

Turning the Page The Future of eBooks

*Technology, Media &
Telecommunications*



Foreword

Publishers, Internet bookstores, and companies that manufacture eReaders have high expectations for the digital future of the book industry. A new generation of eReaders may, at last, achieve the long-awaited breakthrough that lures consumers away from paper and ink. In the United States, Amazon has revolutionized the market by producing an eReader that is easy to use and making it easy for customers to purchase a wide variety of books at competitive prices. While some people herald the advent of digital reader technology as an opportunity to open new target markets and create customers, others mourn the end of traditional books and doubt the industry will be able to retain control over pricing and content.

Today, it seems eBooks and eReaders provide more questions than answers for the book industry:

- Will the industry face the same issues that music publishers did during its digital transformation several years ago – primarily digital piracy and a loss of revenue as customers discovered new methods of acquiring content and adopted new listening habits?
- Who will purchase eReaders? Will they be designed to appeal to a broad group of customers or only to those who have a high degree of comfort with technology? Will people who read once in a while want to buy an eReader, or will they only be purchased by the small group of customers who buy and read a high volume of books?
- Will publishers be able to use eBooks and eReaders to extend the market for books in general, creating a wider audience?
- Will publishers ever move to an all-digital model and abandon printed books?
- Is the media responsible for much of the hype we are now hearing about eBooks and eReaders?

This study will look at consumers' attitudes toward and interest in digital reading. It will also identify market opportunities and developments for eBooks and eReaders, and make recommendations for publishers, traditional retailers, online retailers, and intermediaries. The study includes a general market analysis, a discussion of trends and developments, and the results of a consumer poll conducted among 1,000 online users in the United States, United Kingdom, the Netherlands, and Germany.

This research is complemented by more than 40 interviews with experts and senior executives of reader manufacturers, a wide range of publishers, dealers, online and traditional book shops, and libraries in Germany. The survey considers the importance of eBooks and asks about their market potential, drivers, obstacles for the future market development, and possible income models and marketing structures.

The survey focuses on the international market for eBooks and eReaders, particularly with regard to mass market books in the United States, United Kingdom, the Netherlands, and Germany. It also focuses on opportunities for digital distribution of newspapers and magazines through tablets, such as the Apple iPad.



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Contents

Foreword		
Management summary	2
Current situation	4
1. The Book Market	4
2. The Digital Book: Market of the Future?	.....	4
2.1 eBooks	.....	4
2.2 Electronic Reading Devices	.....	5
2.3 Market Overview: A Market or a Niche?	.....	8
2.4 Taxation of eBooks: Artificial Price Driver	..	10
2.5 Value Chain and Revenue Models	.....	10
What do the experts say?	.....	12
1.1 eBooks: An Opportunity or Risk?	.....	12
1.2 Market Drivers	.....	13
1.3 Market Barriers	.....	13
1.4 Pricing and Distribution Models	.....	14
1.5 eReaders or Tablets?	.....	15
1.6 Looking to the Future	.....	15
1.7 Challenges Facing Companies	.....	15
Discussion: Electronic Newspapers and Magazines	.....	16
What do customers want?	.....	18
1.1 Popularity of eBooks and eReaders	.....	18
1.2 Revenue Models	.....	22
1.3 Purchase Intentions: Tablet or eReader?	....	25
1.4 The Future	.....	27
Outlook and recommended action	.....	28
1. The Situation in the Year 2015	.....	28
2. Critical Factors of Success for Different Business Models	.....	29
2.1 Publishers	.....	29
2.2 Physical Bookstores	.....	31
2.3 Online Stores	.....	31
2.4 Device Manufacturers	.....	31
2.5 Intermediaries	.....	32
3. Conclusion	.....	32
Methodology	.....	33
1. Analysis Framework	.....	33
2. Timescale and Method	.....	33
3. Expert Interviews	.....	33
4. Consumer Survey	.....	33
Bibliography	.....	34
About us	.....	34
Contacts	.....	34

Management summary

Digital publishing appears to be reaching critical mass. Most consumers have an understanding of eBooks and eReaders, thanks to media coverage, as well as extensive reporting ahead of this year's major book fairs. Apple's new iPad, which can serve as an eReader, also brings more attention to the market for the digital technology.

Nonetheless, when consumers are asked about their knowledge of eBooks and eReaders, it becomes obvious that many people are missing the big picture. Although consumers seem amenable to eBooks and eReaders, they do not yet grasp the larger concepts behind digital publishing and may not understand the advantages of reading digital books over paper ones. This is especially true in Europe.

Attitudes toward eBooks and eReaders seem to differ on each side of the Atlantic. In the United States, publishers appear amenable to eBooks because they generally offer lower costs and higher margins than print. An eBook publisher does not incur inventory return costs that are typically associated with traditional print channels. In Europe, publishers seem more likely to view digital publishing as a step backward for their companies – a necessary evil, so to speak – that represents more risks than opportunities. Therefore, European publishers may have less interest than their American peers in actively developing the eBook market. European publishers are more likely to express doubts about digital transformation in the industry, and act slowly out of fear of high costs and the possibility of losing sales of print books.

However, the progress toward a digital publishing industry can only move forward. This is most obvious with the developments in the United States, where eBooks accounted for about 3% of the overall market at the end of 2009 and will

account for 7% in 2010. And this is only the beginning: Driven by the improvement of reading devices with integrated online stores, an extensive range of electronic books, and an aggressive price policy of online retailers such as Amazon, eBook revenue continues to expand. The market is being further stimulated by multifunction devices such as Apple's iPad, and it has already proved lucrative for publishers, whose initial investments are paying off because of higher margins for eBooks.

There is no doubt that the same trends that spurred the adoption of eBooks and eReaders in the United States are having a similar effect in other countries as well, such as:

- Technical development and sophistication of reading devices that provide an experience similar to that of reading an actual book.
- The increasing penetration of the Internet in all areas of life, which is significantly changing reading patterns and reading behavior.
- The increasing extent to which consumers are open to new technological trends, for which in particular the availability of attractive mobile devices such as smartphones, portable games consoles, and MP3 players are responsible.

Publishers, content owners, and retailers should act promptly to secure leading positions in the eBook and eReader marketplace, and not concede ground to participants new to the industry. Publishers, bookstores, and device manufacturers should take the opportunity to provide the market now with innovative products before others do so. And authors should explore opportunities for digital distribution, and support publishers in their efforts to publish content.

Publishers in the nascent European eBook marketplace should actively and

aggressively digitize and market their electronic books, even if eBook revenue does not cover costs in the short term. These investments are necessary to establish the market, and provide a legitimate alternative to any pirated materials that may be available on file-sharing websites. Publishers should also design a pricing strategy that attracts customers without undermining the value of content. A well-thought-out pricing strategy may also help publishers and content owners gain new customers – those who would not have purchased a traditional book but may be inclined to buy an eBook that costs less, offers additional features, and works on a digital device they already own. The strategy of offering eBooks at a price lower than that of printed books is a step in the right direction. As soon as a mass market has been established, the investments will demonstrate their worth because eBooks also provide an attractive source of revenue.

In the future, publishers will need to position themselves as content providers, and not just the suppliers of physical books. They will have to make content available on multiple media, in multiple formats, on multiple platforms. This content may not be limited to the text of a book itself – it may also include audio, video, and games. This additional content may lead to incremental revenue.

Market participants will have to rethink their strategy and adapt to changes in the value chain. Traditional bookstores face the risk of exclusion from the expanding market for digital content. More than ever, the traditional bookstore will have to emphasize its strengths in terms of customer knowledge, customer retention, and competence. And it will have to distribute book content in all formats and all channels.

US companies have been successful by providing user-friendly reading devices

with instant and simple delivery of content through mobile wireless or wi-fi connections, built-in links to online stores, and competitive prices. The device manufacturers are now facing the challenge of rolling out this development worldwide. Manufacturers do not have to vertically integrate the entire value chain for this purpose. Cooperations with publishers and online bookstores are a step in the right direction.

Online bookstores appear to be best situated for digital transformation, thanks to their built-in customer bases and their experience as Internet retailers. However, European-based online bookstores may be challenged by new players, who can offer customers a wider range of products, or a more engaging experience through reviews and integration with social networks. Amazon has already established itself as an online retailer in Europe and has begun selling the Kindle in several European markets. Although Apple's iBookstore does not carry many non-English books, retailers should not underestimate the company as an online content seller, evidenced by the growth of its iTunes Store.

For every company involved in the book industry, these developments are challenging but exciting. For the first time, consumers can purchase eReaders that are relatively inexpensive and easy to use. Customers in the United States already enjoy eReaders with integrated Internet access, which allows them to purchase books directly on their devices or through a website and begin reading them in about a minute. Some of these devices are available in Europe, and more are on the horizon. The iPad and other tablets give publishers and authors the ability to put color pictures, videos, and music in their books. While today's eReaders are mostly limited to black and white, future models will introduce color and video capabilities while maintaining the longer battery life, thinner form factors, and lower prices that

separate dedicated reading devices from the iPad and other tablets.

Publishers should view these technological advancements as opportunities to move established readers to eBooks, which can improve operating margins and reduce production costs while creating a new market for customers who are not frequent book buyers but might find eBooks with multimedia content attractive. If the book industry fails to establish the marketplace now, companies may find themselves playing catch-up later after losing sales and customers to newcomers. What is more, by waiting, established players may lose the opportunity to establish pricing policies, eBook format standards, and partnerships that set consumer expectations and define the marketplace. In addition, if legitimate vendors fail to meet consumer demands, either in terms of content choices or reasonable prices, their potential customers may turn to file-sharing websites for pirated books – a situation similar to the one that set back the music industry.

It is clear that many people are willing to make the transition from printed books to eBooks and eReaders. Recent examples in the United States prove that consumers will adopt eReaders, which ease the process of buying and reading eBooks. While the publishing industry, especially in Europe, is at the beginning of its digital transformation, the breakthrough is under way.

Current situation

1 The Book Market

Reading books continues to be one of the most popular leisure-time occupations around the world, notwithstanding the increasing use and significance of the Internet in our daily lives. In Germany, for example, people said they enjoyed reading books more than they liked using the Internet, going to the movies, and playing video games, according to a 2009 poll. The only leisure activities more popular than reading books were watching television, listening to music and the radio, and reading newspapers and magazines, pursuant to the poll conducted by German companies Axel Springer and Bauer Media. Other surveys show that older women tend to favor books, while men prefer to spend their leisure time with electronic media, such as television and the Internet.¹

Books are big business. Around the world, people spent US\$108² billion on books in 2009. The region encompassing Europe, the Middle East, and Asia represented the largest share of sales. Mass market books, sometimes called consumer books, continue to increase as a percentage of overall book sales. In this mass market category, sales of books for children and young adults have grown steadily. eBooks are too new to make up a significant share of worldwide sales.

There are many indications that books remain popular. Younger readers (10- to 19-year olds) have a strong appetite for reading, thanks to successful books such as Stephenie Meyer's vampire romance series *Twilight*. Consumers aged 40 and older buy the most books, while electronic media is more popular with consumers between ages 30 and 39, according to various industry surveys publishers have an opportunity to bridge these two demographic markets with electronic media— eBooks, music, video, and applications – to attract customers and create new revenue sources.

2 The Digital Book: Market of the Future?

The discussion concerning the viability and chances of success of eBooks is not new. In recent decades, there have been talks as to when and whether the eBook will overtake the printed book in terms of popularity. Following music, newspapers, magazines, television, and radio, the digital transformation has now also caught up with the book industry. The market is undergoing a period of change – and is restructuring itself.

2.1 eBooks

eBooks are digital versions of printed books, which are distributed through the Internet. These files can be read on

eReaders, tablets, personal computers, smartphones, and also on some mobile phones.

eBooks can be published in a variety of file formats. In the United States, there is not much debate about formats, as the industry leaders – Amazon, Barnes & Noble, and Apple – allow customers to read their purchased books on a variety of devices. This multiple-application strategy mitigates the problem of competing file formats, as consumers rarely need to move a book saved in one format to a device that requires a different format. In Europe, where the eBook and eReader environment is less mature, publishers continue to discuss the merits of different file formats. Formats are especially important to customers, as few eReader or eBook companies in Europe provide the multiple-device convenience and flexibility as their US peers. That puts the onus on buyers to understand the file type, and whether it is compatible with their devices.

At this time, PDF and ePUB are the most common eBook file formats. PDF was created by Adobe in 1993 and is used primarily for special interest books. ePUB is generally used for mass market eBooks.³

Here is a brief discussion of the two file formats:

- ePUB is an extensible markup language, like the HTML used for websites. The text adapts to a user's device. If the user wants a larger typeface, the text will be redrawn on the screen. In contrast, a PDF document is like a series of photographs: every page will show up on the screen exactly as the designer laid it out, but the reader may find it difficult to enlarge or decrease the type size.

¹ According to Allensbacher Market and Advertising Media Analysis 2008, 45% of women and 29% of men use books daily or several times a week. And most books are bought by women (66% compared with 52% of men).

² PwC: Global entertainment and media outlook: 2010-2014, 2010.

³ ePUB is an open standard for eBooks, based on XMLM; it has been defined by the International Digital Publishing Forum (IDPF) and replaced the older standard Open eBook (OEB) or Open eBook Publication Structure (OEBPS). In addition to dynamic text adjustment, ePUB files can be individually adapted to a certain extent and support vector graphics. ePUB is also compatible with Digital Rights Management systems. There are plans for further development: Accordingly, the IDPF has set up a commission which is expected to enable advertising and videos to be displayed in ePUB and is also expected to permit standard or interactive add-ons.

- ePUB files allow readers to control the size of the text on their screen. However, eBooks published as ePUB files do not have static page numbers. Researchers and students may not be able to provide accurate page numbers for citations. PDFs allow publishers to create more intricately designed books, with fixed page numbers and illustrations, but these books may be difficult to read on some eReaders and other devices, especially those with small screens. Readers may not want to scroll left and right to read each line of text.

Amazon uses a proprietary format, AZW, which is an extensible markup framework like ePUB but offers a level of copyright protection and digital rights management. AZW is based on software made by Mobipocket, a subsidiary of Amazon. A version of Mobipocket is available for free. It is similar to ePUB: it allows flexible page breaks and is suitable for small electronic devices.

2.2 Electronic Reading Devices

2.2.1 eReaders

What is an eBook without an eReader? The eReader promises a comfortable, computer-free experience for reading. The devices work with so-called electronic ink (eInk), which ensures an experience similar to that of reading a real book as a result of its precise and stable characteristics. eInk displays do not require any background lighting and are easy to read, even in direct sunlight. Because they only require power for turning pages, they do not consume a lot of battery; this means that a recharged device can be used for several thousand pages, or several weeks.

eReaders are not a new phenomenon. Many companies introduced reading devices in the 1990s and early 2000s, but customers generally felt these eReaders were too expensive, had too many technological limitations, and were too expensive.

The new generation of reading devices is now expected to achieve the breakthrough, driven by advances in the US market.

The Kindle: Amazon thinks big with a device that is simple and friendly for customers

Amazon introduced the Kindle in the US in 2007, and in Europe and other international markets in 2009. As the first eReader model with an integrated mobile access link to a major online store, the Kindle generated a considerable amount of market attention. Kindle users do not have to sign a mobile contract or incur

From Data Discman to Kindle A brief history

Sony pioneered the first electronic reading devices in 1990 with its Data Discman, a reading device with a CD-ROM drive that was able to display books and focused primarily on reference works. Its initial selling price, US\$550, would have paid for an entire shelf of books. In the United States, the Data Discman was marketed to college students and international travelers. The product was also marketed in Europe, where it was introduced for €500.⁴ The Data Discman did not sell well outside Japan, and Sony discontinued it in 1993.

In 1998, the German-American joint venture NuvoMedia, in which Bertelsmann was also involved, launched the Rocket eBook for approximately €345 in the United States and Europe. The Rocket could hold up to 4,000 pages, and customers could download additional books from the Internet. Various online shops for eBooks started at the same time as the launch of the Rocket eBook. For instance, eReader.com was launched in the United States, being one of the first websites worldwide to sell eBooks. The site still exists today and belongs to the US book retailer Barnes & Noble. Bertelsmann, in Germany, launched its eBook shop BOL.de, and offered the 600 or so eBooks in German that were available at that time via the online bookstore dibi.de (now trading as libri.de). The books were published in PDF or the open standard Open eBook (OEB), the predecessor of the present-day ePUB format.

The Rocket represented significant technological progress from the Data Discman, yet it was not successful on the market. The Rocket had Internet access, a monochrome LCD display, weighed 22 ounces (or 630 grams), and contained 16 megabytes of flash memory.

Later Rocket models did not establish themselves on the market either, despite the addition of color displays and lower prices. The products were discontinued. The software group Microsoft, which had been working on a reader since June 2003, and the US bookstore chain Barnes & Noble also discontinued their efforts to press ahead with sales of electronic book files. The Librié, a further reader of Sony, which was the first device to be equipped with eInk technology, was initially not published worldwide and was sold exclusively in Japan in 2004, although without success.

The reasons for the lack of customer acceptance at that time included the shortage of available books and the fact that the devices were not attractive, particularly in terms of weight, size, and price. For several years, consumers' appetite for eBooks and eReaders stalled, but Amazon's Kindle changed that in the United States in 2007. Sony, with its PRS-500, had made a further attempt with electronic reading devices one year previously. As was the case with the international Sony model, which was launched in Europe approximately three years later, the US equivalent also did not have mobile access and was hardly perceived at all by the market.

additional connection costs to access the Kindle Store, where eBooks can be purchased, mostly at a considerable discount compared with printed books. Amazon originally imposed a US\$2 charge when a Kindle user purchased a book outside the United States, but this international surcharge has been eliminated now that Amazon sells the Kindle outside the US. Books are purchased at the push of a button, and this facility encourages impulse buying because it is easy to operate and constantly available.

The Kindle's simplicity, connectivity, and integration with Amazon's digital bookstore proved to be very attractive. The first devices sold out within five and a half hours in the United States. The Kindle was not subsequently available for many months – although the device initially cost

US\$399. Today, Amazon has three Kindle models:

- The Kindle 3 with wi-fi, for US\$139
- The Kindle 3 with wi-fi and mobile 3G connectivity, for US\$189
- The Kindle DX, with a larger screen, wi-fi, and mobile 3G connectivity, for US\$359

Amazon sells the Kindle on its website and through two brick-and-mortar retailers in the US, Target and Staples.

Since the international launch in October 2009, the Kindle 2 (and, now, the Kindle 3) can be purchased in the United Kingdom, the Netherlands, and Germany. Since January 2010, the Kindle DX, has also been available on the international market.

⁴ Today's currency. The product would have been sold in each country's respective currency at the time.

The non-US Kindle is also directly linked to the Kindle store, where consumers can access a selection of more than 725,000 (mainly English) books and a wide range of national and international newspapers and periodicals. In addition, Amazon provides access to 1.8 million free, public-domain books. In general, the books cost as much in Europe as they do in the United States.

