, some publishers still supply print jobs on film and require film backups to be made of print jobs, while there is no reason to do this, given the availability of computer-to-plate technologies[50] (industry role-player, 2006). Computer to plate printing is more cost effective since it reduces printers' set-up times, generally provides better quality prints and reduces the need for film – which in itself is expensive (industry role-player, 2006). Some publishers also require proofs to be printed out of what are already print-ready PDF files (industry role-player, 2006). One printer also felt that a lack of software standards between printers and publishers is increasing cost, while another mentioned that they only accept print jobs in a particular file format and will help their clients (free of charge) switch over to this software, since converting file format usually leads to quality issues.

[50] Instead of using film to transfer images to printing drums, the process is now mostly done digitally with the help of lasers (Industry role-players, 2006).

One industry role-player suggested that both printers and publishers have yet to fully grasp the potential of print on demand (digital printing). In particular, it was claimed that publishers have not sufficiently analysed the print on demand financial model. When evaluating the attractiveness of this model, not only the actual cost of printing should be assessed, but also the associated reduction in risk (i.e. fewer returns as a result of smaller print runs), reduced warehousing costs, and lower financing costs (which in South Africa are generally quite high) (industry role-players, 2006).[51] As a result of a lack of demand by publishers, printers have under-invested in print on demand technologies (industry role-player, 2006). The potential of print on demand technologies in the book industry is underscored by the fact that Xerox is currently planning to invest more than R200m in print on demand facilities to serve the educational market (Xerox, 2006). They believe that the flexibility and short turnaround times offered by print on demand can significantly reduce costs and increase access to educational material (Xerox, 2006).

**Distribution**. Internationally, EDI has contributed significantly to more efficient book supply chains (MAPPP SETA, 2004b). EDI streamlines the interactions between booksellers, publishers and distributors and leads to reduced returns, stock write-downs and distribution costs (Eve Gray & Associates, 2006; industry role-player, 2006).

EDI technology has found only limited application in the South African book industry (see Section 2.4.3.2), to a large extent as a result of the industry's failure to come to grips with the extent of cost savings that it could embody (industry role-player, 2006). Such cost savings could be significant - a bookseller consulted mentioned that even the incomplete system of EDI that is used in South Africa (which is more akin to e-mail than fully integrated EDI) is cheaper and more efficient than a paper-based system. The limited appetite for EDI in South Africa is attributed to the fact that many booksellers do not have point-of-sale devices that are sophisticated enough to facilitate automated stock ordering (industry role-player, 2006).

The distribution costs of books are drastically cut when a distributor receives consolidated orders via EDI (industry role-player, 2006). Local distributors all serve a number of publishers and when orders are not consolidated, additional trips to a single bookstore must be made every time a book by one of the publishers served by the distributor is ordered – as opposed to a bulk delivery say once a week (industry role-player, 2006). The way this is done is however not always well

[51] See Eve Gray & Associates, 2006. Supply Chain Solutions for Transformation in South African Publishing: Print on Demand and Digital Content Management for Market Expansion. Available online at: http://www.evegray.co.za/downloads/POD_DCM_for_transformation.pdf.

understood. Most booksellers tend to order books on a per store basis, since there are usually large variations in the type of books stocked, based on the area served (industry role-players, 2006). Even where a group is invoiced centrally, orders tend to be generated by the individual stores in the group (industry role-player, 2006).

Most booksellers believe that central ordering leads to wastage – certain stores will not have enough copies of a book while others may sit with copies they cannot sell (industry role-player, 2006). The perception exists in some quarters that EDI is not compatible with this type of decentralised procurement; or alternatively that EDI is done on a per title basis (i.e. as soon as a book is out of stock the order is relayed to the distributor and the book is delivered) (industry role-player, 2006). In reality, however, distributors should look to EDI to form a midway between truly centralised procurement and just-in-time single title delivery. The ideal is that orders are received from all of a given bookseller's stores and consolidated into a single order, encompassing books from all the publishers served by the distributor. This will enable the distributor to plan the most efficient route to make bulk deliveries to each individual store at set time frequencies (i.e. weekly, bi-weekly etc.) depending on the needs of the bookseller (industry role-player, 2006). One distributor mentioned that the alternative, namely the delivery of individual titles (or even delivering only the titles from one publisher) to bookstores, doubles the cost of distributing books.

Arguably the greatest beneficiaries of EDI are small publishers and small and independent booksellers, as it allows them to compete more effectively with the larger players in the market: small publishers have easier access to large booksellers, while small booksellers gain access to the lists of larger publishers (industry role-player, 2006, MAPPP SETA, 2004b). As a result, one industry role-player mentioned that the big local publishers, in particular, are not in favour of integrated EDI. Access to EDI will be crucial if small independent booksellers are to expand access to books beyond the urban middle-class market currently served by the large bookselling chains (industry role-player, 2006).

### 4.1.4. PAPER PRICING

One of the factors often mentioned as instrumental in increasing the cost of books is the price of paper (BDCSA, 1997). It is generally accepted that import parity pricing is practised in the domestic paper market (industry role-players, 2006). The concept of import parity pricing is explained in Box 1.

BOX 1: IMPORT PARITY PRICING

Import parity pricing (IPP) refers to the practice of pricing goods produced locally at the price it would have cost to import them. When import parity pricing is followed, the local price of a good is equal to the international market price of the good plus freight, insurance and any other expenses that would theoretically have had to be incurred to import the good. Import parity pricing is an emotive issue since it creates a disconnect between the production cost of a good and its retail price. The argument most often made against IPP in the context of paper is that downstream industries do not receive any benefit from having local suppliers of paper (industry role-player, 2006). An additional consequence of IPP is that the main factor driving the price of local paper in the short term is the exchange rate.[52] The exchange rate of the rand directly affects the landed cost of imports in rand, and thus also the price charged for local paper. This exposes downstream players in the book industry to increased volatility with respect to their input costs, since paper prices are usually fixed for only 30 days (industry role-player, 2006).

Industry role-players agreed that IPP is a feature of the paper industry internationally, and thus not unique to the South African situation. It was also pointed out that IPP is a sword that cuts both ways. Admittedly, when the rand depreciates, the paper price increases in a way that is not directly related to production costs; but when the rand strengthens the reverse happens and local producers are forced to reduce their prices irrespective of whether or not it is profitable for them to do so (industry role-players, 2006). Not only do the volumes of the big book printers like Paarl Print and CTP Books allow them to import paper, should the prices of local producers move out of line with international trends, but paper merchants provide a cost effective way for even smaller printers to import paper (industry role-players, 2006).

Industry role-players consulted indicated that the cost of importing book paper ranges from 4% to 11% of the value of the order (2006).[53] A paper merchant mentioned that 70-80gsm can currently be landed at about USD900/t, while the free-on-board[54] price is about USD800/t. Until earlier this year, imports of uncoated paper from countries outside the EU carried a 5% tariff. This implied that local paper prices could be as much as 16% higher than international benchmark prices without increased import penetration (provided that the landed cost of imports from outside Europe was also 5% less than that from Europe). In August of this year, however, ITAC abolished tariffs on uncoated paper (ITAC, 2006). The practical implication of this is that local paper prices can be at most 11% higher than international benchmark prices in equilibrium.[55]

[52] While the international benchmark price of the relevant paper grade also influence the price of local paper, international paper prices move in cycles and exerts a stronger influence on the price of local paper in the medium to longer term.

