An Economic Perspective: The Future of Digital versus Print Media with a focus on the cultural products of books and music

This thesis identifies two of the major media industries: Books and music and investigates the future of digital media and its implications on the printed media.

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Abstract

Digital media has introduced the market to the quickest form of content distribution man has ever seen. Many businesses have tried to adapt their business models to the digital world to maximize their value and influence. Internet has impacted many businesses worldwide giving them an opportunity to evolve and bring innovation to their business direction and economic model so they can offer a balanced value proposition to the consumer and gain competitive advantage in the market. There is a general understanding that since the inception of digital media, the print media industry has been going through several challenges to re-engineer their business models for better profitability.

The objective of this thesis is to provide the reader with an understanding of the implications digital media has over printed media in terms of cost, effectiveness and market share and how the print media industry can accommodate digital media in their existing business model. The thesis identifies two major media industries namely the book industry and the music industry. It discusses the transformation of their information from the printed to the digital platform by studying the risks and benefits of the two platforms. It investigates general concerns faced by the media industries in the present market situation. It further proposes business models for each industry acquired through literature review and various academic sources. Mechanisms through which media industries can accommodate digital transition are discussed and ideas for firms looking to create analogous business communities are advanced in this thesis.
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Glossary

ASP: Application Service Provider
IIT: Image Interactivity Technology
IFPI: International Federation of the Phonographic Industry
IDPF: International Digital Publishing Forum
AAP: The American Association of Publishers
DMR: Digital Media Report
SOR: Stimulus Organism Response
C&B: Click and Brick
BAM: Brick and Mortar
MSP: Music Service Provider
OMM: Open Music Model
DRM: Digital Rights Management
I Introduction

1.1 Background

Digital evolution is one of the fastest growing phenomena in technology pace and business domain. Just in the past two decades man has broken barriers in digital streaming and technology. Digital streaming has offered man the freedom of massive distribution of content with a single touch and minimal effort. Digital content being portable and easy to access is the fastest way of sending and distributing information today. This media is threatening and over shadowing the printed media that is facing a grave challenge globally. The printed media may eventually go into the mode of creative destruction or may act as disruptive technology to its successor, the digital media.\(^1\) It has been observed that the printed media is slowly being replaced by digital media with no clear or specific guidelines on the transition to E-business models for this conventional industry. The abundance of free online content available on the Internet has captured the attention of many. ABA, The American Booksellers Association, held their yearly conference in February 2010 in San José, California, which was dominated by optimism concerning the development in the digital arena: e-books, e-marketing, communication online etc. Possible business models and price models were discussed, that could strengthen the position of online publishers as well as traditional publishers. This thesis therefore provides the reader with an insight on the implications of digital media over the printed media and the challenges faced by print media industries today. It studies methods that are improved, efficient and cost effective in the production of digital or printed content and at the same time offer a competitive advantage from direct or indirect competitors.

1.2 Motivation

The motivation for this thesis comes from a wide known observation of digital media having a revolutionary affect on the printed media. The topic aims to highlight the challenges that many print media industries worldwide are facing today. At the same time, its counterpart the digital media is being dealt by almost every corporation to seek ways and methods to efficiently

\(^1\) Schumpeter 1942: 81-86; Bower & Christensen 1995: 43-53.
produce and distribute digital content. This thesis compares these two mediums of distributing content, the printed or traditional media and the electronic version of it simply stated as the digital media. It then considers variations between the two and verifies their leverage and value against each other. It also suggests transition of the print media industry to a newer E-model for crossing over to the digital media industry as necessary. Industries engaged in print media distribution and publishing need to continuously re-identify their business as the market becomes competitive and introduce changes to their existing business models to keep or expand market share. This thesis observes those values that either of the technologies brings to the overall production chain and their participation in the revenue generation process. It investigates the optimal approach of adding value to the business as this dramatic alteration could be a stepping milestone that may result in digital media either substituting or complementing printed media over the next few years.