Competition for the Kindle

Amazon is no longer the only game in town. Barnes & Noble, the largest US bookstore chain, introduced the Nook in early 2010. Like the Kindle, the Nook is available with only wi-fi, or with wi-fi and a 3G mobile connection. The Nook is priced competitively with the Kindle, but instead of the Kindle's physical keyboard, the Nook has a small color touch screen beneath the main eInk screen. In October Barnes & Noble introduced the Nook color with a colored LED screen.

In August 2009, Sony added the Daily Edition to its line of eReader devices in the United States. The Daily Edition has wireless Internet connectivity, and is integrated with Sony's online bookstore.

Borders, another large US bookstore chain, recently introduced an eReader called the Kobo.

Across the Atlantic, Sony remains the largest player in the eReader market. Sony introduced the Reader Touch Edition with a touch screen in October 2009, targeting professionals. The company then released the Sony Pocket Reader in February 2010, marketing it as an entry-level eReader. Neither model has integrated mobile Internet access, which means users are required to download books on their PC and then transfer them to the eReader.

In August 2010, Sony redesigned its eReaders for the European market, adding touch screens to all models and introducing several new features. However, still none of the eReaders has wireless Internet access.

Amazon's simplified, integrated shopping and delivery system differentiates the Kindle from other products in many countries. A UK-based bookstore chain, WHSmith, is following Amazon's lead by

offering customers a seamless reading and shopping experience. Since July 2010, the store has sold the iRiver Story in its physical store and on its website. The £179 eReader connects through wi-fi to WHSmith's 100,000-title online store.

While Amazon has a head start in Europe, nearly all of the eBooks available to Kindle users are in English. In non-English-speaking countries, customers looking for eBooks in their native tongue may be frustrated with Amazon's selection. European publishers, device manufacturers, and online retailers may have an opportunity to introduce eReaders and services that are as easy to use as the Kindle but offer more content than Amazon for each country's native readers. One part of this puzzle – eReaders with the capability to integrate with online stores in Europe – may already be in place. In Germany, for example, bookstore chain thalia.de offers the Oyo, an eReader with wi-fi access. The BeBook Neo, announced in the Netherlands, has wi-fi capabilities, but its high price may hinder sales.

Lately eReader prices have fallen significantly. The dramatic price cuts are due to the announcement of Apple's iPad, increased competition between Amazon and Barnes & Noble, and falling prices for supplies. The introduction of the iPad highlights the difference between multifunction tablet computers, like the iPad, and eReaders, which are primarily for eBooks. The eInk screens in most eReaders can only display content in black and white, and a few shades of gray, which makes them suitable for text and monochrome photographs and graphics. It takes a moment to display each new page on an eInk screen – a delay that will not bother readers, but that makes the devices incapable of displaying video.

It is only a matter of time before eReaders gain more sophisticated capabilities. American chipmaker Qualcomm and Prime View, the company that manufactures eInk displays, are working on color screens. Qualcomm is developing a display technology that requires little power but can show video and animation in color.

2.2.2 Tablet PCs

Tablets: Alternative reading devices for eBooks

A tablet is a portable computer with a touch screen. Apple ignited the tablet market when it introduced the iPad in early 2010, but the concept is not new. As early as the 1960s and 70s, there were initial concepts of a portable computer with a user interface providing a facility for intuitive operation.

In 1993, Apple launched the first portable computer with genuine pen input, the Newton MessagePad. However, production of the Newton, a predecessor of the personal digital assistants, or PDAs, was discontinued in 1998. (Those PDAs, in turn, have mostly disappeared from the marketplace, having been replaced by smartphones such as Blackberrys and iPhones.)

In addition to Apple, other manufacturers have announced the launch of tablets, or have already introduced tablets to the market. It is expected that about 20 tablets will be available on the market by the end of the year.

Tablets are not designed solely for reading books; instead, they allow users to browse websites, view photos and videos, play games, read and write email messages, and perform many of the same functions they would do with a traditional computer. Unlike the eReaders, tablets use LED-lit LCD displays, which enable information to be displayed in color and also enable the user to read in the dark. However, the LCD displays are susceptible to glare and can be washed out in direct sunlight, which may not provide the most comfortable environment for reading. In addition, the tablets are generally heavier than eReaders, and must be recharged more frequently.

As is the case with purchasing eBooks for eReaders, the digital content can be obtained through specific online bookstores, publishers, or Internet portals with free content (for instance, the Gutenberg Project). For buying and reading books on the iPad, Apple has followed the example set by the Kindle

eReader	Original price	Current price
Nook with wi-fi and 3G (Barnes & Noble)	US\$259	US\$199
Kindle 2/Kindle 3 with wi-fi and 3G (Amazon) Note: The Kindle 3 was announced in July 2010. It replaces the Kindle 2.	US\$359, then US\$299 (July 2009), then US\$259 (October 2009)	US\$189, US\$139 (wi-fi only)
Kindle DX (Amazon)	US\$489	US\$379
Reader Pocket Edition (Sony)	US\$170	US\$150
Reader Touch Edition (Sony)	US\$200	US\$170
Reader Daily Edition (Sony)	US\$350	US\$300

Fig. 1 Price changes of selected eReaders

Store to create a seamless environment in which customers can buy, download, and read books. iPad customers can download from Apple a free application, or app, called iBooks. This app acts as an eBook reader, in which users can read books, add notes, highlight passages, and organize their libraries. A button in iBooks links the user to Apple's iBookstore, where more books can be purchased. Free books from the public domain are also available.

Because the iPad is a multifunction device, users can download many apps, including different eBook reader apps. Amazon's Kindle app is free and provides much of the functionality of the Kindle device itself. An iPad owner can launch the Kindle app, type in his or her Kindle account name and password, and gain access to all previously purchased content. The Kindle app, just like the Kindle device, lets users download new books from the Kindle Store. Bookmarks, notes, and highlights are synchronized across all devices.

Barnes & Noble has a Nook app for the iPad, which is similar to the Kindle app. Someone with a Barnes & Noble account can download the free Nook app, enter his or her account and password information, and use the iPad in much the same way as the Nook device itself.

Why would customers buy eReaders instead of tablets when tablets can act as an eReader? First, tablets cost considerably more than eReaders. The least expensive iPad model costs US\$499 in the United States, £429 in the UK or €499 in Europe. The least expensive iPad with an integrated mobile connection costs US\$599 in the United States, £529 in the UK or €599 in Europe. Second, tablets are multifunction devices. A customer may not want email or social networking notification messages to pop up on the screen. Third, customers may prefer the eInk display to the LED display.

2.2.3 Smartphones and Laptops

Smartphones in Japan popular for reading books

In Japan, the mobile telephone has become a mobile reading device, particularly in recent years. The mobile novels, or Keitai Shosetu, which are written specifically for mobile phones and which are frequently written as sequels as a result of the limited size of display, are popular among young Japanese who use them on their daily commute to work or school, as well as at home and during their leisure time. The great success is attributable particularly to the high mobility of the Japanese (long commuting hours) and the intensive use of the mobile phone.

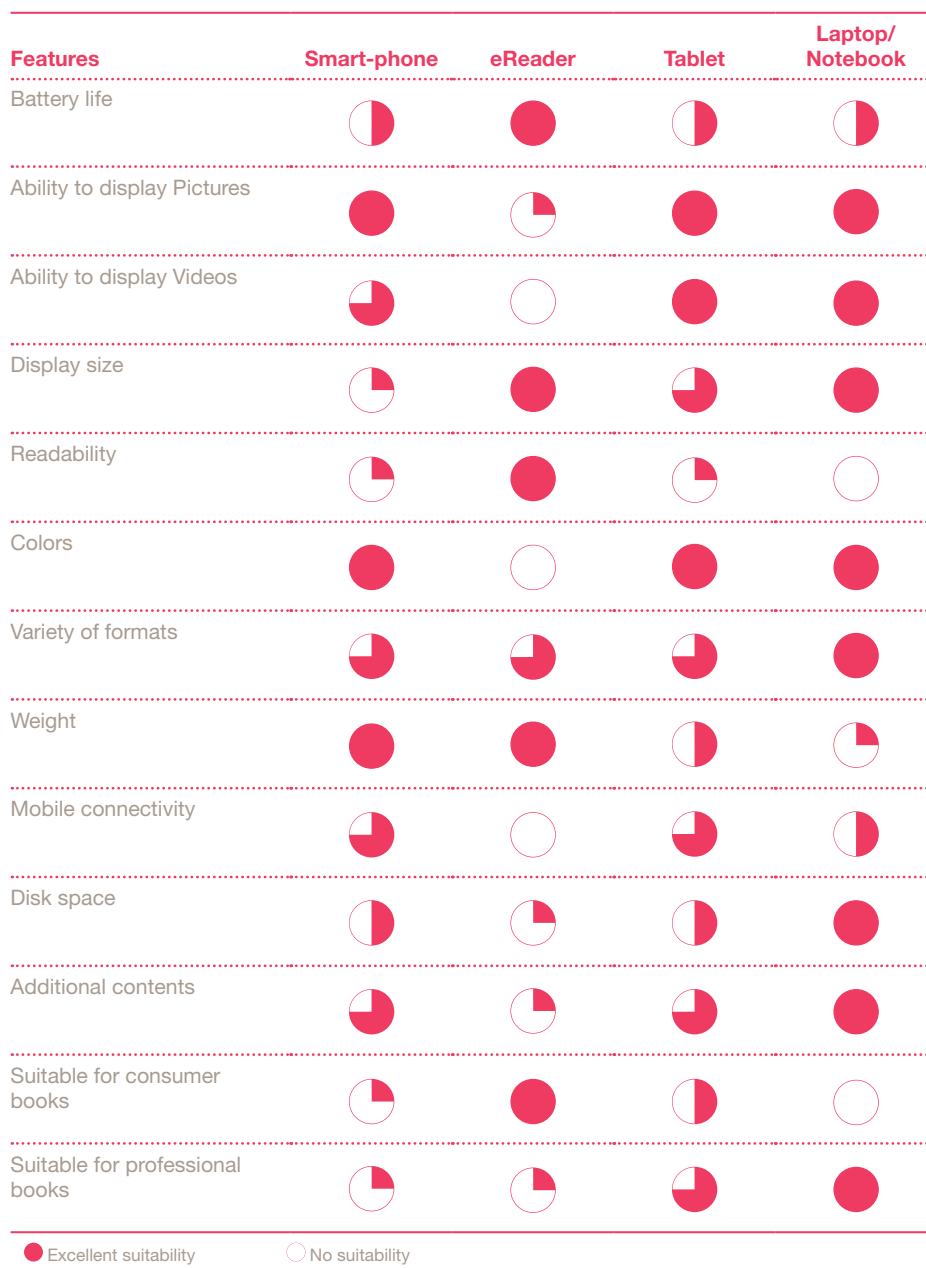


Fig. 2 Comparison of the suitability of different reading devices for eBooks

The national variations between consumer reading patterns mean that it is not possible to generalize such trends; however, in other countries, it is also possible for iPhone users to access an extensive range of eBook apps via Apple's App Store. iPhone owners can, for instance, buy and read electronic books via iBooks, the Kindle app or the Nook app. In addition, companies also offer book applications for other devices, such as Android smartphones and BlackBerry devices.

The advantages of smartphones are their ease of handling and, generally, their direct access to the Internet and thus the possibility of downloading eBooks. The disadvantages of mobile telephones are the small display and the comparatively short battery operating time.

Apart from mobile devices, eBooks can also be read via traditional channels such as PCs, notebooks, and laptops. Amazon

has also published free reading software (Kindle for PC), which, in the same way as the Kindle app, allows eBooks to be purchased and downloaded.

2.2.4 What Device for What Purpose? A Comparison

The launch of Apple's iPad has also set off a discussion as to what is the best reading device for eBooks. While some may say tablets have not been designed primarily for reading electronic books, Apple is clearly positioning its iPad as an alternative to eReaders with the introduction of the iBook app and the iBookstore. In addition, for smartphones and laptops, there are products for reading eBooks such as Amazon's Kindle app. How is the competition posed by the various reading devices to be assessed? Do tablets compete with simple eReaders or do they complement each other? The following table summarizes and compares the main device characteristics.

eReaders are ideal reading devices for mass market books

At first sight, eReaders compare poorly to other reading devices with respect to photos, color content, add-on content, and touch screen navigation. However, they perform much better than other devices in terms of legibility, battery operating time and weight, attributes that are very important for the consumption of mass market titles. eReaders permit lengthy and undisturbed reading of eBooks; the eyes are not fatigued when they look at the screen, as is the case with LED displays with background lighting. In addition, a long battery operating time of up to several weeks and a low weight (about 200 to 300 grams, or 7 to 10 ounces) also result in positive assessments.

In terms of a target group, the eReader is therefore clearly designed to appeal to avid readers. Traditionally, these are women between 30 and 60 years of age, who read several times a week and purchase many books each year. In addition, eReaders are suitable for professional applications, for instance in the publishing environment when the focus is on reading lengthy texts. For these large-volume readers who are interested in the content and not the format of the book, eReaders provide an excellent experience that is close to that of reading a genuine book and also enable numerous books to be read in parallel.

On the other hand, eReaders are less convenient for special interest literature, newspapers, and magazines. These publications often require readers to skip between pages and chapters and search the text for words and phrases. Today's eReaders perform poorly in these areas. Current eInk technology cannot jump instantly from one screen to another: it requires a moment for existing text and images to disappear and then another moment for the new page to appear. In addition, photographs and illustrations may not display well on an eInk display, as the screen lacks color and backlighting. Future eReaders may overcome these limitations.

Tablets for occasional readers and for professional use

PCs and tablets offer many advantages for reading special interest literature. It is possible for content to be displayed in color, which means that tablets are also attractive for selected mass market titles with additional multimedia content. The most prominent example of such a presentation form is probably the iPhone and iPad adaption of *Alice in Wonderland*, in which illustrations are enriched with audio commentary and combined with

music and special effects. Such products will be attractive mainly for younger and technophile consumers who tend to read only extracts of books. However, tablets are also particularly suitable for newspapers and periodicals; in the final analysis, the integrated mobile access enables the user to source publishing content directly at any time or as a subscriber. In addition, photos can be displayed in high resolution, and the device can turn pages and follow hyperlinks without delay, which is a particularly important aspect for publishing products.

As multifunction devices, tablets are attractive for a larger target group. Particularly positive aspects are their user-friendliness and the integrated shop function, e.g. in the iBooks and Kindle apps, which reduce the resistance to buying eBooks and which provide access to a wide eBook range.

Disadvantages include the backlit display, the heavier weight, and the lower battery operating time. Tablets are therefore less suitable as a permanent reading device, particularly as they are, at present, much more expensive than corresponding eReaders. The disadvantages affect laptops to a greater extent, which means that a laptop appears even less suitable for mass market titles.

Typical tablet users are interested in using their devices for many purposes – including, at times, reading eBooks. In addition, tablets are a handy reading device for newspapers and periodicals because they combine up-to-date information with multi-media content, colored forms of presentation and linking and overview functions. Alternative possibilities of use include mobile work environments or increased use of special interest literature and reference works in which the user has to perform many search operations. Tablets, and in particular laptops, are also more suitable for special interest literature than eReaders because they enable the reader to turn pages quickly and provide the possibility of further research.

Smartphones will not be primary reading devices

As primary reading devices, smartphones are less convenient for either mass market or special-interest literature – although they would be suitable as a secondary device given their greater penetration density. The constant availability is a key advantage. For this purpose, eBook providers make apps for smartphones. The key disadvantage of smartphones is their small display, which is problematic with regard to reading large amounts of text

over an extended period of time. On the other hand, they are suitable for eBooks with graphics or short mobile novels, which are written specifically for mobile phones. Smartphone apps also allow users a convenient way to read while “killing time” on daily commutes, in doctors’ offices or in between classes.

2.3 Market Overview: A Market or a Niche?

2.3.1 The Range of Products

The US as the pioneer in a developing market

Internationally, there are considerable differences with regard to the range of eBooks that are available. The United States is a pioneer in this regard: At the launch of the Kindle, Amazon offered 90,000 eBooks for purchase, including 102 of the 112 *The New York Times* bestsellers. According to Amazon's own information, the company now has more than 725,000 eBooks in its proprietary AZW format. And there are an additional 1.8 million free eBooks in the public domain that can be downloaded from Amazon. In addition, Amazon offers 132 newspapers and 40 periodicals under the terms of a subscription or as individual editions. The largest bookstore in the world, Barnes & Noble, has more than 1.2 million eBooks. Its digital bookstore has fewer newspapers and magazines than Amazon: 20 and 14, respectively.

The UK also benefits from an extensive range of English-language content. For instance, the Kindle offers more than 320,000 books for readers in the UK alone, and more than 1 million free books are available in English via Google Books.

On the other hand, publishers in the Netherlands and Germany are more conservative in their approach to digitizing their book holdings. As recently as summer 2009, the range of eBooks in the Netherlands was limited to about 1,000 eBooks.⁵ The largest online bookstore now offers approximately 4,000 eBooks in Dutch (by way of comparison: at the Dutch market leader bol.com, about 350,000 printed books in Dutch are available). The range of German-language eBooks is also relatively limited in terms of an international comparison. It is true that online bookstores such as bucher.de now have a selection of more than 100,000 eBooks, representing about 8% of the currently available 1.2 million German books, in a wide range of formats. However, most of the books are only suitable to a limited extent to be used on mobile reading devices because they are made available in PDF.

5 PwC: *Entertainment and Media Outlook for the Netherlands: 2010-2014*, 2010.

Authors are also responsible for sluggish digitizing

Publishers are not necessarily responsible for the sluggish pace of digital transformation in some countries. In many cases, publishers only have the marketing rights for the printed and audio content. To enable eBooks to be distributed, further negotiations are necessary with the authors. This is frequently a time-consuming and expensive process. In order to press on with developing the market, most publishers are already digitizing most of their front-list books, including current bestsellers and, to the extent that they own the rights, are also opening up parts of their backlist for electronic sales.

Google Books plans to enter the eBook market with Google Editions

In May 2010, Google announced plans to enter the US eBook market with the launch of its Google Editions store. The announcement came even as competition intensified among market leaders with the launch of Apple's iPad tablet and iBookstore. However, Google may be reconsidering or refining its strategy to reflect new market conditions. As of this writing, Google Editions is not yet available in the US market, missing its targeted launch date by five months.

Some analysts are suggesting that falling prices for eReader devices may have substantially negated the consumer benefits originally contemplated for the Google Editions business model. As planned, Google Editions lets consumers purchase and read content from any connected device, using only an Internet browser. It is also intended to benefit independent bookstores and publishers that have previously been excluded from participating in eBook growth. These sellers will be able to use the Google Editions platform to market books on their own sites. A similar announcement was made in July 2010 regarding Google's planned entry into the Japan eBook market.

Through a partnership with the American Booksellers Association (ABA), which promotes independent booksellers, Google plans to offer more than 400,000 titles in the United States initially. Members of the ABA and others will also be able to leverage the platform for selling books through their own sites. Google Editions will be housed within Google Books, the current home for 2 million public domain eBooks. Google will retain a 37% share of the revenue by selling direct to consumers.