[53] While the cost of local bond paper is generally less than the landed cost of imports, the difference is less than 11% (Industry role-player, 2006).

[54] The term “free on board” specifies that the buyer of a good is responsible for all costs incurred in transporting the purchased good (i.e. freight and insurance) once it has been delivered to the seller’s home port or other export staging point. The free-on-board price thus excludes transport costs.

[55] Bulky book paper falls under the headings 4802.61.20 and 4802.62.20 – both of which was reduced to 0 from 5% under the ITAC ruling (Industry role-players, 2006; ITAC, 2006). One paper merchant indicated that they import bulk

In order to evaluate the impact of IPP pricing on book prices, the effect of an 11% decrease in the price of paper on the retail price of books was calculated. For this exercise, a typical breakdown of the components of the retail price of both an educational textbook (shown in Table 10) and a trade textbook (shown in Table 13) was used. The proportion of paper, printing and binding costs was based on the information in Table 7. It was assumed that paper accounts for 34% of the paper, printing and binding costs of trade books (given that trade books on average have a print run of 3 000 units) and 50% of the paper, printing and binding costs of educational books (the estimate of 46.6% in Table 10 was rounded up to 50% to take into account the fact that educational books often have very large print runs). An 11% reduction in paper costs was calculated by removing the customary printers' gross margin of 20% from the original paper, printing and binding costs, and splitting it into a paper cost and a printing and binding cost (using the proportions outlined above). The paper component was reduced by 11% and the 20% margin was reapplied to both components, which were then summed to obtain the new paper, printing and binding cost. The new retail price was calculated based on the new paper, printing and binding cost. The results of this exercise are shown in Table 25 below.

| Cost breakdown of recommended retail price (percentage) | | |
|---|---|---|
| **Cost component** | **Educational book** | **Trade book** |
| Paper, printing, and binding | 10.87 | 12.23 |
| Origination | 13.5 | 6.5 |
| Royalties | 10.23 | 7.51 |
| Publisher's overheads | 28.27 | 20.29 |
| Distributor/ Distribution | 5.36 | 5.46 |
| Bookseller | 29.24 | 45.54 |
| Total | 97.47 | 97.53 |

**Table 25: Effect of 11% decrease in paper cost on retail price (excluding VAT) of an educational book and a trade book**

*Source: Genesis Analytics calculation based on Industry role-players, 2006.*

The exercise shows that an 11% decrease in the cost of paper translates into a 2.53% reduction in the recommended retail price of an educational book and 2.47% reduction in the recommended retail price of a trade book.[56] These reductions take into consideration the effect of margins throughout the value chain:

paper under the heading 4802.57.20 while another has traditionally imported under 4802.57.90. The tariff on the former code was reduced to 0, while the latter is to be phased down from 15% (outside the EU) and 13.5% (EU) to 0 in 2012 (ITAC, 2006). Given that the former code is to be reduced to 0 immediately, and that the paper merchant who provided the 4802.57.90 mentioned that all tariffs are now 0, it seems that all imports will be under the 4802.57.20 code – at least until 2012.

[56] Although these numbers refer to the recommended retail price of books excluding VAT, they are also valid for the recommended retail price including VAT since scaling both the original and new prices up need to be scaled up by 1.14 to calculate the VAT inclusive price.

had this not been the case, the recommended retail price would only have been reduced by 0.63% for educational books and 0.47% for trade books. These calculations suggest that IPP in the local paper market has a relatively small impact on the cost of books.

An issue which is often raised in conjunction with whether or not IPP increases the price of books is whether or not paper price changes are passed on to consumers. This is unfortunately not a question that can be easily answered. Production price index information is only available for the printing and publishing sector as a whole. PICC (2005) states that the printing and publishing sector accounts for 25% of the domestic demand for paper. An industry role-player (2006), however, mentioned that book printing constitutes only 5% of printers' work. The dynamics in the markets for magazine and newspaper printing are very different from books, since advertising revenue constitutes the bulk of income – as opposed to books where income is derived exclusively from the cover price of a book. Furthermore, Statistics South Africa's definition of the publishing industry includes publishing of recorded audio materials.[57] Thus, while information provided by an industry role-player suggests that price changes in paper are absorbed in the margins of firms in the publishing and printing industry as a whole, it is not possible to make any comments about the situation in the book industry.

### 4.1.5. PRINTING COSTS

Some industry role-players suggested that there is limited competition in the book printing market due to the fact that publishers tend to only ask for quotes from the same 4 or 5 printers. While there may be valid reasons for this situation (for example, one trade publisher mentioned that due to bad experiences in the past, they only deal with printers that have in-house binding facilities and a reputation for providing high quality books), this does reduce price competition.

This lack of competition is largely a result of the risky nature of book printing locally. The collapse of educational spending led to significant consolidation in the printing market and seriously damaged the competitive dynamics in this sector (see Section 2.2.1), and there remains doubt as to future patterns of educational spending (industry role-players, 2006). As a result, even though there is currently over-capacity in the printing industry as a whole, most printers tend to steer clear of the book printing market (industry role-player, 2006). In addition, whereas in international markets even smaller book printers tend to go for more efficient reel printing presses, all but the biggest local book printers tend to use sheet-fed printing presses (industry role-player, 2006). Sheet-fed presses, as opposed to

[57] Statistics South Africa website: http://www.statssa.gov.za/additional_services/sic/mdvdvmg3.htm#3243%20. Accessed 12 November 2006.

reel-fed presses, are multi-functional and thus allow printers to diversify away from book printing, should this revenue stream dry up again (industry role-player, 2006). Printing presses used for book printing locally also tend to be older and less efficient than presses overseas; this could point to a hesitancy to invest and would be consistent with high levels of uncertainty in the book market (industry role-player, 2006).

As was highlighted in Section 2.2.4, printing plates carry a 10% import tariff from the EU and 15% from the rest of the world. Since all plates are imported, and the tariff generated at most R24m in revenues in 2005, there seems to be no compelling reason for retaining this tariff (industry role-player, 2006).[58]

### 4.1.6. OFF-SHORING OF PRINTING

There was a general consensus among the industry role-players consulted that printing in the East (in particular in India and China) is considerably cheaper than printing locally. The price differential is estimated to be about 30-40%[59] (industry role-players, 2006). Interestingly, industry role-players largely ascribed the price differential to printers' operating costs, which is in opposition to the common perception that it is access to cheaper paper which reduces the cost of printing overseas (industry role-players, 2006). Most role-players consulted believed that paper on average costs about the same in the East as in South Africa, although it was pointed out that there is typically a larger range of paper available to choose from offshore (industry role-players, 2006). One industry role-player mentioned that while paper prices are slightly lower in the East, the publishers were responsible for paying the freight of the books back to South Africa. The upshot of this was that the effective price of the paper when the books landed in SA was similar to that of locally sourced paper.

The general view among the individuals consulted was that labour and capital costs are the main factors reducing the cost of printing in India relative to South Africa. Relatively low wage rates, higher labour productivity and a culture of working many more hours per day than is the case in South Africa are seen as major factors in reducing the cost of printing in countries like India and China (industry role-players, 2006). In China, books are apparently also often printed on newspaper presses during periods of down time (industry role-player, 2006). Apart from the fact that this could give rise to quality issues, South African newspaper presses very rarely have large periods of down time (industry role-player, 2006).