1.3 Objective

The objective of this thesis is to analyze the recent and dramatic upsurge of the digital media and discover the challenges and dilemmas that print media industries are facing in the digital age. This thesis focuses on the broader context of digital and printed media and identifies two major media industries namely books and music as subjects of this research. The thesis in its next chapter focuses on cost, efficiency and market share of the digital media and then determines its impact on the printed media. In the chapter after, it describes the methodology and scope of this research and then provides a statistical overview of the digital evolution that helps to identify the changes that could complement existing traditional business models. Finally this thesis puts forward some propositions and recommendations for each of the two media industries (books, music) identified in this thesis. The thesis from the literature review studies and references different business models that could be a positive contribution to the expansion of the print media industry. It proposes e-business models by each industry that could help these media businesses sustain their growth and re-shape the distribution method for their content.

Results from this thesis would help businesses from the print and digital media industries (specifically book and music media industries) as it would investigate the implications of digital media with respect to supply and demand of the printed media. This business audience is the primary target audience for this dissertation as they could directly benefit from the results of this
thesis by improving their business models and as a result, open new avenues for a consistent revenue stream. These results could also benefit corporations that could derive advantage from the analysis and conclusions when making business decisions concerning their investments, strategy, marketing, production and distribution of content. Other stakeholders could include magazine business owners, venture capitalists, new media business owners, publishers, producers and educational businesses and institutions. Finally third party actors who contribute in the consumption or distribution of content in any way, shape or form may also find these results interesting.
2 Literature Review

We will now take a look at our findings from the literature review that highlight some important aspects of cost and market share of the digital media. As has been previously discussed, print media industries are looking to modify their traditional business models so they could accommodate the digital part with suited adaptability. This could potentially expand their market share if these conventional businesses diversify their offerings to a broader set of audience. This chapter discusses a few business models that could supplement the traditional print pricing model to be cost competitive and at the same time increase market share. The goal would be to assess the business models that best suit the needs of our study.

2.1 Cost, effectiveness and market share of the digital over the printed media

Digital media is known to be efficient and cheap to the consumer. Its popularity has increased its market share exponentially in recent years. To capitalize on this market share within the industry, there is a need for traditional print media industries to re-invent their existing business models by offering the tangibility and quality of the printed media and complementing it with the affordability and portability of the digital media for the consumer. In the most basic sense, a business model is the method of doing business by which a company can sustain itself that is, generate revenue. The business model spells-out how a company makes money by specifying where it is positioned in the value chain. According to the JMM - International Journal on Media Management, the term business model is often confused with that of strategy such as company or product strategies. A strategy is an approach employed by a firm to meet its objectives. A business model however is much more fundamental. It involves the processes and activities around a business, how it operates and the underlying foundation upon which a business can be successful. It can be created by stepping back from the business activity itself and studying the underlying characteristics that make commerce in the product or service possible.\(^2\)

E-commerce has given rise to many new kinds of business models, but at the same time the Internet is also likely to reinvent tried-and-true models. Business models have been defined and

\(^2\) Picard 2000: 60.
categorized in many different ways and they continue to evolve with new and interesting variations that can always be expected in the future.

For instance Chesbrough argues that companies that pursue Open Innovation need to combine internal research with external ideas and then deploy those ideas both within their own business and also through other companies’ businesses. This truly is Open Innovation where companies are contributing to the value chain by applying external and internal ideas that could result in an economical and cost effective model for the consumer. Chesbrough goes on to further define the term business model and its fundamentals. According to him the functions of a business model are as follows:

1. To define the value proposition created for the users based on the offering.
2. To identify a market segment, that is define a purpose for which a technology will be used and the users who will find it useful.
3. To define a structure for a firm’s value chain.
4. To specify the revenue generation process.
5. To describe the position of the firm within its value network.
6. To formulate a competitive strategy for the firm to gain a competitive advantage over its rivals.