2.3.2 Prices

The prices of eBooks vary considerably, depending on the value-added tax rules and fixed book pricing arrangements. At present, there are fixed book pricing arrangements in 13 of 20 European Union countries, including France, Germany, the Netherlands, and Spain.⁶ In these countries, bookstores have to follow the price policies of the publishers.

Whereas the fixed book price arrangement in Germany is not subject to any time restriction, the corresponding arrangement in the Netherlands is applicable only for the first year after publication of printed and digital books. In the United Kingdom, recommended retail prices were abolished in 1995 and, in the United States, fixed prices contravene competition law.

So far, no standard procedure has been established for fixing the prices of eBooks in countries with a fixed book price arrangement. While some publishers in Germany offer their electronic editions at a price that is up to 20% lower than the corresponding price of the printed versions, others have a policy of offering digital content for the same price as the least expensive printed form, which is usually the paperback format.

The absence of a fixed book price arrangement also explains the strategy of the online bookstore Amazon, which sold nearly all books for US\$9.99 or less to kick-start the eBook and eReader market, encourage Kindle sales, and establish its online store as the market leader. At US\$9.99, a Kindle eBook was significantly cheaper than a hardcover. eBooks are now available mainly for prices between US\$9.99 and US\$14.99. In the UK, new publications are available for the equivalent of US\$12 to US\$14.

Antitrust Scrutiny for the Agency Pricing Model

The introduction of the Kindle in late 2007 with most titles priced at US\$9.99 generated rapid uptake from Amazon's customers as eBooks were sold at a significant discount compared with hardcover and paperbacks. On average, Amazon paid publishers US\$13 per eBook and realized a US\$3 loss on each eBook sold. Setting the price at US\$9.99 resulted in considerable unrest among the publishers. Publishers' concerns extended beyond how much profit they made on each eBook sold; they focused on cannibalization of traditional formats.

At the end of January 2010, Amazon removed all Macmillan eBooks in a dispute over pricing but later adjusted its pricing

strategy and made those titles available again. Macmillan books are now sold for between US\$12.99 and US\$14.99. In addition, Simon & Schuster and Hachette have announced that they will launch the eBook versions of their top titles only after a certain delay to avoid cannibalization of sales of printed books.

In 2009, the iPad presented an opportunity for publishers to establish a new type of pricing strategy, one that would shift pricing power from the retailer to the publisher. Several major publishers worked with Apple to arrive at an agency pricing model for Apple's iBookstore. Under the agency model, online retailers sell publishers' eBooks and receive 30% of gross revenues. The model is not tied to a specific pricing structure, rather publishers set their own prices individually. Amazon also implemented the agency model as an option for publishers shortly after the iPad launched.

As publishers gained more control of pricing, consumers immediately saw higher prices on many titles as a result of this shift. Consequently, eBook pricing is attracting antitrust scrutiny in the US market. Reviews by state attorneys general are under way in Texas and Connecticut. Additionally, according to The Wall Street Journal, the Department of Justice is also showing keen interest in the emerging eBook sector with a focus on the larger technology companies.

2.3.3 The Market Volume

eReaders: A far cry from the hype in Europe

By the end of 2010, eBooks will account for more than 7% of sales in the US book market. Additionally, industry observers estimate that up to 8 times as many of these sales are coming through Amazon's Kindle Store than all other online retailers combined. Comparatively few eReaders were sold last year in European countries such as Germany, the Netherlands, and the UK, where the market is in its infancy.

The UK bookstore chain Waterstone's included the Sony Reader in its program in autumn 2008 and has since sold 60,000 eReaders. In the Netherlands, iRex Technologies, a spinoff of Philips, introduced eReaders at the end of 2008 and reported scarcely more than 4,000 sales at the end of 2009. Sales rose to 50,000 eReaders by midyear, but it was not enough to save iRex from filing for bankruptcy protection in June 2010.

Several other eReader manufacturers have filed for bankruptcy protection, including the manufacturer of the Cool-er eReader

6 Cf. <http://www.javnost-thepublic.org/media/datoteke/stockmann-4-2004-4.pdf>.

and the European division of Foxit. These companies may have succumbed to pressure from manufacturers of tablets and other eReaders.

In Germany, between 50,000 and 80,000 eReaders have sold up to spring 2010, and 15,000 of them were purchased from Weltbild (according to the company's own information).

Despite the extensive range of eReader models on the market, sluggish sales are due to various factors, including the fact that the models have only a limited range of functions and were comparatively expensive for many years until a few months ago when prices began to fall.

In addition to the normal development of prices in the technology cycle, increased competition posed by tablets also has tempered eReader prices. By way of comparison: More than 3 million iPads were sold throughout the world in the first 80 days.

eBooks: Still a niche for mass market reading

In the United States, there have been signs of the market picking up appreciably since 2008, largely due to the Kindle. Overall, eBook sales in the United States amounted to about €400 million, or US\$550 million, in 2009, which accounted for approximately 3% of the mass market. In July 2010, Amazon announced that, for the first time in its history, it had sold more eBooks than hardcovers, despite rising sales of printed books. According to information released by the company, 180 eBooks were sold in June 2010 for every 100 hardcovers; the three-month average figure was 154 Kindle eBooks. During the same period, Barnes & Noble boosted its eBook market share with the Nook, to 20%. The eBook market got a bigger boost with the iPad, which was used for downloading 5 million eBooks (including free eBooks) from Apple's store in the two months following the market launch.

Increasing sales with digital book content, including international sales, are indicated by the expanding sales of eBooks for eReaders, as well as new revenue potential, which can be primarily realized from multimedia devices such as tablets and smartphones. For instance, eBooks can be enriched with multimedia content for devices such as the iPhone or the iPad or can be provided with up-to-date information. A further conceivable possibility is the facility for adding sound or music to novels and thrillers or murder mysteries in order to create a new reading experience. Also, the reader could be enabled to intervene directly in the story

and change the content. Such applications are not suitable for all groups of products but could be used in picture books, comics, or special interest and travel literature, and also in some detective stories.

In Europe, the market remained sluggish in 2009. Germany generated scarcely quantifiable sales of eBooks. The UK, with its comparatively large range of English-language books, reported only approximately €8 million in eBook sales, which represents less than 0.5% of the British book market. Consumers in the Netherlands spent €1 million on eBooks in 2009, a marginal percentage of the country's book market.

Special interest books: eBooks are already established

The comparatively small market share of eBooks on the mass market is opposed by an electronic special interest book market, which is becoming more and more important. According to the British Publishers Association, English special interest and scientific publishers last year generated about €130 million with electronic content. Because bookstore discounts have already been deducted, the figure is likely higher. And even the market in the Netherlands is posting a strong performance, although at a lower level. At the end of 2009, eBook sales on the special interest book market hovered around 5%. However, the market for special interest books in the Netherlands is not subject to a fixed price arrangement, which indicates that strong sales growth is possible. In the United States, the electronic special interest book market accounted for 10% of sales.

2.4 Taxation of eBooks: Artificial Price Driver

According to a study carried out by PwC and the International Publishers Association⁷ 84% of the 88 investigated countries charge VAT on printed books at a reduced rate. On the other hand, electronic book products are not subject to the reduced VAT rate in 70% of countries, including Europe. The discrepancy is particularly extreme in the UK, where printed books are exempt from VAT, whereas the full rate of 17.5% is charged for digital content. And in Germany, the reduced VAT rate of 7% has so far been applicable for printed products due to considerations of cultural and education policy, whereas the full rate of 19% is charged for digital products.

In May 2009, the EU Commission modified the 2006/112/EU directive for reduced rates of VAT. This directive permits member states to apply a reduced rate of VAT to digital book formats, newspapers,

and periodicals. However, the initiative falls short of what is needed: The reduced rate of VAT is limited to physical media, and is thus applicable only for audio books and digital books in the form of a CD or CD-ROM.

Accordingly, eBooks distributed digitally are subject to the standard rate of VAT in the EU. For online bookstores, this means that the only possibility to optimize tax liabilities is to carefully select the country of domicile of the online shop because this is where VAT is incurred for sales of downloads to end users. Luxembourg is particularly suitable in this respect, as it presently has a 15% VAT, the lowest in the EU. A further tax reduction in Luxembourg would appear conceivable, in line with that country's taxation of music downloads. However, this would have to be discussed and implemented with a VAT expert in each individual case.

The reason for the different taxation is that tax law treats the digital book at the point at which it is downloaded or read online as a service that is rendered electronically and not as a cultural asset. Accordingly, tax law is based on the type of distribution (download, online use) and not on the product to be taxed (the work as such). In this context, the French publisher Antoine Gallimard, chairman and CEO of Éditions Gallimard, demanded a reduced rate of VAT at the end of November 2009 in an EU-wide petition. And the major German industry association (Börsenverein des Deutschen Buchhandels e. V.) also pleads for a reduced VAT rate for eBooks and audio books. It argues that books are more than an economic asset as they encourage ideas and characterize cultural identity. For the cultural value, it is irrelevant whether a book is read in physical or digital form or whether it is consumed in audio form. Because the digitizing and electronic dissemination of content increases the chances of social participation in cultural education, the current unequal tax treatment of physical and digital books is no longer justifiable objectively and ought to be changed.

2.5 Value Chain and Revenue Models

Digital transformation affects the book industry's established value chain and revenue models of the book industry. New competitors – some, like Google and Apple, also new to the industry – enter the market and take on the tasks of established players. Existing relationships are breaking down, and new ones are being forged.

The development of the digital value chain is being driven primarily by the shift toward end-consumer business and direct sales. The potential effects of this

7 PwC, International Publishers Association: VAT/GST/Sales Tax Rate: Global survey on books and electronic publications, 2010.

development are evident in the United States: Barnes & Noble has invested in both hardware sales and eBooks with the Nook. Meanwhile, the Kindle has transformed Amazon from an online retailer to a hardware and software developer and online content provider. Sony, which previously focused on selling eReaders but now wants to provide both the hardware and content, has opened an electronic bookstore. All three examples: the Nook, Kindle, and Sony Reader, show how companies are extending beyond their traditional lines of business and redefining themselves in the eReader and eBook environment.

Publishers: same role, new tasks

Initially, eBooks and eReaders will not significantly change the role of mass publishers. They will continue to search for, aggregate, filter, process, and distribute content. The change, of course, is that in addition to creating paperbacks and hardcovers, publishers also will need to provide eBooks. Digital transformation will not eliminate paper books, but it will create new formats for publishers, with new responsibilities and opportunities. There will always be demand for books in printed form. The digital environment also opens doors to new sources of income not possible with ink-and-paper products, such as apps, and special eBook editions enriched with music and video. Some US publishers are exploring these revenue sources already.⁸ Publishers also should gain a greater ability to distribute content themselves, either through their own digital platforms or shared platforms. For instance, in July 2010, the Bertelsmann Group and the publishing group Holtzbrinck established a joint venture to distribute eBooks in Germany.

Special-interest publishers: Developing new sources of revenue

The entire value process for special-interest publishers is changing, from aggregation right through to distribution. Electronic and special interest book contents differ significantly in terms of

script and structure. In addition, special-interest publishers will have to develop new revenue models, such as sales of individual chapters and sections from their books, and offer additional content in order to provide consumers with added value in relation to their content. Because the increasing digitization of the special-interest book market means that printed circulations will become less significant, new revenue models and the integration of upstream distribution stages are particularly important. In these areas, the printing and storage stages no longer will be applicable and will be replaced by digital production, digital storage, updates, and books on demand.

Authors: Time for self marketing?

In addition to content production, authors are able to extend their role to include further stages of the value chain. Rather than requiring traditional publishers to market their titles, successful authors may take on responsibility for distributing their books, as Stephen King and Paulo Coelho have done. The advantage is obvious: They not only receive the author's fee, but also retain sales for themselves. One disadvantage is that authors are unable to access publishers' editing, marketing and distribution services. However, they could license their books directly to online bookstores. In the United States, agency Andrew Wylies stirred up sentiment among publishers when it secured exclusive distribution rights for 20 books for the Kindle store. Publisher Random House, who published 13 of the 20 books, stopped acquiring new books from the agency's more than 700 clients immediately. After intense negotiations, Random House was granted the right to publish the 13 books digitally and reentered into business with Andrew Wylies. The 13 books will now be available through a variety of distribution channels, including Amazon and the Barnes & Noble store.

However, a self-marketing model can only be successful if authors are well-known, and an author is not likely to be well known without the help of a publisher.

Intermediaries with considerable additional costs

The role of intermediaries within the value chain will be redefined in the digital environment. Production and distribution processes for eBooks are not comparable with those for printed books. It is true that traditional functions will continue in parallel, but they will be increasingly redefined and substituted. This is because core functions, such as the transportation and storage of printed books, are becoming less significant in the digital environment. In order to fill this gap, numerous new services can be provided by intermediaries, such as the creation of an eBook platform, handling of payments, support for digital conversion, and establishment of a digital content system. But they are not the only ones: International Internet or startup companies, which can handle distribution operations for publishers too, will increase the competition.

Shifting of business models into the Internet

Online sales of books will increase by way of eBooks. The Internet and online bookstores will become the key distribution channels and will take on more tasks. In addition to aggregating the publisher's content, the online bookstore will also take on the traditional functions of physical bookstores, such as offering advice and customer service. These will become more important as a result of online reviews.

As a result of the comparatively low barriers to entering the digital market, all players in the value chain will continue to expand their operations into the Internet—starting with the authors (self-marketing), publishers (own distribution), and intermediaries (directly via their own platform or indirectly via platforms for bookstores), right through to the bookstores themselves (own online shops). In addition, competition will increase as a result of mass aggregators such as Amazon, Apple, and Google, which also boost the market with their own devices.

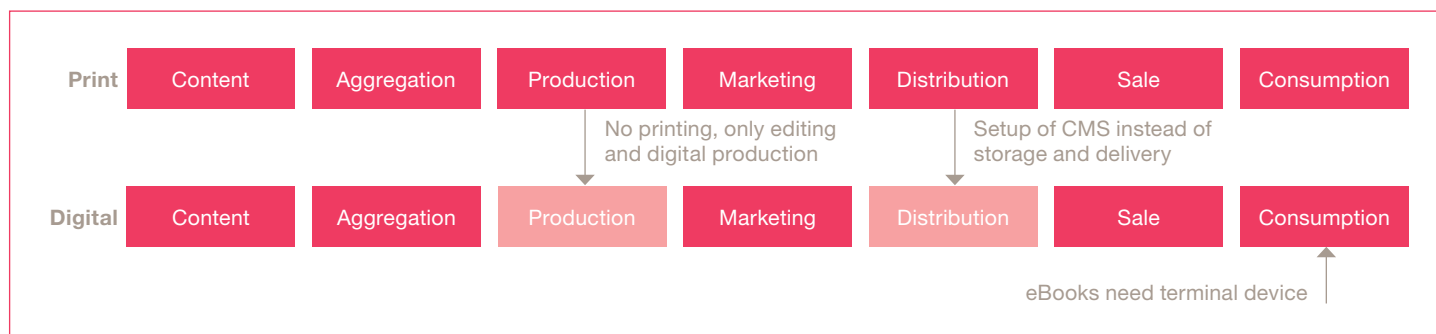


Fig. 3 New value chain of the book publishing industry

⁸ The Hachette Book Group, Penguin, and Simon & Schuster already offer enriched eBooks. David Baldacci's *Deliver Us From Evil*, Ken Follet's *Pillars of the Earth* and Rick Perlestein's *Nixonland* also contain video clips (*Nixonland*, *Pillars of the Earth*), research photos of the author and deleted sections from the manuscript (*Deliver Us From Evil*) and are offered at a higher price than the standard editions. For instance, the enriched version of *Nixonland* costs US\$15.99, US\$1 more than the regular eBook.

What do the experts say?

1.1 eBooks: An Opportunity or Risk?

The book market is undergoing a phase of transition. Developers are introducing new formats, manufacturers are building new devices, companies are creating new business models, and – most importantly – new readers are making the leap from paper books to eBooks. Experts agree that eBooks and eReaders are gaining momentum and are poised to make the breakthrough that will significantly change the book industry. But just what does this transformation mean? What will the market look like? What will consumers pay for eBooks and eReaders, and what do they truly want? Which formats will become industry standards, how long will change take, and how many eBooks will people buy?

To determine the opportunities, potential, risks and significance of this digital transformation, PwC in Germany spoke to more than 40 experts from companies in the book industry. The survey included senior executives from mass market and special-interest book publishers, physical bookstores, online bookstores, intermediaries, device manufacturers, and libraries.

Here is what the survey revealed:

The breakthrough will be achieved in the course of the next few years. We are at the beginning.

Most experts are convinced that eBooks will achieve a significant share of the mass market in the course of the next few years. However, there are reservations regarding the extent of this development.

The following factors were cited:

- The development, marketing, and decreasing costs for eReaders with eInk screens have attracted customers because the devices simulate the experience of reading ink on paper.
- Consumer behavior is changing, with the Internet becoming more pervasive in all areas of life and mobile devices – such as MP3 players, smartphones, and portable game players – becoming commonplace companions. Because consumers are used to carrying devices, familiar with technology, and accustomed to reading onscreen, they are also receptive to eReaders. Apple's iPad, although not designed solely to read eBooks, has raised the profile of eReaders and tablets. More books are available than in the past, and more content is made available every day. The lack of content hindered eReader adoption as recently as a few years ago.

Experts are also convinced that eBooks will continue to be established in the field of professional books. This result is hardly surprising, as eBooks have already made a significant share of revenue in the professional book market segment for several years.

Opportunities outweigh risks

Most experts interviewed consider digital advances in the book industry to be an opportunity. Accordingly, they hope that new target groups can be addressed with eBooks (young consumers, sight-impaired persons, or certain professional groups) and that new sources of revenue can be generated by means of impulse buying and personalized offers. They believe eBooks complement printed formats.

However, some dispute the contention that new target groups can be addressed with eBooks. Critics say new types of reading devices are not likely to convert nonreaders into voracious readers. It is more probable that people who read a lot of books today will buy eReaders and continue to buy a lot of eBooks tomorrow. As a result, publishers may see an increase in digital sales but lose hardcover and paperback sales. The increase in overall sales would be negligible.

The chorus of critics includes some publishers, who say that eBooks represent an increase in costs but not in sales. They predict the digitizing process will require investments that will not be offset, initially, by additional income.⁹ Printed books would still be in demand, but likely with lower circulations, and this would actually increase their unit costs of production.

Some online bookstores also have identified risks with eReaders and eBooks. They say competition is becoming fiercer because companies such as Google, Apple, and Amazon have extended their business models to include sales of electronic books.

⁹ Publishers that have already invested in digital production systems may find the transition less costly and disruptive than those that have not. In the United States, publishers say the cost of producing an eBook is low because the manuscript, editing, layout and production were already handled digitally.

1.2 Market Drivers

The eBook market is in its infancy, particularly with regard to mass market publishers. What factors will significantly enhance the development of the market and pave the way to a mass market? In the opinion of experts, two aspects are relevant in this respect: attractive devices and the availability of content.