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[58] Genesis Analytics calculation based on value of imports in 2005 (obtained from TIPS SA Trade database) and the maximum tariff of 15%. It is unlikely that all plates where used for book printing.

[59] One industry role-player mentioned that this was still the case at the start of November 2006 when the Rand/USD exchange rate was about 7.5,

Anecdotal evidence suggests that an increasing amount of South African book printing is being outsourced to the Far East (industry role-players, 2006; MAPPP SETA, 2004b). In fact, industry role-players believe that not only are publishers off-shoring, but that even printers are sending books overseas to be printed. In fact, the off-shoring of printing was mentioned as one of the reasons for the diminishing role of finishing houses in book production. According to one source, the large printers are losing out on printing jobs that are being outsourced to companies in India and China. This is forcing them to take on jobs that would traditionally have gone to smaller printers without bookbinding facilities. The net result is that there is less bookbinding being done by finishing houses and more by printers.

There are however challenges to printing overseas. First and foremost is the size of the print runs required. Printers in the East will typically not be interested in print runs that do not run into tens of thousands (industry role-player, 2006). This effectively limits printing overseas to the educational market, and to a lesser extent, non-fiction trade works. The second major constraint is the time required to print the books and ship them back to South Africa (industry role-player, 2006). This limits the ability of industry to print educational books overseas. While educational books have the highest print runs, they face the severest time constraints (industry role-player, 2006).[60] While some publishers did mention that they print time insensitive products like dictionaries overseas, most mentioned that the tight deadlines they work to in the education market prohibit them from printing schoolbooks offshore (industry role-players, 2006).

An added complication is uncertainty regarding how long it will take for the books to be released at the local port they are shipped to (industry role-player, 2006). Publishers are particularly hesitant to ship books to Durban harbour (industry role-players, 2006). This fear seems to be founded, based on a recent article in the Business Day outlining the problems the shipping industry is having with delays at Durban Harbour (Ensor, 2006). The barrier that time constraints pose for printing books overseas is highlighted by the fact that one printer mentioned that the time-sensitivity of educational books is the only reason these books are still printed in South Africa at all.

[60] Based on discussions with industry role-players, a short description of the dynamics in the educational market read as follows: Each educational department has its own style, but generally the educational market works as follows: A date is set by which publishers must submit books for next school year. If books are deemed acceptable by the provincial department of education, they go onto an approved list (they are “adopted”) and into the catalogue of books schools are allowed to order from. Books can also be provisionally accepted subject to certain changes being made. If books are rejected, and thus do not make it onto the approved list, schools are not allowed to order them. Section 21 schools are only limited to ordering from the approved list when using Departmental funds, but Section 20 schools are restricted to the approved list as they do not have own funding. The Department then places orders at the various publishers for the books selected. Only once this happens do the publishers know how many copies of each book to print. The publishers can now contract printers to print the books.

A lot of management time also needs to be invested in insuring that the outsourcing process runs smoothly and that the books arrive in the specified time (industry role-player, 2006). If this is not done, the possibility exists that print jobs can be put on hold in favour of larger jobs for other customers. One publisher mentioned that while the common perception is that the quality of books printed in India is necessarily inferior to that printed locally, if the printing job (i.e. paper and ink used etc.) is specified very carefully, the required quality of book will be received.[61] Finally, one factor that inexperienced importers often neglect to take into consideration is that VAT still needs to be added to the price of books once they land in South Africa (industry role-player, 2006).

The factors listed above imply that printing overseas can be a risky endeavour. The requirement of large runs means that a publisher would need to order the estimated number of books in one go. Given the time delays involved, a publisher needs to order books printed offshore before they receive orders for the book, and the books will already be printed once the orders for the book arrive (industry role-player, 2006). An industry role-player mentioned that they were aware of an educational publisher who had printed 50 000 copies of a book in Malaysia but only received orders for 15 000 copies. Ordering conservatively is however also risky, since it is highly unlikely that a printer overseas will be willing to print a few thousand copies of a book (or at least not at a competitive price) should more orders than expected arrive for a book (industry role-player, 2006).

The barriers to printing overseas may however sometimes be overstated. One industry role-player consulted mentioned that while it is true that the lead times for local printing are quicker in quiet times of the year, this is not the case towards the end of the year when printers are overloaded with orders. During the busy period it usually takes 6-8 weeks for local printers to complete orders, while books can be printed and imported from places like Singapore and Malaysia in 3-4 weeks, provided the publisher has a good relationship with the printer[62] (industry role-player, 2006). The industry role-player believed that the reason for the shorter import lead times is the fact that, while local printers may work overtime during this period, they are not willing to run 24 hours a day 7 days a week to get an order done in the minimum amount of time. This particular industry role-player printed about 80% of their books offshore. This publisher also mentioned that given the mad rush to implement the new curriculum, publishers need to print their books before they are approved anyway, in order not to miss opportunities in the market.

[61] One publisher also mentioned the risk of run-ons (the situation where the printer prints additional copies of a book and sells it to someone else who then imports it to South Africa. While this might be a problem for generic items like dictionaries which also have very large runs, the market for most South African books are so small that it is unlikely to be a problem (Industry role-player, 2006).

[62] Interestingly, the industry role-player mentioned that orders from India could take up to 2 months to arrive in South Africa.

The one area where offshore printing is ubiquitous is full-colour and glossy publications. A high proportion of interviewees indicated that they mostly print these types of books in the East. One publisher stated that off-shoring this product type is 20% to 30% cheaper than printing in South Africa, after taking freight costs into consideration, while another mentioned that depending on the characteristics of the book, the cost saving could be as high as 50% to 70%.

### 4.1.7. VAT ON BOOKS

The possibility of a VAT exemption on books has been suggested by a number of commentators as a relatively easy way to reduce the cost of books and grow the South African book market (see for example BDCSA, 2006; DACST, 1998; Combrinck & Davey, 2000, Thumbadoo, 2004). Canoy et al (2004) suggests that the consumption of books can be increased by reducing the specific VAT rate on books, and points out that all European countries (bar Denmark) have a differentiated VAT rate on books, with the UK and Ireland going so far as to remove VAT on books altogether. These differentiated VAT rates are largely used as a way to increase book sales and reading in general, since it is difficult to promote specific cultural aims with such a broad instrument. The differentiated rates thus apply to "cookbooks as well as more esoteric poetry collections" (Canoy et al, 2004:27). Canoy et al (2004) also state that government sees interventions in the book market, such as differential VAT rates on books, or subsidies to public libraries and bookshops, or literary prizes and grants, as a way of signalling that books do not only have economic value, but also cultural value.[63]

Similar advantages would no doubt accrue if a reduction in VAT was introduced in the local market. In South Africa, however, there would be both advantages and disadvantages to doing so, and it is not clear cut that the net effect of the policy would be advantageous. For example, there has been some debate as to whether small booksellers would be able to handle the administrative burden of multiple VAT rates. Also, in order for the social benefits from a reduction on the VAT on books to outweigh the cost of say, increased administrative costs and reduced tax revenues, the reduction in VAT would need to lead to a significant increase in book consumption. This implies that books would need to be relatively price elastic. Before a convincing argument for a rethink of the VAT regime applicable to books can be made, the price elasticity of books would need to be evaluated for the different market segments.

Some potential issues as regards introducing VAT relief for books are discussed below.

[63] For a discussion of the cultural and economic values of books, and the interaction of the two, see PICC (2005).

**Equity**: it would be hard to justify a reduction in VAT on trade books on equity grounds, since in the short run, most of the benefit of such a move would go to the traditional target market for trade books in South Africa – namely higher-income urban dwellers. This point was highlighted by the Minister of Finance in his 2004 budget speech when he mentioned that "the case for reducing [VAT] on, say, magazines and coffee-table publications, is not compelling. As it happens, the tax loss would be large, and would very largely go to higher income households" (Manuel, 2004:25). In the long run, a VAT reduction could be used to support the sale of more books to lower income individuals, but this would probably need to be accompanied by other policy initiatives supporting equity goals in order to be effective.

**Administration**: when considering the reduction of VAT on books, it must be kept in mind that "[t]he definition of a 'book' for tax purposes raises challenges" (Manual, 2004:25). For example, it would be difficult to distinguish between books and magazines. Given the above equity concerns, it might also be best to distinguish between books as regards VAT rating. For example, the argument for a reduction in VAT is stronger for educational books, which are distributed, on average, to a lower income group. This assertion is supported by BDCSA (1997) who recommended that public expenditure on educational books not be subject to VAT. DACST (1998:40) also argued that academic books should not be subject to VAT as they fall "within the field of public education." It would however be problematic to only reduce the VAT on educational and academic books. The dividing lines between these two market segments and trade books are often arbitrary. Educational readers, for example, are often sold in trade bookstores (industry role-player, 2006). It would also be difficult to draw the line between general academic works aimed at the scholarly market and trade books. Some of these titles, especially those related to the social sciences, regularly make their way to general bookstores.

**Zero-rating or exemption**: the issue of whether books would be zero-rated or exempt for VAT purposes would need to be clarified. When a product is zero-rated, VAT paid on inputs in the production of the product can be reclaimed as input VAT. When a product is VAT exempt, however, this is not the case. If books are VAT exempted, it would increase operating costs throughout the value chain as the VAT paid on inputs cannot be reclaimed. Exempting books from VAT could also hamper the development of new firms in the book industry since they will not be able to claim input VAT on their start-up capital costs. Thus, while zero-rating books (i.e. levying a VAT rate of zero on books) will be to the advantage of firms in the book value chain by reducing the reducing the price of their outputs, a VAT exempt status would be the worst possible outcome for the book industry.

While the arguments put forward in this section by no means preclude the possibility of a reduction in the rate of VAT on books (as evident in the widespread use of lower VAT rates on books overseas), they do illustrate that it is a decision that is not to be entered into lightly.

## 4.2. THE EDUCATIONAL BOOK MARKET

### 4.2.1. DECENTRALISED PROCUREMENT

The most important factor viewed by industry participants as increasing the cost of schoolbooks is the decentralised system of textbook procurement, where each provincial department of education is responsible for screening and ordering its own textbooks (see footnote number 60 on page 58) (industry role-players, 2006). Apart from the fact that multiple and differing submission processes are costly for publishers, the decentralised system as implemented currently reduces economies of scale, since the cut-off dates for orders in the different provinces are not synchronised, and publishers are not able to pass on consolidated orders to printers (industry role-players, 2006). Also, not only do orders from the various provinces not reach publishers at the same time, but orders in some provinces are relayed to publishers in drips and drabs, further reducing economies of scale in printing (industry role-players, 2006). In the Eastern Cape and KwaZulu Natal, for instance, orders are received in three phases (industry role-player, 2006). Orders are also often late – forcing printers to work overtime and further increasing the cost of printing (industry role-player, 2006).

While the screening of Grades R to 9 is envisaged as remaining decentralised, screening books and compiling the catalogue for Grades 10-12 will be the responsibility of the National Department of Education in future (industry role-player, 2006). This is to pave the way for the scheduled harmonisation of Grade 12 exams in all provinces in 2008. This system is expected to cause a big improvement in the time it takes to compile the catalogues for the individual provinces (industry role-player, 2006). Grade 11 has already been implemented on this basis, in 2006. The submitted books were screened early in the year (by the National Department of Education) and a national catalogue was circulated in May (industry role-player, 2006). The individual provinces now know which books to include for Grade 11 in their catalogues. The National Catalogue for Grade 11 is thus included as is in the Eastern Cape catalogue, for example (industry role-player, 2006).

The publishing industry is currently spending R15-R20m on submission costs and fees to get their books included in provincial catalogues (currently three grades are being implemented each year) (industry role-players, 2006). It is expected that the

move towards national selection of schoolbooks will significantly reduce this cost. One of the publishers interviewed mentioned that there are however still some coordination problems between the national and provincial departments of education. Despite being included on the national Grade 11 approved list, some of their books were not included in the approved lists of some provinces.

Schoolbook publishing is a very risky industry – small publishers often only submit only one book a year (whereas large publishers may submit many books); if this book is not accepted they are in serious trouble (industry role-player, 2006). Although the centralisation of catalogue development is expected to lead to greater efficiency in the supply of schoolbooks, it does increase the risk for publishers. When a book in one of the lower grades does not make it onto the catalogue for a specific province, there is still the possibility that it could be accepted in another province (industry role-player, 2006).

Including all submitted books on the approved list, however, is also detrimental to the publishing industry. One publisher mentioned that only Grade 11 textbooks were screened by the National Department of Education, while all the submitted literature books were included on the approved list. The publisher believed this was due to capacity constraints at the National Department of Education. While the fact that all the books were included in the list may at first glance seem to be beneficial to the publishing industry, since more publishers have the opportunity of selling their books, economies of scale are destroyed as the available orders are split over a larger number of books.

Given these factors, there is little doubt that synchronised central orders, with aligned cut-off dates for orders in all provinces, and national screening of all grades, would be more cost efficient for the book industry as a whole (industry role-player, 2006). The National Department of Education would also need to create a cycle for submissions of books (and then stick to it), in order to reduce uncertainty in the educational book market (industry role-player, 2006). If consolidated orders are received in a timely fashion, there would also be more scope for educational publishers to reduce their printing costs by off-shoring printing (see Section 4.1.6) (industry role-player, 2006).

### 4.2.2. UNCERTAINTY

Unpredictability on the part of the national and provincial departments of education is seen as increasing the cost of educational publishers and hence the price of educational books (industry role-player, 2006). For example, Grade 6 (implemented under Curriculum 2000) only lasted one year before being replaced by the Revised National Curriculum Statement (RNCS) (industry role-player, 2006).

Many educational books only recoup their investment costs after 2 years, and one educational publisher mentioned that they would only have started to make a profit on the Grade 6 books after 2-3 reprints. This experience has caused publishers to rethink their pricing models, and increase them so as to build a profit into their costing from year 1 (industry role-player, 2006).

Another example of curriculum uncertainty is the decision to bring forward the implementation of Grade 9 from 2007to 2005 (industry role-player, 2006). This led to increased pressure on publishers' time resources, which increased costs (industry role-player, 2006). As a final example, an educational publisher mentioned that after publishers had already incurred the usual promotion and marketing costs in the Northern Cape earlier this year (i.e. marketed books to schools), the provincial department of education in that province decided to order books on behalf of schools – effectively rendering all marketing and promotion spending useless.