Choice of attractive devices is important

Devices are driving the market. For almost all experts, it is very important or important that consumers are able to access a choice of attractive devices. Experts agree that Apple, in particular, will stimulate the market with the iPad. This device addresses a large mass of consumers, and enables eBooks to be downloaded simply by way of iBooks.

Increasing number of eBooks

In addition to the devices, most experts agree that a wide range of available eBooks is key. Indeed, the shortage of eBooks in the past was one of the main reasons why the market did not develop. Many publishers now recognize the attractiveness of the eBook opportunity, both in terms of volume and margins. Accordingly, larger publishing houses, in particular, have significantly expanded their eBook portfolio, and most of them publish all new books in printed and digital form.

However, the digitizing process is posing several problems for publishers that should not be underestimated. For example, publishers frequently have the marketing rights only for the printed and audio content, particularly in the case of older books. Therefore, further negotiations with the authors will be required. These negotiations frequently fail because authors do not respond to the request of

the publishers or do not agree to digital marketing. They also fail because of wide discrepancies between authors' fees and the prices publishers are willing to pay. In addition, eBooks require a level of investment that is particularly difficult for smaller publishers.

The supplementary range of free content, such as that provided by the Gutenberg Project or Google Books, is considered to be less important. This is, at best, an additional driver for encouraging consumers to enter this market. However, this is not a crucial factor for market success, according to the experts.

Closed systems

Experts are of divided opinions with regard to user friendliness and closed systems (so-called walled-garden models). It is true that the Kindle and iPad's user-friendly experiences have helped kick-start the market. However, it was thought that such models in the long term would result in frustration and a lack of acceptance because consumers are critical with regard to access restrictions.

At present, it is not possible to foresee whether open or closed systems will become commonplace. Special-interest publishers, in particular, are critical when discussing the chances of the success of walled-garden models; because users of special interest information primarily work with a laptop, any user restriction might quickly deter them. On the other hand, in the mass market, it would take longer before consumers expressed concern over restrictions. Not surprisingly, executives from online bookstores hope that open systems will become established so that they will be able to gain a slice of the digital pie. The industry also tends to be critical with regard to closed models.

Additional content and updates

Publishers have different views with respect to additional content and multimedia enrichment. While all special-interest publishers surveyed stated this was important, most mass publishers said such features were of minor importance. This trend is understandable if we consider that, for instance, an animation of the blood circulation in a medical book can significantly enhance the reader's understanding of the organism, whereas a video in a novel would be a hindrance to relaxed and in-depth reading. Indeed, according to experts, additional content is a crucial criterion for special interest literature because it creates added value for consumers and opens up further revenue possibilities in the digital environment. However, it is necessary to consider how added value can be offered to consumers with publisher's content and also what services would have to be developed to make the content interesting.

1.3 Market Barriers

According to experts, obstacles are posed by the prices of electronic reading devices, the lack of compatibility of the devices with different formats, and restrictions posed by digital rights management (DRM).

Prices of eReaders are still too high¹⁰

Even if the experts praise the attractiveness of eReaders, they are still too expensive for the mass market. In order to energize the market, eReaders should cost no more than €100 (about US\$135). At this point, only the U.S. and lately also the German market seeing such affordable pricing. The publishing industry representatives involved in this survey were emphatic about low prices. They said that ideally a reader should cost about €50 (about US\$70), with a few bestsellers already installed.

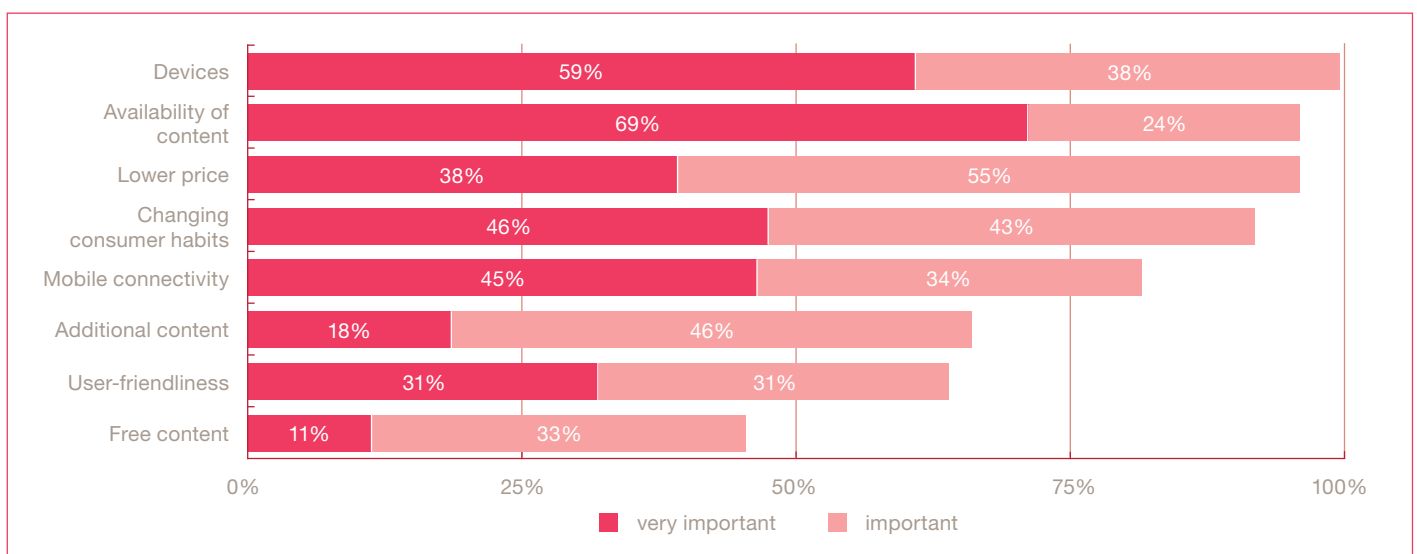


Fig. 4 Drivers for eBooks and eReaders in the opinion of the experts

¹⁰ Rate of exchange: 1€= US\$1.35

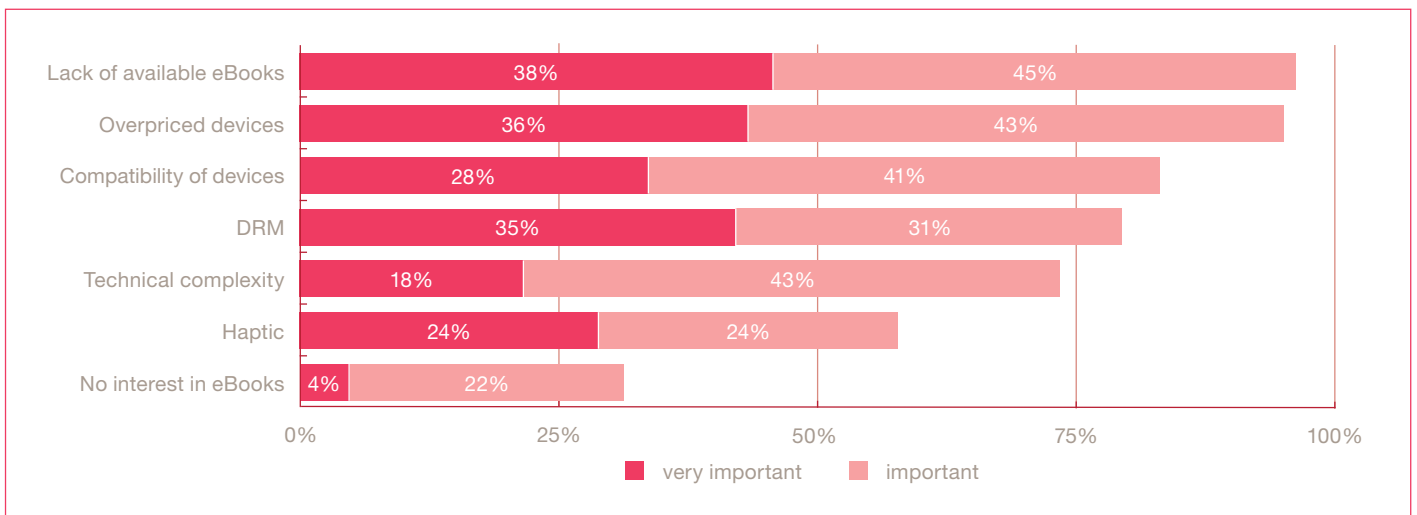


Fig. 5 Obstacles for eBooks and eReaders in the opinion of experts

Digital rights management (DRM) – not an inherent problem

Scarcely any other subject has stirred more intense discussions in relation to eBooks as DRM. The publisher or the author is responsible for deciding whether eBooks are granted protection. DRM is not limited to one format and is fundamentally conceivable in all formats. In general, Adobe Digital Editions (ADE) copy protection is used for this purpose. In order to read text, users must first install ADE on their PC or mobile reading device, and then register with an Adobe ID. This is a relatively complicated process and distracts the user experience.

One alternative to Adobe Digital Editions may be a watermark, which is partially visible for the consumer but not distracting. This means that purchased eBooks can be uniquely allocated to one consumer. The advantage of a so-called soft DRM strategy is that it does not have a negative impact on the process of reading eBooks.

Another option is the model introduced in the US by Amazon and Apple, in which content is registered to one user. This DRM policy allows the user to read eBooks on many devices, but not to transfer it to a device registered to someone else. The restriction often goes unnoticed and usually does not affect consumers.

In the long term, most experts expect cumbersome DRM will disappear and that developments on the eBook market will follow those that have been seen on the music market. Music publishers abandoned DRM in spring 2009, after a lengthy battle against file sharing. Experts believe that abolishing DRM is necessary sooner rather than later because illegal content will be available anyway as the market develops, and that DRM will not be able to perform its protection function. Most experts expect that soft DRM will become established.

The advantage of soft DRM is that the legal owner is easy to identify, and that the use and forwarding of the electronic book is not affected by the watermark.

Technical complexity – not an issue for everybody

Online bookstores and physical bookstores also complain about the technical complexity of the devices and claim that eReaders should be intuitive.

On the other hand, for experts of publishers or special interest publishers, technical complexity is less important. In their opinion, the problem is the willingness of consumers to tackle the problems associated with new devices for reading books.

Customer interest and look and feel

Nevertheless, experts believe that consumers are (at least potentially) interested in eBooks. Even the look and feel argument – that consumers would prefer to hold a book in their hands and thumb through the pages – appears to be an unimportant factor. On the contrary, industry representatives agree that this attitude will change as soon as consumers have tried out eBooks and eReaders.

No Oprah Winfrey effect

Most experts believe Oprah-moment consumers have not yet been adequately informed of the advantages of electronic reading. One expert believes that, in Germany, there has not been an Oprah-moment for eReaders. “When Oprah Winfrey holds the Kindle up to the camera and says, ‘I love this device’, at once, the target group that identifies itself with Oprah Winfrey will consider whether to purchase such a device. This still has to happen in Germany.”

The experts consider that there are two not-to-be underestimated arguments

against eBooks: The book on the shelf and the book as a gift. Books are a prestige object frequently used to demonstrate the owner’s authority, taste, and education. They are also a popular gift for birthdays, holidays and other special occasions.

1.4 Pricing and Distribution Models

There are also major differences among experts with regard to the pricing of eBooks. Overall, approximately half of industry representatives consider that a discount of between 20% and 30% compared with the paperback price is necessary to kick-start the market. Even publishers believe eBooks should cost less than printed books to encourage the development of the market. Consumers are less willing to pay for eBooks because they do not believe they are acquiring a tangible object: they receive the rights to a virtual asset instead of a physical product made of paper and ink that has been printed and shipped. Online bookstores, intermediaries, and device manufacturers therefore believe that publishers should permit a discount compared with the prices of printed products.

Mass publishers and also most special interest publishers, on the other hand, are convinced that there is justification for setting the price of eBooks at least at the level of paperback editions. This is because publishers incur additional costs as a result of the production of eBooks; together with the full VAT rate of 19% charged for digital content, this exerts pressure on margins. This is especially true in an early market state. A further aspect is that some authors demand higher fees for the digital marketing rights. In the opinion of the publishers, this does not appear to be very acceptable. Some publishers also believe that the prices of eBooks should be higher than the prices of printed books if the eBooks contain multimedia enrichments.

Club and subscription models as well as product combinations are conceivable

Club or subscription models, in which the consumer purchases an eReader for a low or subsidized price and pays a certain flat rate per month for books, are considered feasible by most industry experts. This would increase penetration of the devices in the market, and sales of eBooks might surge, assuming that the devices are indeed used for reading books. However, publishers consider that the specific design of such models might be an obstacle to market success. There are problems, for instance, with regard to legal issues and authors' fees.

Most experts believe there will also be a market for jointly distributing eBooks and printed books. It is also conceivable that consumers might read an eBook on their mobile reading device during the day when traveling and that they would then have the printed version on their desk when they arrive home. Such solutions would be attractive, for instance, in conjunction with a cloud model, in which consumers acquire the rights to access digital books and would be able to access their eBooks with any device with online capability via their secured online access. In this case, the book would not be stored on the devices; it would be stored in the cloud, as it would be the case with Google Digital Editions.

No advertising banners between the lines

Advertising might also be integrated in eBooks to reduce the prices of electronic books or to open up new sources of revenue. However, most respondents agree that such models could only function in conjunction with electronic sales of newspapers and magazines. Here, new types of digital ad models (beyond conventional online display and search) might present ad opportunities that are more appealing to consumers, advertisers, and publishers, such as a video pre-roll prior to a download or the placement of logos, ads, or coupons on the device home screen.

Not only consumers may not accept advertising in eBooks, also advertisers are unlikely find advertising in eBooks attractive. Devices on the market lack the functionality to implement advertising. And authors may take a critical stance with regard to advertising banners in their books. Only some special interest publishers could imagine using advertising in eBooks.

1.5 eReaders or Tablets?

Will multifunction tablet devices such as the iPad push eReaders out of the market?

In view of the strong market success in the United States, and notwithstanding the defects of and criticism leveled at eReaders, most experts expect that both device categories will co-exist. However, the prices of eReaders will have to drop further for this to occur.

Representatives of the industry assume eReaders will occupy a niche market. They are suitable for people who read a lot and who do not wish to be disturbed by other functions, such as incoming emails. eReaders might also be attractive for elderly readers: those with weak eyesight can adjust the typesize and font size to make reading easier, while those with impaired mobility can purchase new books from the comfort of home.

The experts are convinced that both breeds of devices – tablets and eReaders – are at the early stages of evolution and will undergo significant changes. The experts expect that the devices will be merged, particularly if color eInk displays become marketable. The trend is going clearly in the direction of more usability, connection to mobile networks, and color.

1.6 Looking to the Future

All experts agree: eBooks and printed books will co-exist. In certain cases, printed editions will be replaced by digital editions, but in other cases both media will complement each other. In the long term, only one representative of the industry expects that demand will dry up for printed books. Most experts believe eBooks will partially replace the paperback. This is probable particularly in the case of special interest and travel books and in areas in which only sections of books are read.

On the other hand, experts are less optimistic with regard to printed newspapers and periodicals. The vote in this case is by no means clear. Tablets such as the iPad will ensure that newspapers and periodicals can be attractively displayed in digital form and that they can be purchased or acquired as part of a subscription at any time as a result of the integrated Internet access. Accordingly, experts expect that the newspaper and periodical publishers will have to devote more attention to the digitizing process because, according to the majority, some editions will be replaced by apps.

1.7 Challenges Facing Companies

eBooks are changing the value chain in the book industry. The challenges are great for all parties involved, but experts say the opportunities are also great. This is because any company establishing a well-thought-out position will have the prospect of additional business in the digital market. On the other hand, if a company fails to

take the opportunity, it might find itself at a disadvantage with regard to the competition and may lose revenue and market share.

Publishers: Transfer the business model to the digital environment

The main challenge facing publishers, according to the experts, is to avoid making the same errors as the music industry. This will require a new business model, a wider range of content, and clarifications regarding the question of copyright. In order to meet these challenges, publishers will need to adapt their business processes. To integrate content properly, editors will have to become familiar with the special features of the eBook. Legal departments will have to devote more attention to rights for eBooks and draw up fee models to take new circumstances into account. Publishers will have to concentrate to an even greater extent on the role of a content provider. It is, therefore, essential for these ideas to be established in the minds of employees, and for these employees to incorporate these technological aspects and ideas in relation to eBooks.

Special-interest publishers, in particular, will face a greater challenge. They will have to generate products with additional content to meet their customers' needs. These products will have to offer additional value to generate sales. It is true that customers are prepared to pay for additional content, if they can clearly derive its benefit. This is also confirmed by a current study of PwC concerning the development of the market for special-interest information: Consumers expect to receive greater support in their work processes– irrespective of the media form and in line with the individual needs of the specific work situation.¹¹

No threat due to self-marketing of authors, so continue maintaining strong relationships

Despite the digitizing process, publishers do not fear a significantly negative impact on sales. In particular, they are relatively unconcerned with regard to the risk of self-marketing of authors via the Internet. Nonetheless, some bestselling authors have proven successful at marketing their own books and related products. Publishers should not take their relationship with authors for granted. They should continue to work as the authors' partners in marketing, selling, and promoting books.

Online bookstores: Generating content and assuring unique selling points

Experts in online bookstores agree that a comprehensive range of products is the most important factor for distinguishing a

11 PwC: *From paper to platform: transforming the B2B publishing business model*, 2009.

Discussion: Electronic Newspapers and Magazines

company from its competitors. According to the experts, the range of products must be compatible with the devices in order to provide various customer groups with the best reading experience. In addition to PDF, an extensive range of books in the ePub format is therefore particularly crucial factor. Simple user guidance is also essential. In addition, the online bookstores state that the arrival of new players in the market (for example, Google and Apple) represents the most significant challenge. It will be crucial for players to gain a strong market position, especially in Europe, through a first mover advantage.

Bookstores will have to restructure themselves

“I would not want to be a bookstore in this business”, said one of the experts. He was not alone with this opinion. Most experts are predicting lower sales of physical books, due mainly to the success of the online bookstore Amazon. In addition, the increasing distribution of eBooks will be a big factor in future business models.

eBooks and eReaders allow authors and publishers to circumvent the bookstore and reach end consumers directly. Bookstores will have to work hard to build, maintain, and strengthen relationships with customers through consumer knowledge, profiling, customized recommendations, and the ability to complement local selection with online products.

Even small bookstores will have to meet the challenge posed by the digitizing process

Internet sales also offer smaller bookstores the opportunity to participate in digital business. This is because the market's systems enable an independent online shop to establish itself. However, many experts believe that bookstores have a long way to catch up in this respect.

The intermediary market is changing

Wholesalers and intermediaries are also facing several changes. It is true that services such as transport and storage are no longer applicable. However, intermediaries have retained their clearing functions. In addition, they could also provide services such as hosting, conversion, storage, or delivery, and would be able to assume responsibility for optimizing processes and economic procedures. They might also offer contract clearing.