Publishers also mentioned that they often received requests from provincial departments of education less than two months before the submission date (industry role-players, 2006). One publisher mentioned that this put considerable strain on them and increased costs, since they ideally need 14 months to produce a quality textbook from scratch (industry role-player, 2006). Not only do such extreme turnaround times increase origination costs, but authors often need special incentives to motivate them to work under such extreme conditions (industry role-player, 2006). Furthermore, since all publishers are in the same boat, they are all trying to recruit additional freelancers at the same time – which drives costs up even further (industry role-player, 2006).

Uncertainty about the flow of educational orders from government is also one of the factors preventing smaller printers from ordering paper in bulk from paper merchants at more competitive prices (see Section 4.1.2). One smaller printer mentioned that if there were clearer trends in book buying from the central government, they would be confident enough to put in larger orders to paper merchants far enough into the future to also have access to indented paper (industry role-player, 2006).

### 4.2.3. BARRIERS TO ENTRY

The educational market is currently structured in a way that does not encourage entry by new participants. Of the 12 new educational publishers that entered the market after 1994, only 2 are left in the market (industry role-player, 2006). The main factor counting against new and/or smaller players is the large marketing cost in education (see Section 2.3.3.2). This seems to be a result of the way the market

is structured. Currently schools only order books in the year that a new grade is implemented, and then again whenever the Education Department decrees. One publisher mentioned that the Foundation Phase textbooks were implemented in 2003, and that they suspect the next significant purchase of these books will be in 2008. Between the implementation and the next significant purchase a “top-up” system is utilised, whereby a certain percentage of the titles that were initially ordered are sent to each school annually, regardless of actual wastage and loss of books and changes in learner numbers (industry role-player, 2006). This creates incentives for publishers to spend large amounts on “locking-in” such future sales by aggressive marketing techniques in the initial sales period.

The way in which grades are implemented also increases the cost of marketing. Grades 8, 9 and 11 were all implemented this year, but publishers were only allowed to promote books to schools for a period of one week, and on three different dates for each grade (in May, July and October) (industry role-player, 2006). This effectively tripled the overhead costs of promoting books, since publishers had to visit school three times. The higher the necessary marketing costs, the less likely it will be that small publishers will be able to afford the marketing investment, and thus participate effectively in this market.

The uncertainty created by the educational authorities also disadvantages smaller publishers. One smaller publisher mentioned that the decision to move the implementation of Grade 9 forward cost them an additional R6m in expenditure – a significant amount for a small publisher without large financial reserves.

One educational publisher mentioned that promoting textbooks by distributing sample chapters of books (known as “blags”), rather than the actual book itself, would not only lead to significant cost savings in the industry, but would also level the playing field between large and small publishers. Introducing such a system would require some expenditure on training teachers how to use blags to pick books, but even given this, savings are possible. This role player also mentioned that of the 12 new educational publishers that entered the market after 1994, only 2 are left in the market.

Uncertainty about future textbook orders was, however, mentioned as the main factor discouraging entry into the educational book market (industry role-player, 2006). The printing industry is a case in point. While smaller players face additional barriers to entry like high capital costs – a problem which is exacerbated by a decline in the number of finishing houses, necessitating additional investment by entrants in book-binding facilities – the fact that printers are shunning book printing despite overcapacity in the printing industry as a whole points towards uncertainty

about the viability of the market as the main factor discouraging new entrants (see Section 4.1.5).

### 4.2.4. PRICE INSENSITIVITY

The publishers were in agreement that price did not seem to be one of the characteristics on which submitted books were judged. The various educational departments are currently only screening books on content and production quality (e.g. by requiring that books be printed on “quality paper” and that bindings, covers and so forth are of an “acceptable standard” (industry role-player, 2006)). It is generally accepted that books must be of sufficient quality to last for 2 to 3 years (industry role-player, 2006). However, one publisher felt that the education departments are accepting books that will last for periods well in excess of three years, and sees this as one example of a lack of price ethos in the educational book market – as this over-specification presumably has implications for the cost of books.

While some publishers pointed out that the cost of a book is amortised over the life of a book, meaning that the effective cost of a book is reduced the longer the book is in use, most were in agreement that the low level of schoolbook retention invalidates this argument in the short term. Research by Proudfoot Consulting, quoted in Asmal (1999:1) found that book retention in primary schools is mostly “non-existent or less than 20%” and on average about 40% for secondary schools. While the best case scenario would be to create the capacity at schools to foster high book retention rates (by, for example, by equipping them with lockable bookstores), this is only achievable in the medium to long term (industry role-player, 2006). In the mean time, the National Department of Education should lay down clear specifications of both minimum and maximum acceptable standards for textbooks in different grades as a way of encouraging publishers to create textbooks as cheaply as possible (industry role-player, 2006).

Until a saturation point has been reached, where every learner has an acceptable quality textbook for every subject, price should be an important consideration in the educational book market (industry role-player, 2006). One publisher mentioned the example of Kenya, where educational publishers actively compete on price and advertise their books as a way for schools to “stretch their government allocations”.

The lack of price ethos in the local educational market has created perverse incentives, in that it is very difficult to compete on a price basis. One publisher mentioned that they had tried a strategy of aggressively competing on price, but that they could not get their books distributed and in the end had to increase their prices. The reason for this was that distributors charge a percentage of the value of

the book to distribute it, and as a result favoured expensive textbooks (many of which have specifications in excess of those laid down by the education departments).

One publisher pointed out that since the prices of books are set in advance, any reduction in printing costs as a result of consolidated orders would end up as a higher margin to the publishers. What is implicit in this statement is the (unproved) assumption that the publisher would have no intention of passing on reduced costs to customers. Publishers also mentioned that there was uncertainty in some cases about what percentage of the booksellers' discount of 30% was passed on to schools by firms that won tenders to supply textbooks, particularly in cases where these firms are already paid a fee to administer the distribution process.

One educational publisher, however, pointed out that uncertainty about educational spending is one of the reason publishers do not compete on price. The fear exists that if prices are lowered, the education authorities will purchase the same amount of books at a lower cost. Publishers are thus not convinced that lower prices will translate into more books being purchased.

### 4.2.5. ALLEGATIONS OF CORRUPTION

The research process uncovered widespread and consistent allegations of corruption in the educational book market. If true, this may be to some extent a consequence of the lack of price sensitivity in the educational book market: it becomes easier to influence the purchasing decision when choice does not need to be justified on price grounds.

A number of specific allegations were made by industry role-players, all of which are hearsay-based and thus must be treated with caution. For the interest of the reader, however, examples of allegations include: teachers offering to influence other teachers to order certain books in return for kickbacks; public officials in charge of large budgets offering to let publishers choose which books to supply in return for a percentage on the value of the transaction; all manner of sponsorships to schools and/or teachers unions in return for orders; kick-backs to distributors; and a strong suspicion that administrative staff are being bribed to change orders at order processing centres. Further research would be needed to substantiate these claims, but to reiterate, they were consistent and widespread enough to suggest some substance.

In addition to the direct cost of bribes, lost sales and so forth, corruption reduces the ability of publishers to forecast sales. Under normal circumstances, publishers mentioned that it is possible to infer sales of Grade 8 textbooks, for instance, based

on sales of the same textbook for Grade 7. The reason for this is that teachers tend to stick to textbooks which they and the learners are familiar with (industry role-players, 2006). In recent years, however, this relationship seems to have broken down, and some publishers felt that this was a sign of underhanded practices. The greater uncertainty about sales makes it more risky for publishers to print books in bulk in advance of receiving orders, which in turn increases printing costs (industry role-player, 2006), as well as the risk of printing offshore.

#### 4.2.6. GOVERNMENT CONTRACTING

Some industry role-players expressed concern about the level of discretion that has been given to certain distributors to purchase books on behalf of educational authorities, as this removed government oversight on public spending. One publisher also mentioned that educational authorities seemed to lack insight into the functioning of the educational book market – in particular the vertical linkages among firms. When contracting with a distributor or bookseller that is vertically integrated with a publisher, for instance, there is likely to be a conflict of interest, as it would be more profitable to give preference to books by the publisher that is part of the same group (industry role-players, 2006). The educational authorities need to take these linkages into consideration when contracting in order to insure that the market functions as efficiently as possible.

## 4.3. THE TRADE BOOK MARKET

### 4.3.1. SIZE OF THE TRADE MARKET

Industry role-players concurred that the main factor increasing the cost of trade books in South Africa is the relatively small size of the market for these books. If the cost of trade books is to be reduced, the size of print runs will need to increase. In order to do so, the appeal of trade books needs to be extended beyond the relatively narrow middle-class urban segment that trade bookstores currently cater to (industry role-player, 2006).

In building the market, however, one industry role-player felt that too much emphasis is being placed on creating a reading culture – which is a longer-term solution – and not enough emphasis is placed on identifying and entering new markets that may already exist. There is a lack of market research by trade publishers and as a result opportunities are likely to be missed (industry role-players, 2006). This view was shared by a trade publisher who mentioned that they are currently developing mass market titles explicitly aimed at the emerging black middle class (or “black diamond”) market. The publisher mentioned that while the opinion is often raised that there are too few black authors, this problem can be

overcome by pairing inexperienced authors with experienced development editors[64].

### 4.3.2. LIMITED DISTRIBUTION POINTS

A significant problem facing the expansion of the trade market is a lack of bookstores located outside urban and predominantly wealthy areas (BDCSA, 1997; industry role-players, 2006). As a result of the tender system in the educational market, many independent booksellers who used to serve rural areas have closed down in recent times (BDCSA, 1997; industry role-players, 2006). Educational books accounted for the bulk of these independent booksellers' revenues, and enabled them to carry slow-moving trade titles as a by-line. One industry role-player mentioned that even relatively big booksellers like CNA and Juta Bookstores had to review their business model as a result of a significant downturn in their educational sales (industry role-player, 2006).

The lack of a suitable distribution channel is stated as one of the main reasons that more publishers have not branched out into indigenous language publishing (industry role-players, 2006). Not only indigenous language, but also English books aimed at non main-stream markets, are struggling as a result of the lack of access to bookstores. One publisher mentioned that despite generating very positive reviews and considerable media coverage, a local content book they published did not perform nearly as well as expected. They believe this was due to distribution of the book not reaching its target market (although they did add that it may have been slightly overpriced) (industry role-player, 2006).

Trade publishers mentioned that the concentration of the bookselling sector in South Africa is affecting their publishing decisions – before going ahead with a new project they need to consider whether or not it will be carried by the major bookselling chains. If this is not the case, it is highly unlikely that a title can be published profitably. PICC (2005) mentioned that book clubs and internet retailing have not managed to increase access significantly. This sentiment was borne out by industry role-players consulted, who mentioned that these services essentially catered to the same target market as mainstream bookstores.[65] It is also interesting to note that Kalahari.net seems to have decided to compete with brick and mortar bookstores on convenience rather than price (see Section 2.3.3.3).

Many publishers are however trying their hand at publishing children's books in indigenous languages. These books can be distributed as readers through the

[64] The publisher did however mention that there was a shortage in good development editors – that is editors who not only edit a book but actually help develop the storyline and structure of the book.
[65] Shuter & Shooter publishers launched a isiZulu bookclub in the mid nineties that failed (BDCSA, 1997).

school library network, and thus do not face the same kind of access constraints as general trade books (industry role-player, 2006). Sales to the school library market are intermediated by library suppliers, and usually range between 5 and 500 books. These books are mostly translated from another language in order to save origination costs, and because most publishers do not currently have the necessary skills in-house to originate a book from scratch in an indigenous language (industry role-players, 2006). The risk in producing indigenous language books can be further reduced by marketing these books as prescribed readers. One publisher however mentioned that this process is complicated by the fact that the educational authorities do not provide clear guidelines on how to go about getting a book adopted as a prescribed reader. The publisher mentioned that they submitted an isiZulu translation of a French children's classic to the KwaZulu Natal Department of Education, and that the book was turned down because it was not accompanied by a teacher's guide.

#### 4.3.3. LIBRARY SYSTEM

The general consensus amongst industry role-players was that the library system is not realising its potential as an engine for growth in the trade market. Not only could the library system serve as a distribution channel for indigenous language content, but the sale of a few hundred copies of a book to this market will increase print runs and reduce the risk associated with publishing such books (industry role-player, 2006). Publishers interviewed felt that the most effective intervention the government can make in the trade market is to provide them with more opportunities to sell books. One publisher mentioned that despite 2006 being the Year of African Languages, the Department of Arts and Culture did not purchase any African language books to mark the occasion.

## 4.4. THE ACADEMIC BOOK MARKET

### 4.4.1. SIZE OF THE ACADEMIC MARKET

The major factor increasing the cost of academic books in South Africa is relatively small print runs (industry role-players, 2006). One academic publisher mentioned that they are looking to increase print runs through exporting academic books (industry role-player, 2006). One way in which they do this is through co-publication of some of their titles with Australian publishers (see footnote 20 on page 16). The publisher is also actively promoting their health list to the rest of Africa. They mention that the fact that both developing and developed country health issues are typically covered in South African health textbooks makes them well suited for export to the rest of Africa and other developing countries.

The price of scholarly books, in particular, is increased by the small local market. Grey (2000:178) mentions that, not only are there insufficient outlets willing to purchase scholarly books, but there are “too few serious readers in the community with enthusiasm for serious books.” One industry role-player mentioned that the problem of a small market for scholarly books was exacerbated by the tendency of academics to purchase the majority of their books online. When doing so, however, they tend to only compare the purchase price of books from local internet retailers like Kalahari.net with international internet retailers like Amazon.com (industry role-player, 2006). The reason for this is that delivery costs are often paid from a separate budget and, as a result, are ignored by academics (industry role-player, 2006). This can create the (often incorrect) impression that imported books are cheaper, since all the costs of acquiring the books are not taken into consideration (industry role-player, 2006).

### 4.4.2. LIMITED SELL-THROUGH OF ACADEMIC TEXTBOOKS

The problem of a small academic market is worsened by sell-through rates that are often as low as 50% for academic textbooks (industry role-player, 2006). The main reasons for these low sell-through rates are illegal photocopying of books, and lecturers who do not encourage the purchase of prescribed textbooks (industry role-players, 2006). Sell-through rates also vary as a result of factors like ease of access to academic bookstores, and whether or not there is a culture of book-buying at the tertiary institute in question (industry role-players, 2006). Industry role-players mentioned that the photocopying problem is worsened by the appearance of illegal photocopying shops close to the campuses of tertiary institutions. They also mentioned that current copyright legislation makes it a cumbersome process to close down these illegal photocopying shops.