The main challenge facing intermediaries is that they will also have to position themselves as relevant service providers in digital business. To do so, they would have to invest in technology and skills. Even if new services such as hosting for documents, conversion, eBook storage, or delivery of eBooks were to be added, it is not necessarily the case that intermediaries would provide these services.

The following chapter summarizes consumers' attitude with regard to the new type of reading: whether they will buy eBooks and eReaders or tablets; what conditions will factor into whether they choose to buy; and what expectations they have with regard to the development of the book market.

The development so far

Newspaper and periodical publishers have been affected by the same trend for many years: Circulation figures are declining, and advertising budgets are increasingly being shifted to the Internet. In addition, readers are going online more frequently, demanding their news in digital form, but they are not prepared to pay for such a service. In order to open up new sources of revenue, compensate for falling circulation figures and stagnating advertising revenue, and make themselves more independent of advertising business, publishers are increasingly concentrating on paid content for their online products and digital revenue models. For example, USA Today announced in August 2010 a strategy that places digital content in the center of all activities. Apple is considered to be the solution in this respect because the company with its App Store has been the first company to make paid content acceptable. Apps for mobile devices are expected to curtail users' expectations for free content from the Internet, and to create new revenue streams for publishers. The App Store is proving fertile ground for publishers. So is the Kindle, which allows customers to buy single copies or subscriptions to newspapers and magazines.

No wonder publishers were excited when Apple announced the iPad, a tablet that resembles an iPhone with a larger screen. In the weeks leading up to the iPad's launch, it was nearly impossible to find a newspaper, website, blog, TV station, or radio that did not mention the device. Mathias Döpfner, CEO of German newspaper publisher Axel Springer, said, "Every publisher should thank God every day that Steve Jobs is rescuing the publishing industry with the iPad." Several US newspapers and magazines have launched apps for the iPad. Free apps include the The New York Times Daily Edition and USA Today. Paid apps, which cost between US\$3.99 and US\$4.99 for each issue, include Wired, the New Yorker, and Vanity Fair.

Range of products for eReaders: Different from one country to another

In America, the choice of electronic publishing products for eReaders is much larger than is the case in other countries: Amazon is offering 132 newspapers and 40 periodicals for its Kindle as a subscription or single issue. Barnes & Noble has announced to expand the range of offered newspapers and periodicals for its Nook with a colored screen.

However, the search for specially processed digital newspapers and magazines for electronic readers in European countries

has so far been in vain. And for a good reason: The devices available on the European market do not have mobile access, which makes it difficult to download subscriptions to newspapers and periodicals onto the device. In addition, eReaders are scarcely suitable for newspapers and even less suitable for periodicals because of their small size, their monochrome displays, and the limited facility for displaying images and graphics.

Tablets – A success model for paid content?

Tablets are expected to be the breakthrough product for newspapers and periodicals. With mobile Internet access, color diagrams, good display quality, the possibility of displaying videos, and accepted distribution channels, they form a virtually ideal platform for the digital range of newspapers and periodicals.

The United States is, once again, the pioneer. Major newspapers such as The New York Times, The Wall Street Journal and USA Today as well as periodicals such as Time or Newsweek offer apps with functionalities and content that go far beyond what is available in Europe (especially concerning non-English content). The free and advertising-financed app of the The New York Times had been downloaded more than 400,000 times by the end of July 2010. And more than 10,000 iPad users have subscribed to The Wall Street Journal for a monthly fee of US\$17.99. The advertising space within the apps was in demand even before the launch of the iPad; for instance, Morgan Chase booked all advertising space of The New York Times app for 60 days, and the advertising space of The Wall Street Journal was overbooked at the beginning.

Despite the success of the apps, some consumers use the iPad to simply go to websites, which are way more appealing on the larger screen of tablets than they are on smartphone screens. With more tablets joining the market, a possible development could be that apps will give way to specially designed web pages, which offer the same functions but are not accessed by a store and are free on the Internet.

However, the response of numerous European publishers is moderate compared with the restrictive business policy of Apple, which currently dominates the market with the iPad. Indeed, the company demands a sales commission of 30%, controls the content, and blocks access to all user data. In order to stimulate the competition, numerous publishers are working on producing a generic solution, as further tablets will be launched on the market in the course of the next few months.

Consumers are considering newspaper and periodical subscriptions on tablets and readers, but the focus is on reading books.

The fact that publishers have taken a step in the right direction is also confirmed by a PwC consumer survey. Consumers are receptive to digital reading of newspapers and periodicals. Although book reading is considered to be the more important function, 36% to 49% of periodical subscribers and 30% to 48% of newspaper subscribers would use the iPad for reading electronic newspapers and periodicals.

The situation with eReaders is similar: Approximately one in three newspaper subscribers considers that reading magazines on the eReader is a possibility, and 29% to 34% of newspaper subscribers also consider that it is conceivable that they would page through their newspapers on an eReader. However, the focus with eReaders is also on reading books: About 70% of consumers would use the eReader for purchasing and reading mass market titles.

If consumers are asked to describe their attitude toward digital publishing products, one in ten consumers says that he or she might subscribe to digital newspapers and periodicals; the figure in the United States is 16%. Indeed, half of all people covered by the survey are thinking about an electronic periodical subscription. Subscribers and nonsubscribers are also in agreement with regard to the future viability of printed products. About two-thirds believe that digitally distributed newspapers will at least partially replace the printed editions; only 24% (US) to 45% (UK) of people covered by the survey continue to believe in the printed edition without any restriction.

What do customers want?

Are consumers aware of the possibility of taking their library with them everywhere? What do they think of electronic reading devices? What product characteristics are important for them? Are they willing and prepared to purchase eBooks in the future? If so, at what price? Are there regional differences among eBook and eReader consumers in the United States, UK, Germany, and the Netherlands? What are the reasons for such differences?

In order to be in a position to answer these and other questions, PwC has carried out a quantitative survey of end customers in the aforementioned countries. An online questionnaire was used to interview 1,000

people between 18 and 65 in each of the surveyed countries.

1.1 Popularity of eBooks and eReaders

Even without much advertising, consumers have at least a vague idea that books can also be read in digital form and on specific devices. The concept of the eBook is known equally in all countries. Fewer than one-fifth of respondents in Germany, the United States, and UK said they owned at least one eBook; in the Netherlands, only 8 percent said they had an eBook.

In general, eBooks are purchased by younger, well-educated adult males who

like to read. On the other hand, nonbuyers tend to be older and female consumers who read and buy books less frequently.

About one-third of Germans surveyed have not heard of an eReader. In comparison, fewer than one-fifth of the people interviewed in the United States, UK, and the Netherlands said they were unfamiliar with such devices.

The distribution of eReaders is (unsurprisingly) most pronounced in the United States, where 7% of survey participants have an eReader. The latest reduction in the prices of eReaders is likely to boost the market even further: The results of the consumer survey show that only 15% of US consumers would pay more than US\$200 for a device, but that an additional 31% would consider purchasing an eReader for a price between US\$100 and US\$200. The Nook and the Kindle have fallen below this critical price threshold. This will not only boost sales in the US. Also on the international scene, demand is likely to rise appreciably due to the now affordable devices.

The distribution of eBooks is comparatively low, and most survey participants do not

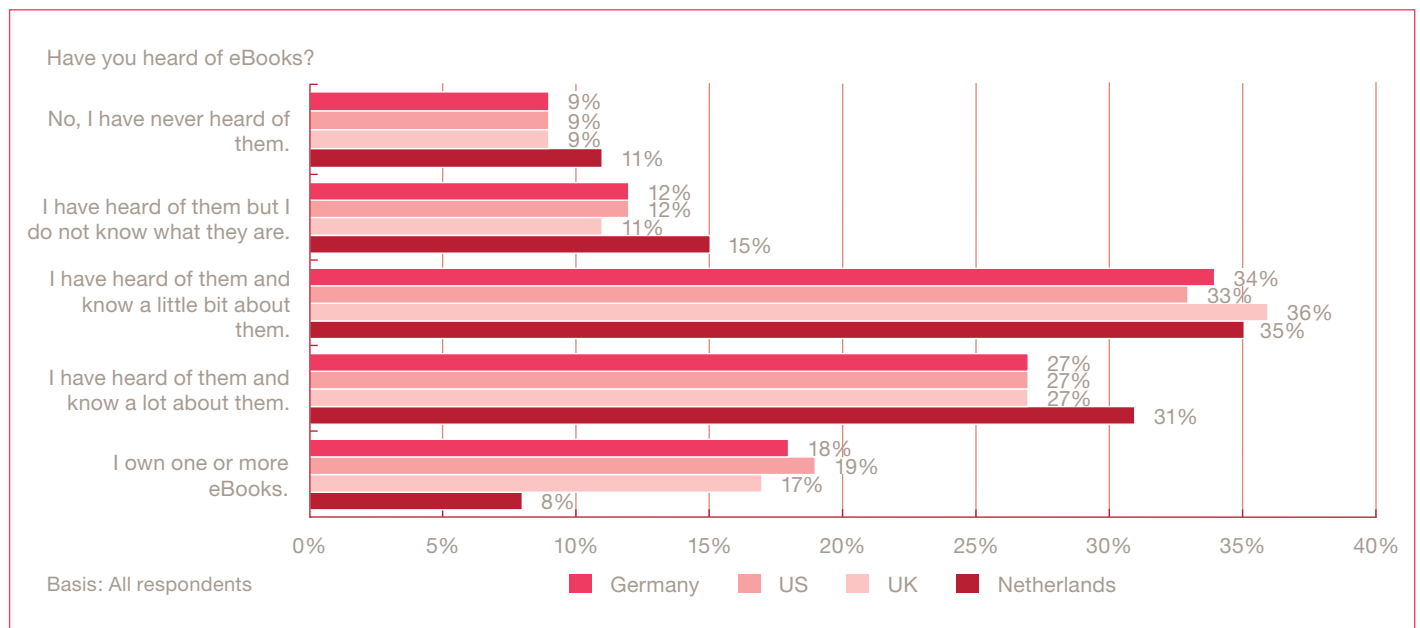


Fig. 6 Popularity of eBooks

own any eBooks – except in the United States, where 7% of consumers already possesses an eReader. But the market is gradually picking up pace. Indeed, 20% of people surveyed in the United States, 17% in the UK and 14% in Germany purchased at least one electronic book last year. In general, consumers often still use their computer for reading eBooks; eReaders have not been established as reading devices.

Country-specific differences with regard to the appreciation of eReader functions

There are various differences in the individual countries what consumers consider as important criteria for eReaders. The look and feel aspect is a major element particularly in the Netherlands and in Germany, and is an argument against buying eBooks. On the other hand, US-Americans and the British are more

prepared to apply an eBook. Moreover, a wide range of eBooks is particularly important for Americans and the British. This is not surprising because they already have the advantages of a choice of several hundred thousand books. As specific advantages of eReaders, consumers in other countries also appreciate the mobility, space savings, rapid availability, and environmental friendliness.