### 4.4.3. UNDER-ORDERING BY ACADEMIC BOOKSELLERS

As a result of low sell-through rates, academic booksellers do not have confidence in the enrolment numbers they receive, and tend to under-order textbooks (industry role-players, 2006). This increases the sell-through problem, since there is a critical period at the start of the year when students both have money and are interested in buying textbooks (industry role-player, 2006). Booksellers then often need to fly in books at short notice (or require publishers or publishers’ agents to fly in the books) when they receive more orders than they expected (industry role-player, 2006). Having to fly in books adds an additional 10% to 20% to the cost of the books and this cost is often passed on to students (industry role-players, 2006). This leads to resistance to purchasing on the part of students and creates a vicious circle, where low sale-through numbers and under-ordering feed off each other (industry role-player, 2006).

### 4.4.4. LACK OF COORDINATION IN THE ACADEMIC MARKET

Academic booksellers are often not given book/adoption lists in time to use cheaper freight options, and prescribed books are often changed without informing booksellers, which leads to books having to be flown in and thus increases the costs of books (industry role-player, 2006). Lists are also often provided on an ad hoc basis by individual departments (industry role-player, 2006). It is believed that the introduction of institution-wide adoption lists and enrolment figures would increase efficiency, as it would allow booksellers to order books in bulk (industry role-player, 2006).

An additional problem that is currently experienced is that publishers and publishers' agents typically do not see adoption lists, since many booksellers consider access to adoption lists as a competitive advantage (industry role-player, 2006). While publishers and publishers' agents try to keep up-to-date databases of enrolment numbers and prescribed books at the different institutions, they are often only able to form an accurate picture of the demand for their books when they start to receive orders from bookstores (industry role-player, 2006). This uncertainty makes it hard to print or import the correct number of books and often leads to additional books having to be printed or imported at short notice and higher cost (industry role-player, 2006). The situation with imports is complicated by the fact that orders are typically received from bookstores from October to February, while the window period for ordering books from the UK (where the main tertiary semester begins in May) is May to July (industry role-player, 2006).

### 4.4.5. POTENTIAL CONCENTRATION ISSUES

Some industry-role players mentioned that while it is not currently a problem, they fear that the concentrated nature of the academic bookselling market may increase the price of academic books in future. Van Schaik has now established bookstores on the campuses of most of the main tertiary institutions in South Africa, and their dominance in the academic retail market is unlikely to be challenged in the near future (industry role-player, 2006).

An interesting development in the academic retail market, however, is a greater emphasis on e-commerce. Van Schaik Bookstores and Kalahari.net have entered into a strategic partnership whereby Van Schaik Bookstores provides Kalahari.net with academic books and they jointly agree on a retail price for the books (industry role-player, 2006). Juta & Company is also currently revamping their online bookstore and will initially aim to serve students at Unisa and one or two other large institutions (industry role-player, 2006).

Brainbooks have an interesting telephone-based e-commerce model, with a Dial-a-book service where students phone and ask for a quote on a book. The book can then be purchased via a bank deposit, and is delivered for free.[66] This move towards e-commerce is likely to stimulate competition in the academic bookselling market, and may alleviate concentration concerns.

[66]Brainbooks website: http://www.brainbooks.co.za/home.html. Accessed on 9 November 2006.

# 5. RECOMMENDATIONS AND CONCLUSION

The research identified a number of factors which industry role-players felt were increasing the cost of books in South Africa. Some of these factors can be resolved within a given industry, but it is worth noting that **co-ordination problems** between firms in different segments of the value chain are also an issue. There is thus a need for the book industry to identify the areas where it should focus its collective efforts to achieve the greatest impact in reducing the cost of books locally.

The traditional scapegoat of South African book prices, namely IPP pricing practices in the paper market, does undoubtedly increase the cost of books. However, the **net impact of IPP seems to be relatively modest**. Coupled with the fact that book printing constitutes only a small portion of the paper market locally, it seems unlikely that efforts to reduce the cost of local paper via a ban on IPP practices would lead to a significant reduction in the cost of books. It is also noteworthy that **little evidence of excess profit-taking** at any point in the value chain was found in the book industry.

**Smaller players across the value chain find it difficult to compete** in the book industry. Small printers are faced with high capital start-up costs and this problem is likely to increase as a decline in the number of finishing houses forces printers to invest in in-house binding facilities. Other cost factors include the difficulty that smaller firms have in pre-buying paper in bulk, or investing in more efficient single-purpose book-printing equipment. Smaller publishers in the educational market are less able to cope with high marketing costs and uncertainty about syllabus implementation dates. Small trade publishers may find it hard to gain access to a retail distribution network with a relatively narrow focus. Small booksellers, on the other hand, are finding it hard to get access to the lists of big publishers as a result of the limited uptake of EDI technology locally. Across the value chain, smaller players also bear the brunt of a shortage of skilled labour, since they cannot match the pay packages offered by bigger firms.

The research suggests that many of the factors increasing the cost of books in South Africa, like the limited size of the trade and academic markets, are largely beyond the control of the book industry in the short term. In the long term, it may however be possible to capitalise on economies of scale, by improving distribution, market research, and marketing so as to **grow the book-reading market** in South Africa.

## 5.1. POLICY RECOMMENDATIONS

We conclude with a list of recommendations that could potentially reduce the cost of books in South Africa. While some of these recommendations may not reduce the cost of books in the short term, over the longer term they should contribute to the kind of sustained efficiency improvements that are necessary to systematically reduce prices.

The recommendations are divided into general and market segment-specific recommendations, and are further broken down according to whether they fall under government or industry's sphere of influence. In each section, a number of recommendations are made. Although it would of course be optimal to implement all of these recommendations, they need not be seen as an "all or nothing" package, and a gradualist approach to change would also reap dividends. We have attempted to rank the recommendations in each section, starting with those which we believe will have the largest impact (and where possible, prioritising those that will require the least effort to implement).

### 5.1.1. GENERAL ISSUES

**Government**

- *Import tariffs on printing plates* should be dropped, as they are the only remaining tariffs affecting the book industry, and the revenue loss to government will be minimal.

**Government/Industry**

- Greater emphasis needs to be placed on *training*, across all segments of the book value chain, to alleviate a general skills shortage in the book industry. Greater support for current training institutions may be appropriate.
- Industry bodies should *research new technologies* like print on demand and EDI, and *champion their adoption* by industry if potential cost savings are found to be substantial. EDI in particular would support the goal of realising operational efficiencies through *better coordination* between the various parts of the value chain, and means should be found to improve coordination in the relationship between publishers and printers as well.