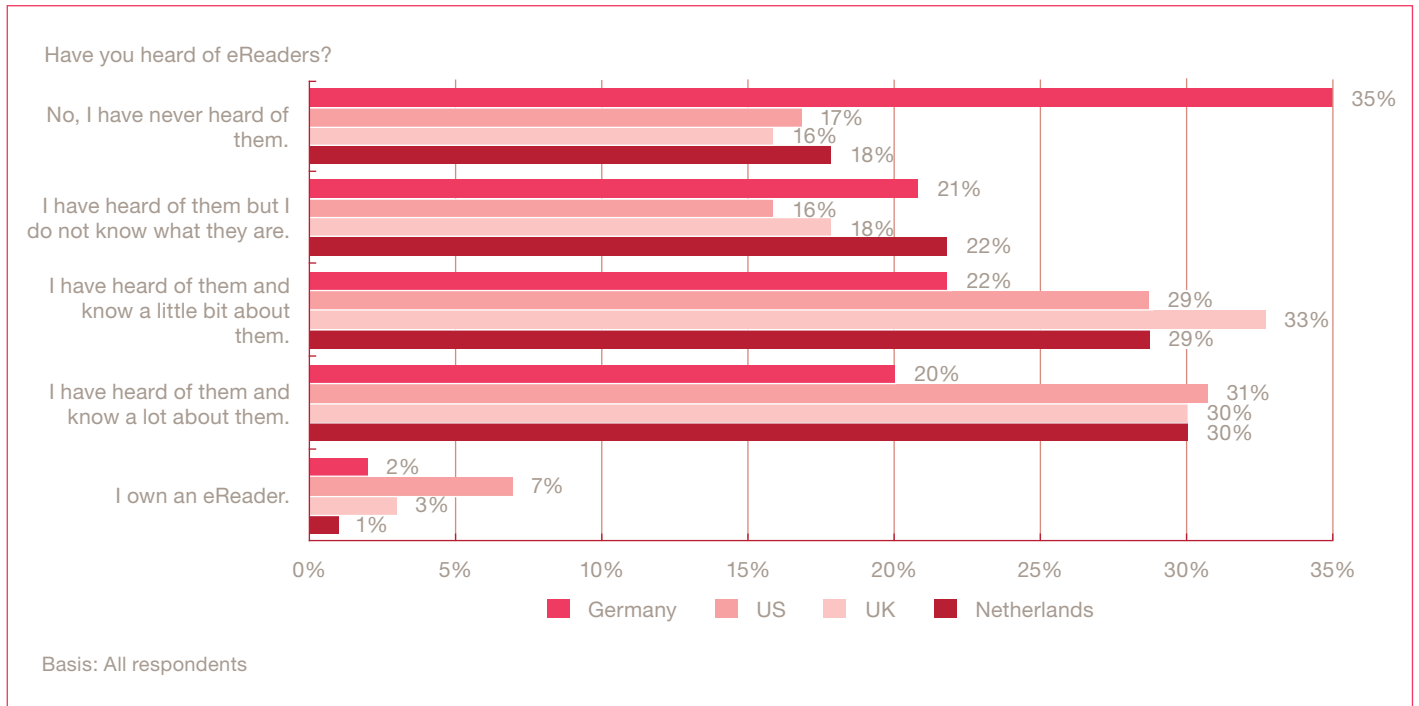


Fig. 7 Popularity of eReaders

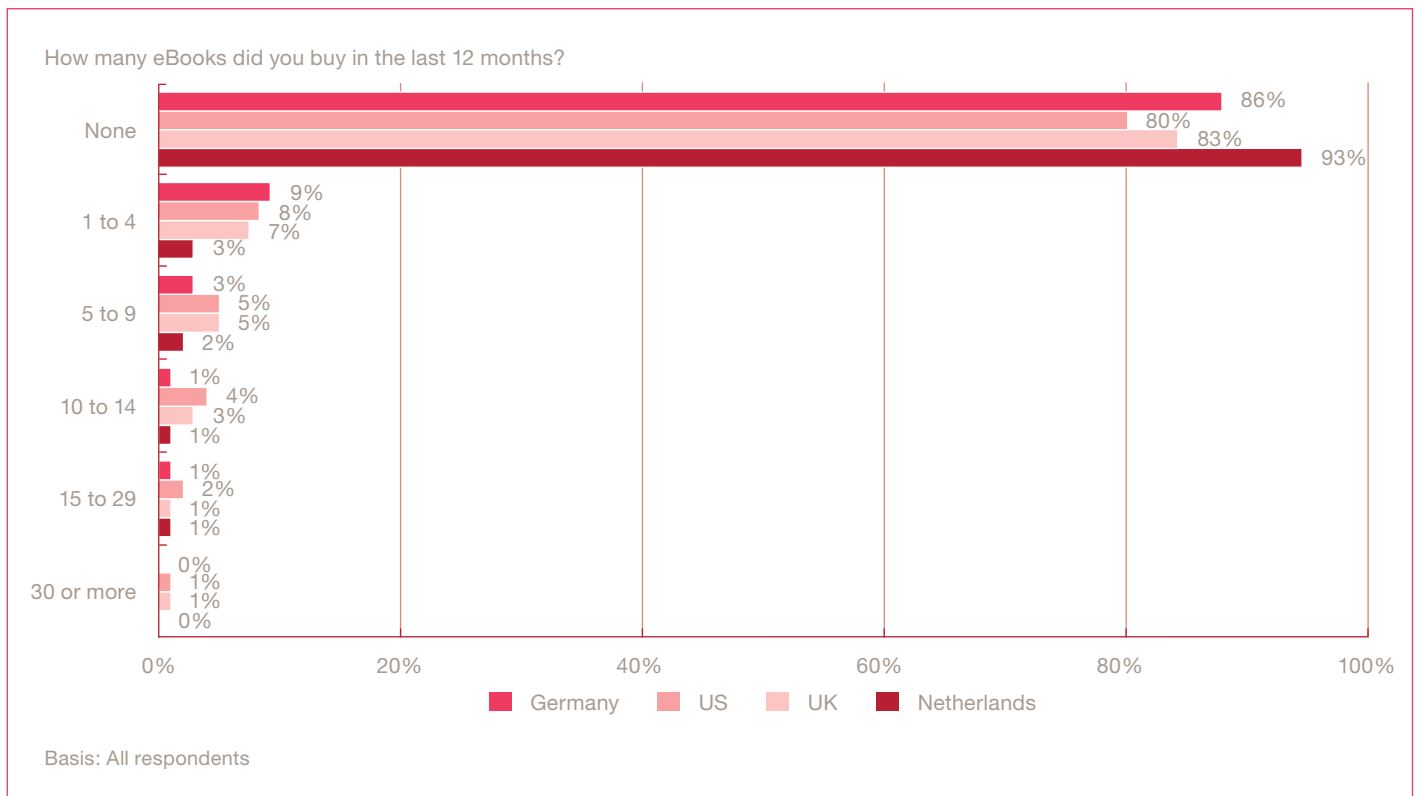


Fig. 8 Number of bought eBooks in the last twelve months

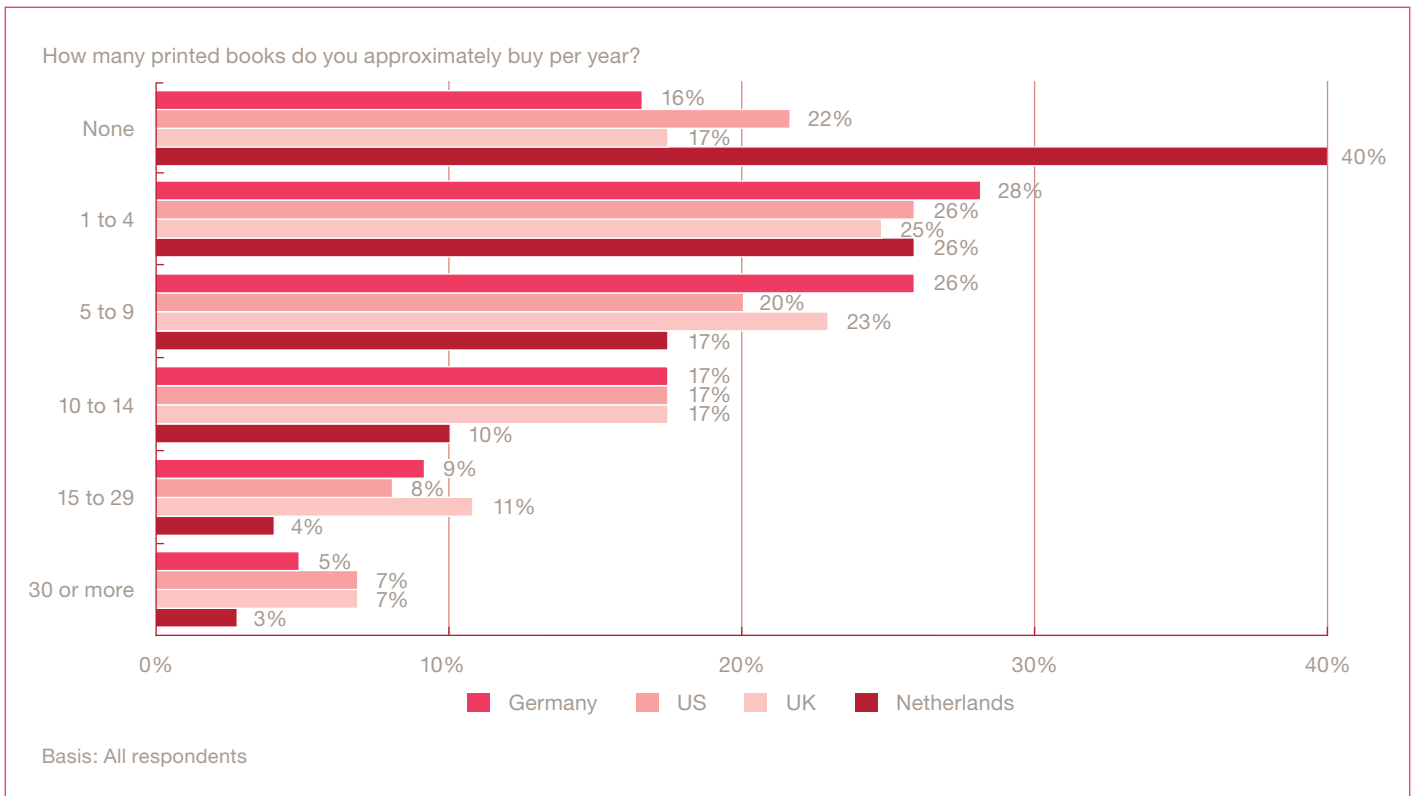


Fig. 9 Number of bought printed books in the last twelve months

More respondents in the United States and UK said direct mobile access to an eBook store is important than respondents from Germany and the Netherlands. This is probably also due to the fact that many devices distributed in the United States and UK (the Kindle, Nook, Sony Digital Editions, iRiver Story) are already equipped with this function, and because consumers would consider that it is relatively impractical to purchase and transfer the books via the PC. In general, there is much stronger interest in eReaders in the United States and UK, and considerably more consumers in these countries are intending to purchase eReaders than in Germany and in the Netherlands.

On the other hand, there are no differences with regard to the competition of eReaders and tablets. However, consumers tend to prefer to use eReaders over multifunctional devices. This is due mainly to the fact that add-on functions such as music, camera, telephone, video, and other applications result in a higher price.

How important are the following features of an eReader for you?



Basis: Only Owners and Interested in eReader

Fig. 10 Appreciation of product characteristics of eReaders

1.2 Revenue Models

Price is an obstacle to market success. Consumers are expecting much lower prices for the readers and electronic books. Approximately half of all people surveyed said eBooks and eReaders are too expensive. Only 15% of the consumers interested in buying would pay more than €150 (about US\$210) for an eReader, and more than 60% said the price should be below €100 (about US\$140).

Consumers said eBooks should be less expensive than paperbacks. Respondents from Germany, the Netherlands, and the UK had similar ideas about eBook pricing; only those from the United States said price is not a critical factor. The highest price people are willing to pay in the UK, the

Netherlands, and Germany is about 60% of the price for a paperback edition (or €6), while US\$10 is perceived as acceptable in the United States. The US result is hardly surprising, considering that Amazon conditioned the market with its US\$9.99 price policy starting in 2007 – and this also has to be considered in conjunction with a much higher hardcover price in the United States. Even the recent price increases evident for eBooks will probably have virtually no impact on the popularity of electronic books in the US because most eBooks (about 80%) are available for about US\$10 and because Amazon has reduced the prices of its eReaders.

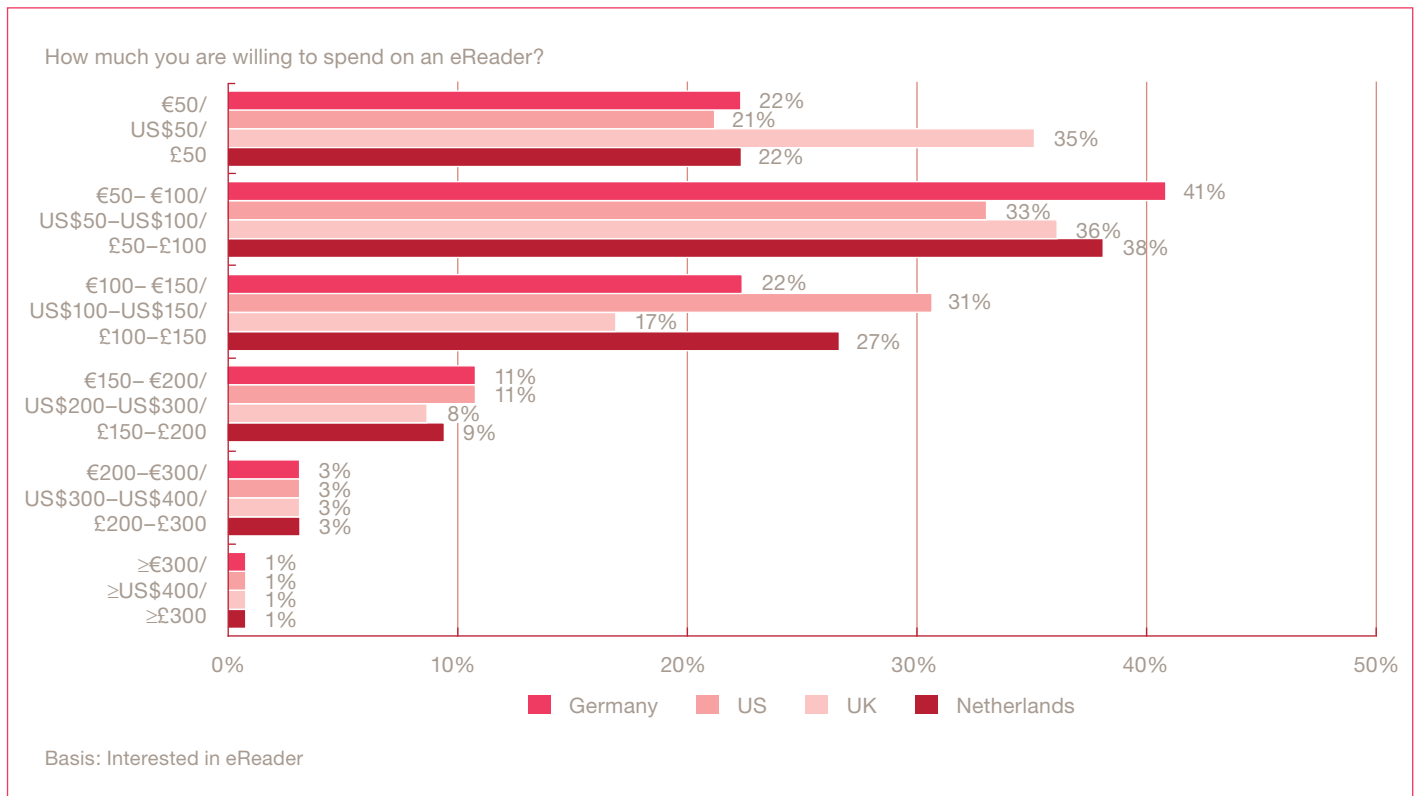
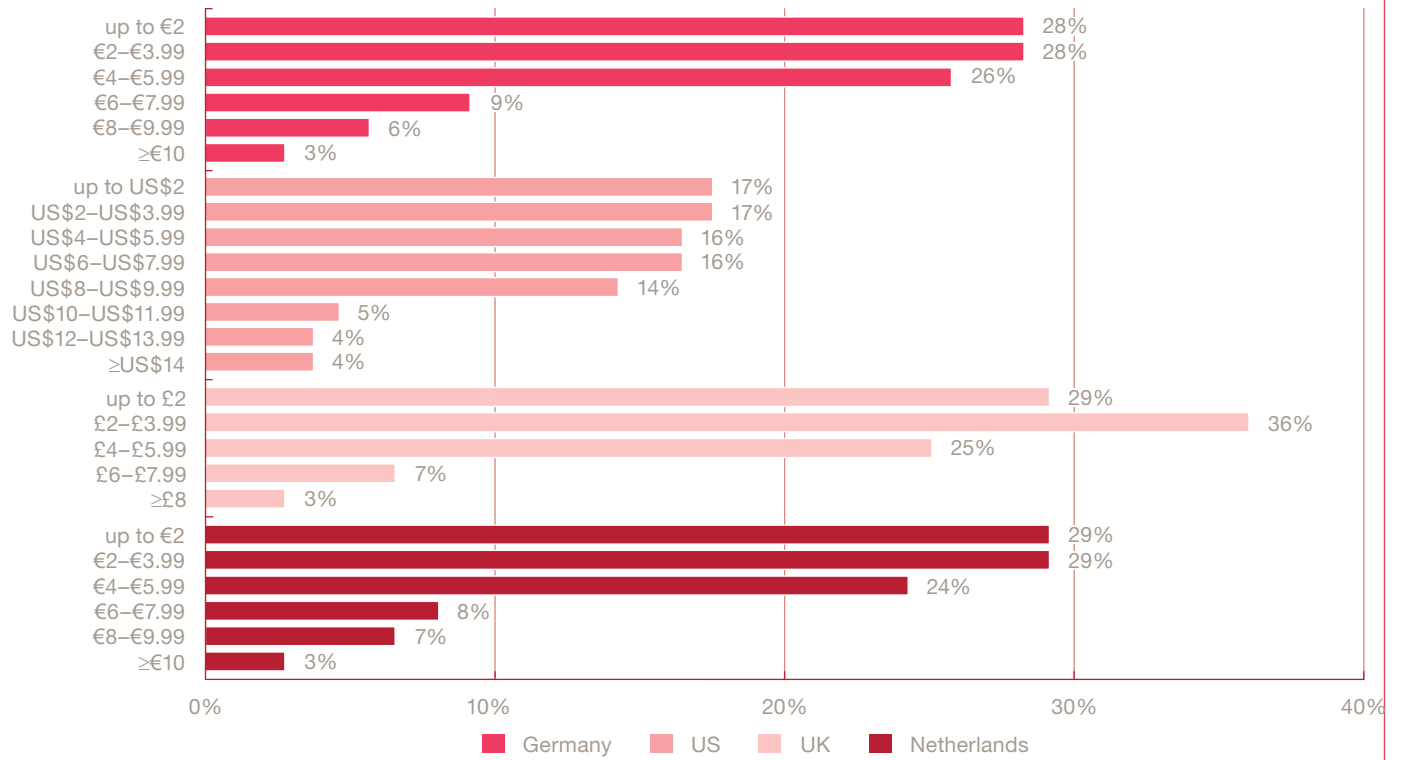


Fig. 11 Willingness to pay for eReaders

How much you are willing to pay at most for an eBook if the price of the corresponding paperback is €10/US\$14/£8?



Basis: All respondents

Fig. 12 Willingness to pay for an eBook

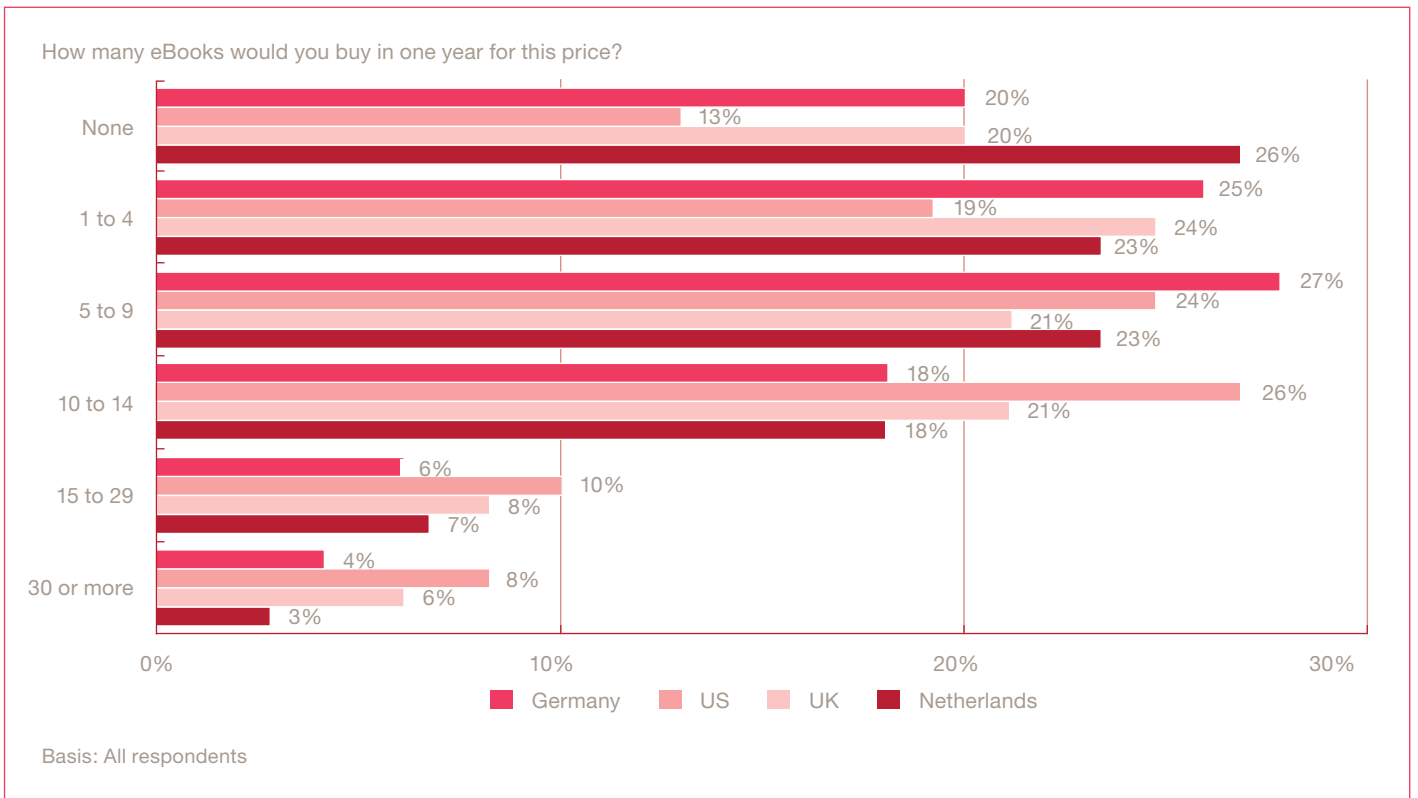


Fig. 13 Number of potential eBooks bought per year (acceptable price)

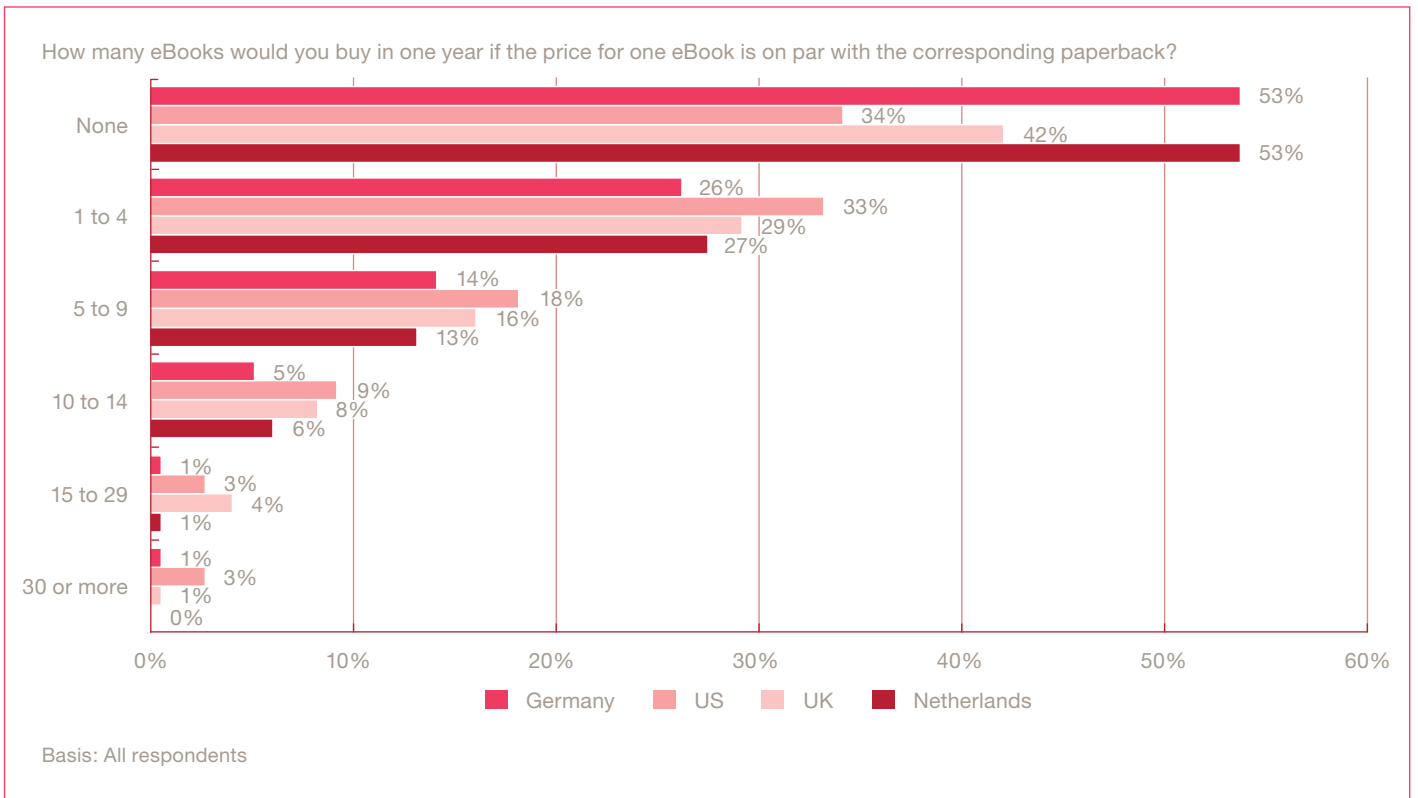


Fig. 14 Number of potential eBooks bought per year (at price of paperback)

1.3 Purchase Intentions: Tablet or eReader?

Would consumers buy an eReader if the price was right? Most people in the survey would consider this, but only 3% to 8% said they intended to buy a device in the next six months.

On the other hand, what is the situation with regard to tablets such as the iPad? Do consumers prefer a multifunction device compared with a simple eReader? Does the iPad make the eReader device superfluous or redundant? Or do the two devices complement each other? Surprisingly,

most of the consumers covered by the survey prefer a reader, which can be used only for displaying books, instead of a multifunctional device, provided the eReader costs less than a tablet. Survey participants would also use a tablet as an eReader if they purchased one. More than half the people interviewed said they would use the tablet for reading mass market books, while 29% to 41% would also consider using a tablet for reading special interest books, and one-fourth to one-third would use it to read newspapers and magazines. Only respondents from the Netherlands stood out in the survey: just

17% said they would use an iPad or similar tablet as an alternative to an eReader for mass market titles.

As is the case with eReaders, there is a gap between the number of people interested in tablets and the number actually planning to buy them. The survey shows that 53% to 63% of participants are interested in a tablet, compared with 56% to 76% who are interested in an eReader. However, only 1% to 5% said they intend to buy a tablet in the next six months (Fig. 15).

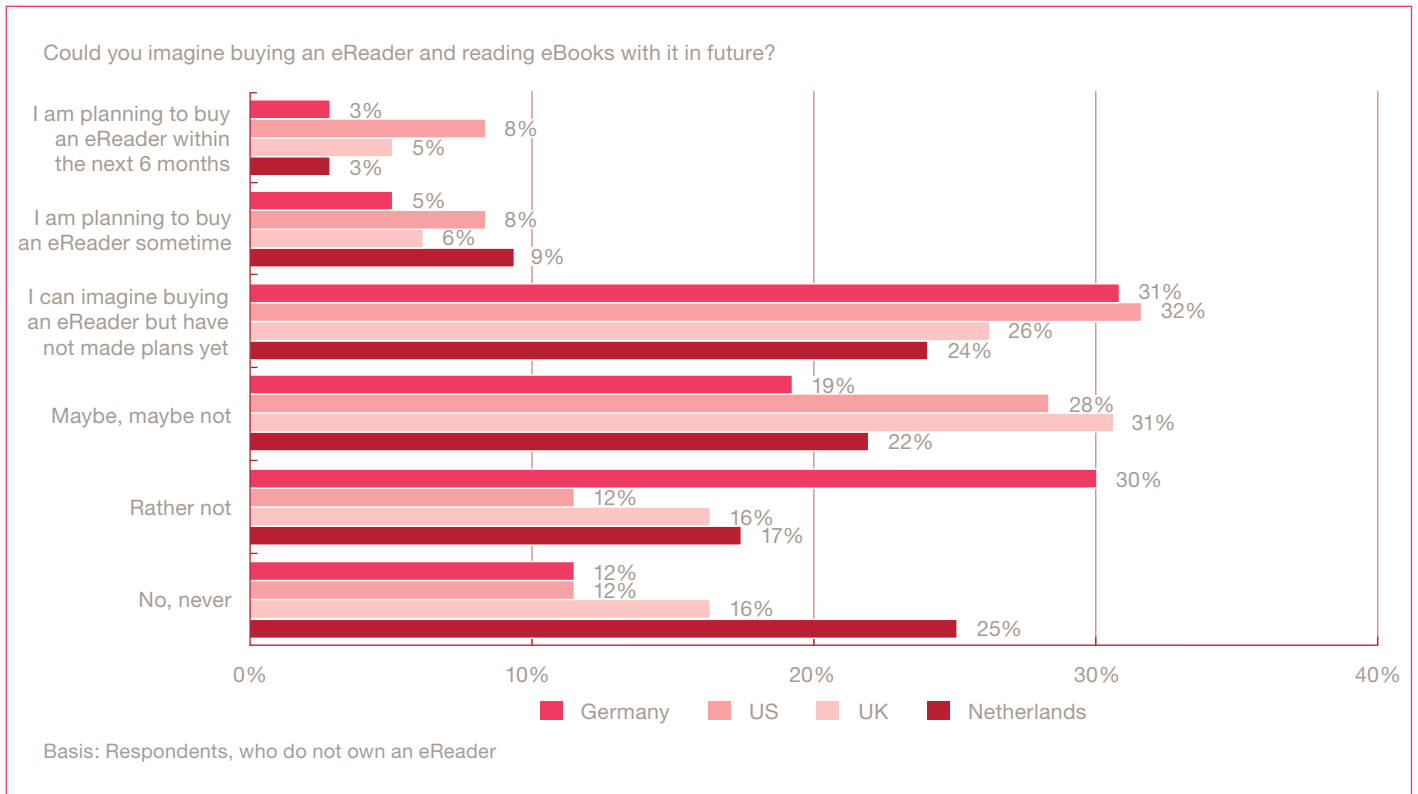


Fig. 15 Buying interest eReader

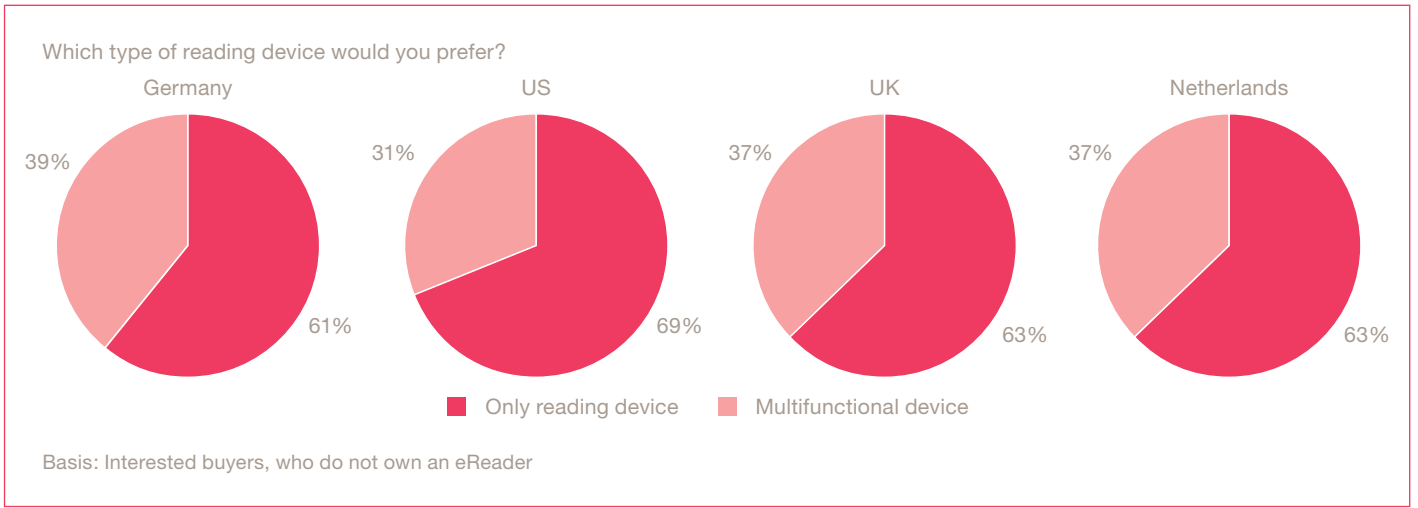


Fig. 16 Preferred device

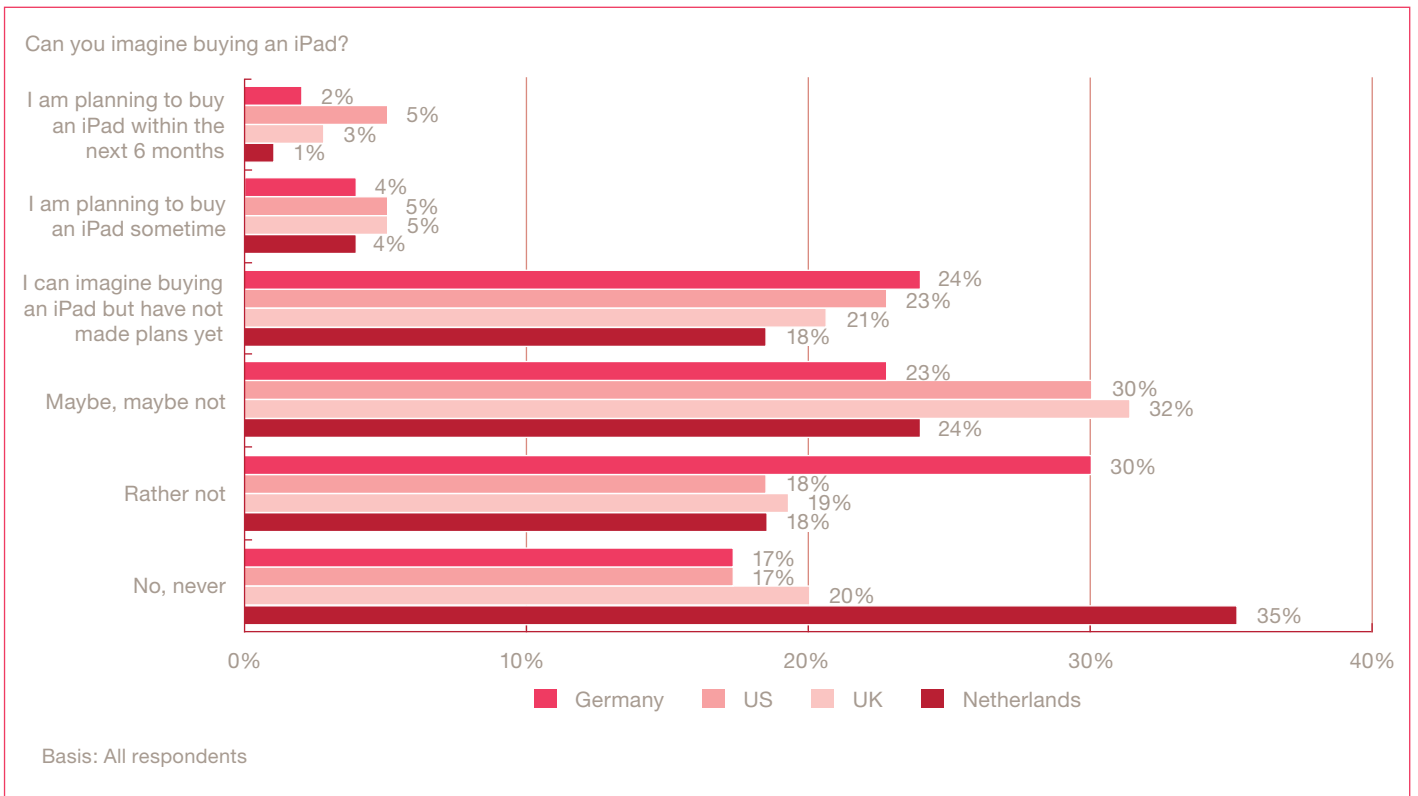


Fig. 17 Buying interest iPad

1.4 The Future

Survey participants assume that printed books and eBooks will co-exist. Acceptance of eBooks appears somewhat stronger in the United States and UK. In the United States, for example, 7% of respondents said they plan to only read eBooks, online newspapers, and online magazines.

Fig. 18 summarizes the assessments of the future in the various countries.

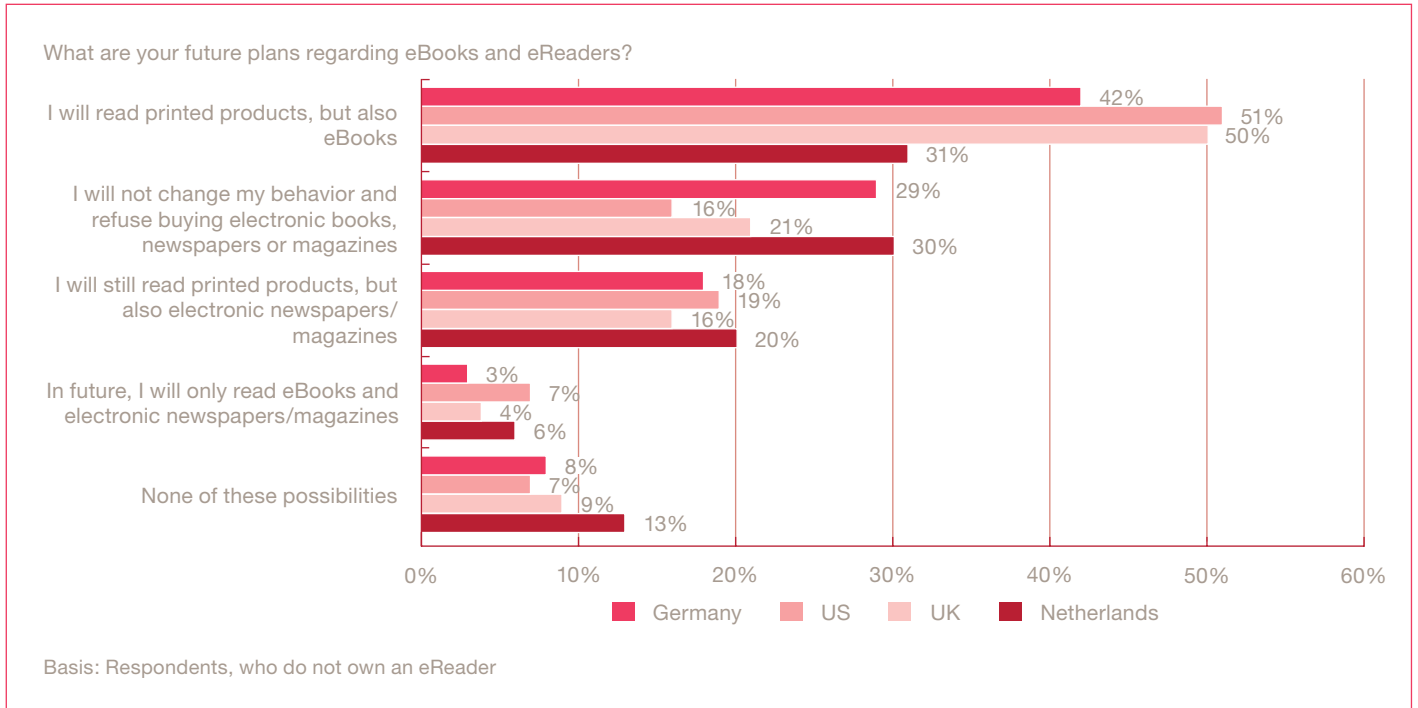


Fig. 18 Future behavior

What conclusions can be drawn from the assessments of the experts and the consumer survey?

How will the book market develop?

What action can be recommended for the various players in the market?

These final questions will be answered in chapter D.

Outlook and recommended action

1. *The Situation in the Year 2015*

The Gutenberg era is not about to come to an end. Printed books will still exist. After television, we still have cinema and radio. There is no need to fear that bound books will only be found in museums, connoisseurs' collections, and in antique markets, or considered curiosities the same way we now view eight-track tapes. The book industry that we know and understand today will continue to thrive, but it will be transformed by eBooks and eReaders.

In coming years, printed books will still account for the majority of sales. Technology may change rapidly, but people's habits do not. People will continue to want books to fill their shelves, give as gifts, and place on their bedside. But make no mistake – modern reading devices such as the Kindle and iPad mark the beginning of a digital transformation, and the book market has taken its first, irreversible steps into new territory.

At this point, it is difficult to predict how quickly developments in the book industry will play out. The momentum in the US eBook and eReader market shows what is possible in Europe. What's to come soon:

- Prices for eReaders will fall, and color screens and Internet connectivity will become commonplace. They will

remain less expensive than tablets, and have fewer features to disrupt readers.

- Tablets will be lighter and have longer battery life than today's models. They will remain attractive options for people wanting to read eBooks but will not take the place of dedicated eReaders.
- Tablets will take the place of printed magazines and newspapers, especially for men and young adults.
- More publishers will offer multimedia content in eBooks.
- 'Special interest books' will be sold on a chapter-by-chapter basis.
- More special interest books, such as cookbooks and travel guides, will be offered as apps or eBooks with interactive features, online updates, and subscriptions.
- Libraries may invest in eBooks and eReaders to complement their collection of print books.
- As demand decreases for print books, some titles may no longer become available in print. Others may be offered in a customized, on-demand basis.

- Demand for certain types of books will remain strong. These include religious books such as the Bible and Koran, children's books, and books for gifts and special occasions.

We expect eBook sales will gradually but constantly drive revenue. The United States, which had 3.7 million eReader owners at the end of 2009, leads the world. Many earlier predictions about an eBook and eReader breakthrough did not come to fruition. What is different now? First, the new generation of eReaders promises to meet consumers' needs for simple, easy-to-use devices with improved screen technology and integrated mobile and wi-fi connections that streamline the purchasing and downloading of eBooks. Second, customers are ready for eBooks and eReaders – their consumption patterns are evolving, they have become accustomed to buying digital music and video, and their reading habits have evolved.

In addition, a majority of consumers are still not aware of eReaders and eBooks, or have only a vague imagination of digital reading – even in the United States. With eReader sales and market awareness rising more consumers will be attracted to digital reading, which will further boost sales.

The US market is by far the most mature, with eBook revenue expected to account for 7.2% of all consumer book sales in 2010. The majority of eReaders have been sold there, and with Amazon announcing rapid sales of the new Kindle, there is no indication that momentum is slowing. Furthermore, we expect strong sales of tablets in the next few years, outpacing sales of eReaders in 2012. These will stimulate the market because tablets are recognized as reading devices by consumers. However, we believe that by the end of 2012, most avid readers will be equipped with an eReader and the growth will therefore slow down, because

eReaders will continue to be the primary reading device for eBooks. We expect that eBooks will have a market share of 22.5% of consumer books in 2015.

The UK is lagging behind the US in terms of supply of devices and availability of content. However, market conditions are changing, which is reflected by market participants reporting rising sales of eBooks. Furthermore, new attractive devices such as the Kindle are now sold in the UK, and it quickly sold out after its introduction. We expect that the eBook market in the UK will, to a certain extent, mirror the development that can be seen in the United States. In 2010, we expect a market share of 1.5%, which will rise to 14.2% in 2015.

Germany and the Netherlands show similar characteristics. The supply of eBooks in the ePub format is limited to a small percentage of available books. Furthermore, available eReaders still lack the ability to satisfy customers' needs concerning usability, connectivity, and pricing. But the situation is changing rapidly.

In both countries, 2010 will be the first year with significant sales of eBooks. We expect a market share of 0.4% in Germany and 0.3% in the Netherlands. The market shares will rise because of increasing availability of content in German and Dutch, increasing consumer awareness, and advancements in eReaders and tablets. The numbers of eBooks available

in the ePub format rose significantly in both countries from 2009 to 2010. And apart from Apple's iPad, eReaders with a wi-fi function have been introduced to the market, including the BeBook Neo in the Netherlands or the Oyo Reader by the German bookstore chain thalia.de.