### 5.1.2. THE EDUCATIONAL MARKET

**Government**

- *Price should be included as a criterion* for judging educational material submitted for approval by publishers. This also implies that the over-specification of educational books should be dealt with, by imposing both minimum and *maximum quality standards*.
- *Allegations of corruption should be investigated* by relevant authorities, and structures like anonymous hotlines and improved auditing of LTSM procurement should be put in place to discourage corruption in future.
- Opportunities to market books to schools should be structured in a way that minimises marketing costs by, for example, *restricting publishers to only providing sample chapters* for evaluation purposes, and allowing publishers to market books for multiple grades at the same time. This should ultimately feed through to lower book prices, and help to level the playing field for smaller publishers.
- The system of ordering textbooks should be rationalised. This should include the following components: firstly, a schedule of planned large-scale purchases of educational books (or curriculum changes) on a national (preferably) or provincial level *should be available well before the event* (and preferably at least 2 – 3 years before), to facilitate planning by players throughout the value chain. Secondly, a system of *aligned cut-off dates for orders in all provinces* and *national screening* of educational books for all grades (with the possibility of limited screening at provincial level for say language texts) should be advocated.
- Administrative and physical structures (like book storerooms) should be put in place to *enable effective book retention* at schools. Once these structures are in place, the minimum and maximum specified quality standards for education books should be adjusted based on the fact that books can then realistically be expected to be used for longer periods of time.
- Government contracting in the educational market should be made more transparent and efficient, by requiring firms to *disclose conflicts of interest by vertically integrated firms* and by specifying a set of *verifiable criteria for book selection* decisions.
- Procedures and guidelines for the approval of educational readers should be clearly specified to *encourage an overlap between trade and educational* books, and thus enable greater scale efficiencies to be reaped.
- The use of own-buy markets for Section 21 schools should be encouraged to stimulate the *development of new general booksellers*, particularly in poor and/or rural areas.

The fact that all the recommendations with respect to the educational market fall directly under the influence of the government should not be seen as an indication that the book industry does not have a role to play in creating a more efficient market for educational books. The recommendations, if implemented, will lead to significant changes in the way the educational market in South Africa functions. It is unlikely that government will implement such changes without the support of industry bodies. Industry bodies would also need to convince their constituents that these recommendations will lead to a healthier educational book market in the long term. Some larger educational publishers, for instance, may not be happy with the recommended changes to the way educational books are marketed, since this will increase the competitiveness of smaller players.

The first three recommendations, namely including price as a criterion for judging submitted books, investigating corruption and reducing marketing costs, are believed to be the “low-hanging fruit” in this market and could potentially have the largest influence on the cost of books in the shortest period of time.

### 5.1.3. THE TRADE MARKET

**Government**

- The *library market should be used as a driver for growth* in the trade market, through the use of dedicated funding to provincial and municipal libraries for the purchase of local (and particularly indigenous language) books suitable for the area the library is situated in. A minimum level of such purchases in monetary terms should be specified and enforced.

**Industry**

- An emphasis should be placed on *growing the trade market*, in order to realise economies of scale. Initiatives towards on this goal should not only focus on creating a reading culture locally, which is a longer-term strategy, but also on using market research to identify untapped markets that may already exist.

In the long term in particular, growing the trade market has great potential, as can be seen from the success of such initiatives in similar markets. For example, the growth of the South African music industry, supported by local content requirements on radio and television, must be seen as instructive.

### 5.1.4. THE ACADEMIC MARKET

**Government/Industry**

- *Up-to-date institution-wide adoption lists and enrolment figures* accessible to both academic booksellers and publishers, and publishers' representatives, are needed. Ideally, one central database for all tertiary institutions in South Africa should be created.
- *Closer interaction between publishers, publishers' representatives and academic booksellers* is necessary to reduce the problem of under-ordering of tertiary textbooks by booksellers.

Issues in the academic book market to some extent reflect wider concerns about institutional capacity at South African tertiary facilities. It may thus be difficult to achieve great improvements in this market, without first seeing improvements in general management at the institutions which require the books. There may thus not be true "low-hanging fruit" in the academic book market.

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- Industry Associations contacted: Paper Manufacturers Association of South Africa (Pamsa), Printing Industries Federation of South Africa (Pifsa), Publishers' Association of South Africa (PASA), South African Booksellers' Association (SABA).
- Paper manufacturers and paper merchants – 4
- Book Printers – 5
- Finishing Houses – 4
- Publishers: Educational Publishers (8), Trade Publishers (7), Academic Publishers (5)
- Distributors: Educational distributors (3), Trade distributors (5), Academic distributors (3)
- Booksellers: Educational Booksellers (3), Trade Booksellers (5), Academic Booksellers (3)
- Independent consultants – 3

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# GLOSSARY

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|---|---|
| **Academic books /market** | •Academic books include books aimed at the tertiary education sector. It also includes books produced for the legal, accounting and similar professional industries. |
| **Approved list** | A date is set by which publishers must submit books for next school year. If books are deemed acceptable by the provincial department of education, they go onto an approved list (they are “adopted”) and into the catalogue of books schools are allowed to order from. |
| **Bond Paper** | Bond paper is a type of uncoated woodfree paper. The bulk of South African paper is printed on bond paper, which is both imported and produced locally. |
| **Bulky book paper** | Bulky book paper is a mechanical paper that is produced specifically for the trade book market. As the name suggests, bulky book paper creates a book that looks thicker, given a similar grammage, than bond paper. All bulky book paper is imported.. |
| **Co-publication** | Co-publication refers to the practice of releasing a book published overseas locally under a local publisher’s imprint |
| **Dedicated book printer** | A dedicated book printer is able to produce a finished book that is bound and ready to be sold to consumers. Dedicated book printers do not necessary only print books. |
| **EDI (Electronic data interchange)** | EDI, a system whereby orders are electronically transmitted between retailers, distributors and publishers, and which allows detailed tracking of transactions between these parties |
| **Educational books/market** | Educational books include books used primary and secondary education, i.e. books for Grades 1 – 12. |
| **Import parity pricing** | Import parity pricing (IPP) refers to the practice of pricing goods produced locally at the price it would have cost to import them. When import parity pricing is followed, the local price of a good is equal to the international market price of the good plus freight, insurance and any other expenses that would theoretically have had to be incurred to import the good |
| **Indent paper** | Paper is indented when a supplier cuts the paper to his client’s size specifications before the client has ordered the paper. Suppliers keep a limited supply of indented paper for their larger clients to supply them at short notice. Indented stock is typically cheaper than paper “off the shelf”. |
| **Net receipts** | “Net receipts” is a publishing industry term for the recommended retail price of a book minus the bookseller’s discount. |
| **Origination costs** | Origination costs refer to the fixed costs that a publisher has to incur to create a book. Origination costs include costs like typesetting, editing, cover and book design, project management, proof reading, obtaining permissions to use copyrighted material and all other once-off costs that are linked to developing a book |
| **Price elasticity** | Price elasticity refers to the extent that the demand for a product reacts |

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| | to a change in the price of the product. A product is said to be price “inelastic” if a certain percentage decrease (increase) in the price of a product leads to a less than proportional increase (decrease) in the quantity sold (e.g. a 5% decrease in prise results in a 1% increase in volume sold). In contrast, with a price elastic product, the quantity sold will increase (decrease) by a larger proportion than the percentage decrease (increase) in the price of the product. |
| **Print on demand** | In contrast to traditional offset printing, where books are printed in bulk and then sold, print on demand is a process whereby digital printing is used to print a copy of a book only after an order for the book has been received. |
| **Print-to-plate printing** | Instead of using film to transfer images to printing drums, the print-to-plate process is done digitally with the help of lasers. |
| **Section 21 schools** | Section 21 schools are schools with relative strong administrative capabilities where expenditures and management issues are overseen by governing bodies, rather than the provincial department of education. |
| **Scholarly books** | Scholarly books refer to “university press”-type books aimed at academics and other more technical readers rather than students. |
| **Trade books/market** | •Trade books include both fiction and non-fiction books aimed at the general market. |