By 2015, we expect eBooks to make up 6.3% of all book sales in Germany, and 4.4% of all book sales in the Netherlands. The projection for eBook sales in the Netherlands is lower than in the UK, US, and Germany, and reflects several trends that emerged during our consumer survey. Dutch consumers expressed the least amount of interest in eBooks and eReaders among the countries we surveyed and were least interested in using iPads or other tablet computers as reading devices. In addition, the eBook and eReader market is less mature than in other countries and eReaders in the Netherlands are still comparatively expensive. Finally, few eBooks are available in Dutch.

The book industry is undergoing a process of change. And it is up to the industry itself to ensure that the digitizing process does not pass by. The industry should take the opportunity of supplying the market now with innovative products before others do so. What aspects should the companies consider to ensure that eBooks become more than merely a cost factor for publishers and a new sales driver for Apple, Amazon, and others? What action is recommended for the players on the market?

2. Critical Factors of Success for Different Business Models

2.1 Publishers

Adapting for the future

eBooks and eReaders represent both a risk and an opportunity. If publishers accept change, transform their processes, train employees, and offer their content in multiple formats – in digital or printed form, bound or on demand, as a PDF or ePUB – and on all platforms, they will have a good chance of developing a viable digital business model. Publishers that resist change, consider the digitizing process to be merely an additional cost, and attempt to defend their existing content and business models, will face the greatest risks.

Illegal products threaten the book industry

Many current bestsellers are available for people who wish to download them. But also people can download illegal copies even if they are not yet on sale in a digital format. Frequently, these illegal issues are scanned copies in PDF and lack the quality of a legally distributed book or eBook. However, consumers will not care about quality if they cannot obtain an eBook through legal distribution channels, or if they cannot obtain it at an acceptable price.

The current state of illegal eBook distribution does not mean that publishers face the same consequences as their

	2009	2010	2011	2012	2013	2014	2015	CAGR 2010-2015
Germany								
eBooks	4	28	95	190	299	394	490	77.1%
Print/Audio	6,665	6,756	6,849	6,956	7,061	7,194	7,326	1.6%
Total	6,669	6,785	6,944	7,146	7,360	7,588	7,816	2.9%
Share eBooks	0.1%	0.4%	1.4%	2.7%	4.1%	5.2%	6.3%	
Netherlands								
eBooks	1	2	7	14	24	33	41	77.5%
Print/Audio	808	812	819	829	843	861	880	1.6%
Total	809	815	826	843	868	894	920	2.5%
Share eBooks	0.2%	0.3%	0.8%	1.6%	2.8%	3.7%	4.4%	
UK								
eBooks	8	52	121	214	320	427	534	59.3%
Print/Audio	3,541	3,484	3,429	3,370	3,322	3,280	3,238	-1.5%
Total	3,549	3,536	3,550	3,584	3,642	3,707	3,772	1.3%
Share eBooks	0.2%	1.5%	3.4%	6.0%	8.8%	11.5%	14.2%	
US								
eBooks	551	1,518	2,569	3,371	4,302	5,022	5,571	29.7%
Print/Audio	19,890	19,620	19,359	19,224	19,110	19,113	19,169	-0.5%
Total	20,441	21,138	21,928	22,595	23,411	24,135	24,739	3.2%
Share eBooks	2.7%	7.2%	11.7%	14.9%	18.4%	20.8%	22.5%	
PwC: Global Entertainment and Media Outlook: 2010–2014, German Entertainment and Media Outlook: 2010-2014, PwC Research. Numbers are calculated using the average exchange rates of 2009.								

Fig. 19 Market data books and eBooks (Books, million US\$)

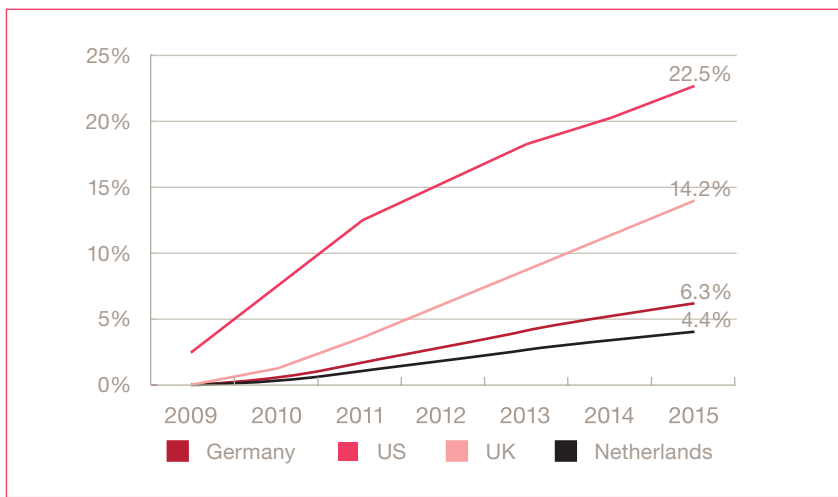


Fig. 20 Market share of eBooks 2009–2015 in % (mass market books)

peers in the music industry. Unlike music and video games, there is little overlap between the demographic groups that are most often associated with digital piracy (generally men between 20 and 39 years old) and those demographics that are typically associated with high-volume reading of mass market books (in general women age 40 and older). Among this latter target group, the interest in and the resistance to using illegal downloads will probably be much greater. Secondly, any comparisons to the music industry and the potential impact of piracy must also be weighed against the differences in the way consumers engage with books and the way they engage with music. We may listen to the same song from one album over and over, but we rarely re-read a single chapter more than once. We may listen to 10 or 12 different artists in the course of an hour's music listening, but we will devote several hours to completing a single book. These differences probably make it less likely that potential eBook buyers will choose to take on the technical complexities and legal issues surrounding the use of piracy sites. Nevertheless, if publishers do not make their products available in digital form, they will lose potential revenue and will facilitate the creation of an illegal market for eBooks.

Piracy poses a significant threat to the educational market, where the incentive to copy books illegally is higher than on the consumer book market because textbooks can be expensive. To protect revenue while meeting the needs of students, publishers could establish basic contracts with university libraries to offer free eBooks for students or offer special editions exclusively to students for a discounted price, like Springer Science and Business Media.

Adjust business procedures; ensure new ideas in the minds of employees

Publishers will retain their traditional mediator functions between the author and consumers and will continue to

take on tasks such as selection, editing, and marketing in the digital environment. However, it will be essential to concentrate on the role of the content provider. They will need to offer new training to their employees and modify their business processes. For example, editors will have to adapt content to meet consumers' changing reading and shopping habits. Publishers also require technical skills that will ensure content can be transferred and enriched smoothly. Some companies may need to acquire new staff members with advanced technical skills. The legal department will have to establish rights for eBooks, draw up fee models to reflect digital content, and review existing contracts to ensure that digital rights are in place or can be negotiated. Finally, finance departments will need to assess tax law and consider whether accounting policy changes might be required around either agent or principal relationships, or new retailing activities.

Additional content

Special-interest publishers should consider offering additional content in eBooks because it increases the value of digital publications. Multimedia enrichment may justify higher pricing, or attract customers that would not have been interested in a book without sound and video. With additional content, publishers may be able to customize eBooks in a way not possible with printed books, creating loyal customers that will return to buy updated editions and related volumes that interact with their existing titles.

Additional content may provide new revenue opportunities, as publishers may be able to offer supplemental or updated information, music, or video for an additional fee. Instead of abandoning this business to others, publishers should enter into partnerships with innovative software companies that can offer such applications.

Pricing: Customers demand a discount – or identifiable added value

To convince consumers of the benefits of buying legal eBooks, publishers will need a well-thought-out price policy and a broad, attractive range of products. The aim for publishers cannot be to undermine the value of their books with low prices. The development in the newspaper industry shows how difficult it is to get away from the free mentality of the Internet. It is the responsibility of publishers to convince consumers of the benefits of digital books to gain new target groups. Amazon has shown the way with its US\$9.99 price policy in the United States, while the current pricing struggle in the UK demonstrates how a weak strategy can prove challenging for publishers.

To prepare the way for lower-priced eBooks, the European Commission should be encouraged to remove the unequal VAT rates for printed and digital books.

Developing new distribution models

Club and subscription models present an attractive alternative to traditional sales of eBooks via online bookstores. Such models offer an advantage with regard to the constant buying of eBooks when mobile or online access for eReaders is not readily available. However, such ties will interest consumers only if they are notified of the latest books of their favorite authors and bestsellers through their Reader or their mobile phone, and if they are able to receive these books and bestsellers on their device without any hassle. To ensure that this can be implemented successfully, publishers should start to think about the contractual form of such models and clarify the legal questions, including those in connection with the authors.

Product bundles, in which the printed and the digital books are sold as a package for an attractive price, offer another option. However, they are probably attractive for a relatively small but active target group, one that enjoys reading only. Again, the first step to make these models work will be to carry out preparatory tasks.

Clarify the format issue, reconsider copyright

The variety of formats – ePUB, PDF, AZW, Mobipocket, and so on – is delaying the market success by creating concern among consumers and additional costs for publishers. Consumers generally wait until a format is established in the marketplace before investing in a product. Consider the examples of HD-DVD and Blu-ray players, Betamax and VHS video players as well as Minidisc and CD players. Accordingly, publishers would benefit from an agreed-upon uniform format with all players on the market. Consumers appear to be in favor of two systems: PDFs for special

interest books and ePUB for the mass market. It is now up to publishers, online bookstores, and device manufacturers to join forces, press ahead, and develop a format that provides the greatest benefit to content owners and customers. The format issue is less important for walled-garden environments because consumers are highly satisfied with the user experience. However it will become an issue if other market players such as Barnes & Noble or Borders become more powerful and consumers wish to move books they have purchased to a non-Amazon or non-Apple device.

Publishers – and also authors – should rethink their stance on digital rights management (DRM). As Apple and Amazon have successfully demonstrated, DRM can be user-friendly. Publishers should strive to embrace DRM systems that do not act as a deterrent by making it difficult to buy or use digital content.

Cooperation: To be represented on all platforms

For publishers, it is important to establish a presence with content on all platforms: in bookstores, online, and as apps. A more open attitude with regard to cooperation and more courage are necessary in this respect.

2.2 Physical Bookstores

Physical bookstores have much to do in order to prevent the digitizing process from passing them by. The United States has seen an increase in bookstore closings in the past few years, although this may be partly due to economic conditions. Bookstores must emphasize their strengths in customer knowledge, customer retention, and related skills, and sell book content in all formats and across all channels. Bookstores should embrace a multichannel strategy, in which the Internet, physical bookstores, and catalogues complement one another. In particular, the bookstores that have a strong presence in inner-city locations and are able to transfer this to the Internet enjoy a good starting position in this respect.

Rethink integration of the value chain – or enter into co-operations

Despite the delayed launch (the Nook has only been available on the market since 2010), Barnes & Noble has successfully established a position against Amazon. As a result of its own reading device, Barnes & Noble has been able to at least partially compensate for the decline in physical bookstores, although the company had to close one of its largest New York City locations, along with other stores throughout the country. But within a short

period, Barnes & Noble has succeeded in increasing its market share for eBooks while its traditional bookstore business has shrunk. As a bookstore chain, the company has an advantage over Amazon: customers across the United States can visit one of its stores and test the Nook. Owners of the Nook can visit any Barnes & Noble location for free wi-fi, download free content, and receive other in-store promotions. Amazon has no retail locations and has only recently started selling the Kindle through other retailers. Barnes & Noble also sells the Nook through another retailer, i.e. electronics giant Best Buy. In 2009, Barnes & Noble's online revenue increased 24% to US\$573 million: digital revenue is expected to double this year. Bookstores should consider Barnes & Noble's experience with the Nook as they plan their own eBook and eReader strategies.

Consider cooperations for online sales

Large bookstores may have the resources to open online stores or even develop their own eReader. However, even small and special-interest bookstores will need to participate in the digital book environment. In order to get the most from investments, smaller companies may consider working with external providers, such as intermediaries, to develop an online shop. In addition, smaller stores should analyze their strengths and develop strategies to exploit them in an eBook and eReader world. For example, a small bookstore may consider creating customized book and eBook packages for institutional clients, or setting up terminals for customers whose eReaders do not have an integrated Internet connection.

Just as eBooks cannot replace printed books as gifts or on bookshelves, online bookstores cannot replace physical bookstores as:

- Locations for book club meetings
- Author signings and speeches
- Cafes, lounges, coffee shops
- A place where customers can relax and browse books at their leisure

As the digital environment becomes more important to readers, bookstores that emphasize their real-world advantages will remain relevant, retain customers, and target new revenue streams.

2.3 Online Stores

Competition posed by global players requires a multiplatform strategy

The outlook is rosy for national online bookstores, but there will be challenges. The primary hurdle is competition from international major players. To respond,

the national online stores need to convince customers of the value they provide by offering a wide range of products, user-friendly service, and features like reviews and social networking. Stores should also develop apps so customers can shop from their smartphone or tablet. These efforts can improve customer retention, loyalty, interaction, and revenue potential.

What do the international online stores offer customers? Consider one of the advantages of Amazon's Kindle. eBooks are available not only for the Kindle but also for nearly every type of computer or gadget a user is likely to own: a PC, Mac, iPhone, iPad, iPod, Android smartphone, or late-model BlackBerry. The applications are synchronized to users' Kindle accounts, so when they pick up a book on another device they will continue at the place they stopped reading on the last device. Bookmarks, notes, and highlights are also synchronized across all the devices.

As is the case with physical bookstores, online stores should explore the integrated range of products with their own reader. Online stores do not have to enter the hardware market for this purpose. They may seek out suitable arrangements with device manufacturers that integrate the online platform on their gadget. In such a scenario, the online stores would assume responsibility for actively marketing the products through their platform.

2.4 Device Manufacturers

Amazon (with the Kindle) and Apple (with the iPhone and iPad) have demonstrated how sales and reader can be skillfully combined. In conjunction with a well-planned communication and business strategy, the two companies have encouraged demand to a previously unknown extent and have revived the market with user-friendly and attractive devices.

Adapt devices to customer requirements

Device manufacturers that are active in the European market would be well advised to learn from the successes in the United States. The Kindle and Nook are easy to operate, with Internet access, integrated shops, eInk screens, and pages that turn rapidly.

Manufacturers for European devices should consider partnerships with leading mobile network operators and online stores. These devices may be distributed to customers either in a proprietary or in a branded format. In addition, active market communication is also of crucial importance. The market has so far been passing by the most important target group.

Buyers of eReaders at present are mostly technophile men who do not necessarily read a lot. In order to convince avid readers of the advantages of buying such devices, it will be necessary to emphasize the benefits of simple use, which requires an integrated mobile access and shop (as is the case with the Kindle and Nook) as well as a light gadget with an attractive design. Significant promotion and consumer education will also be necessary, particularly in Germany and the Netherlands, where the look and feel argument (contrary to the opinion of many experts) is more significant among consumers than in other countries.

In the United States and Europe, the primary goal of device manufacturers should be to gain and retain their market share because this strategy will strengthen their position automatically as the market grows. One strategy involves entering into agreements with retail chains like Amazon did; the online retailer is selling the Kindle through Target and Staples.

Rethink price policy – low price devices with a clear reading focus

In addition, device manufacturers will have to rethink their price strategy. With its wide range of potential uses, the iPad is exerting considerable pressure on pricing. The performance of eReaders on the market can hardly be compared in any way with the performance of tablets that offer the facility for reading books as one of many functions. To avoid sinking into insignificance, manufacturers will have to concede to a clear price reduction for the current devices and emphasize the benefits of eInk technology. Moreover, they will have to use specific advertising to convince their most important target group, namely avid readers, of the product's advantages.

2.5 Intermediaries

Transfer services to the digital environment

Intermediaries will have to redefine themselves in the digital environment. It is true that numerous tasks will continue to exist as a result of the co-existence of digital and printed books, but they will become less important. The intermediaries would therefore be well advised to adapt to the new requirements and to develop services for publishers and stores that have difficulty in providing such services on their own due to their weak financial position or lack of technical skills.

This includes support for converting content to an eBook format, the establishment and maintenance of a content management system and payment processing, document hosting, eBook storage, and digital delivery of eBooks.

Support for small stores with modern shop system

In addition, a possible solution would be to handle online sales by way of an integrated shop system for physical stores. This would involve technical and financial processing, as well as new functions such as the integration of customer reviews or social networks. To successfully stand up to the increasing competition posed by small independent companies, intermediaries will have to ensure that they have lean operations and position themselves as experienced and accepted service providers. They should also establish agreements with numerous small stores and publishers to cover the fixed costs of the systems.

3. Conclusion

eBooks will become established as a further book format in addition to paperbacks and hardcover. With the Kindle, Amazon has demonstrated the necessary criteria in this respect. At the end of July 2010, Amazon reported it had sold 1 million copies of Stieg Larsson's Millennium trilogy books through the Kindle store.¹² If markets for legal eBooks are to become established, and if publishers are to be able to benefit from the development, it is essential that all providers consider the process of digitizing the book industry to be an opportunity of establishing book reading as a popular leisure-time occupation in all target groups, including the younger generation. Generating profits with eBooks will not be easy, but publishers, device manufacturers, and online stores will have to work together and focus on the needs of customers to ensure that the transition is smooth and successful.

Because habits of media usage are changing gradually, book readers will initially have to be nudged in the direction of the new possibilities. Publishers will need to explain the benefit of eBooks and eReaders: reliability, functionality, and ease of use. In addition, user-friendly readers with a permanent link to the online shop, a clearly communicated customer benefit, an intelligent combination of all distribution channels and a wide range of content are key factors for success. eBooks will not replace the printed book. They will be available in parallel with printed books and will stimulate reading behavior. The book market is facing an exciting future. If publishers are to benefit from this process, they must invest now.

Methodology

1 Analysis Framework

This study investigates the latest trends and developments on the book market. It is based on extensive market research of PwC, in which current sources concerning the subject of eBooks and electronic readers have been brought together. The study discusses developments and prospects of the markets in Germany, US, UK, and the Netherlands. These countries were chosen because of their different market maturity.

2 Timescale and Method

PwC has carried out expert interviews and consumer surveys in order to assess the significance, market potential, and the opportunities and risks of eBooks and eReaders.

The consumer survey was carried out online. Results were evaluated by the German market research institute GIM; the more than 40 interviews with representatives from the industry were managed by eBook experts of PwC. The expert survey and the consumer survey were carried out in May 2010.

3 Expert Interviews

Experts of leading publishing houses (special interest books and the mass market), intermediaries, online stores, device manufacturers as well as a telecommunication company were included in the survey for the study.

4 Consumer Survey

An online survey was held among 1,000 consumers aged between 18 and 65 years in each of the following countries Germany, the Netherlands, UK, and US. The consumers were selected in a census-representative manner with regard to sex, age, and profession.

	Methodology
Method	Online survey of approximately 10 minutes
Random sample	<ul style="list-style-type: none">• 1,000 people per country• Between 18 and 65 years old• Online panel in Germany, United Kingdom, the Netherlands and the United States• Census-representative with regard to sex, age, and profession
Field work	May 2010
Carried out by	GIM, Gesellschaft für innovative Marktforschung mbH, Germany

Fig. 21 Consumer Research

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