A successful business model would cover all these aspects. Chesbrough further elaborates on the business model acting as a cognitive map across different domains. To define a business model the physical domain of technical inputs need to be linked to an economic domain of outputs. We see that in figure 2.1 the business model acts as an intermediary between the technical and economic domains. Technical inputs could be capacity, speeds, functions etc and economic outputs could be value, price, profit, support, warranties etc. He strongly emphasizes the fact that a firm’s realization of economic value from its technology depends on the choice of its business model and not on characteristics inherent in the technology itself.  

Chesbrough 2008: Chapter 4, 64-65, 68-69.
Although Chesbrough states some commendable points, Hedman and Kalling use Porter’s chain of causality as the determinants of success in a distinct business. Porter after receiving some criticism on the five forces model for being too focused on the factors external to the firm that create competitive advantage introduced Porter’s chain of causality arguing that the cost and differentiation advantages firms enjoy on the product market are driven by initial conditions and managerial choices.

Porter states that initial conditions of a firm are the first determinants of success in a business, firms that may have preexisting reputation and skills as a result of their history. These conditions would clearly influence the business direction. Another alternative are the management decisions which according to Porter affect key drivers that make up the activities that enable low cost production and product differentiation, both of which contribute to the success of the firm. Porter concludes according to Hedman and Kalling that initial conditions and managerial choices ultimately determine success because these events are the original factors that are moving business in a specific direction.4

4 Hedman & Kalling 2002: Chapter 6, 106-108.
Many companies have taken management decisions to determine their success. Take Amazon for example where the initial state of the company under which management decisions were taken extensively influenced the way its operations moved in a specific direction. Amazon started off as a cyber book store, built a strong reputation, a loyal audience and a results-driven mechanism. Based on that credibility, it started expanding when management took decisions driven by innovation to adapt to the growing and continuously changing business needs of the market, which according to Porter is the second determinant of success that is managerial choices. These decisions are independent of the firm’s initial conditions and are not based on the certainty of its future. These decisions define the firm’s concept in terms of cost effectiveness, market share and competitive advantage. Backed by these decisions, Amazon consistently expanded its operations and branding to cater to a wider set of audiences at each turning point of its business life to increase its market share. Its strong positioning against its competitors continuously proved to be the driving factor of success and growth to this organization. These decisions helped the company meet many significant milestones that eventually resulted in its transformation from an
online retail store to a true application and web solutions provider. A business model this strongly tied to the cost, efficiency and market share of the business it represents is the key driver that sustains the strategic position of an organization within a given market segment. Digital media businesses that have identified such a large market segment where their products and services have been tested and proven to bring value to the consumer enjoy such leverage and positioning.

2.2 The need to the change of the business model

There is a constant changing need for businesses to stay competitive in the industry and sustain their market share. When a business sets a market trend such as how best could a consumer acquire a service or product, or what could be the most convenient medium for a purchase, or the best platform to reach a wider audience is what defines its success and its ability to capitalize on that opportunity and not necessarily by simply introducing more products/services or opening more stores, because that business has inspired and changed consumer behaviour in that given market segment. It explores an opportunity to introduce new revenue generation streams to its portfolio by re-shaping its platform, business direction and economic model to adjust to that trend. Print media industries in a similar way have been trying to capitalize on the digital technology for years since it first hit the market a few decades ago. E-business modeling is a common challenge discussed in many print media forums, where industries are trying to complement their conventional models with their digital counterparts. Amazon, Wall Street and Apple are some examples that have modified their business models to adapt to the growing and changing consumer demands. Porter states “The internet is arguably the most powerful tool available today for enhancing operational effectiveness. By easing and speeding the exchange of real-time information, it enables improvements throughout the entire value chain, across almost every company and industry.” but simply improving operational effectiveness does not provide a competitive advantage. Companies should be able to sustain and achieve higher levels of effectiveness than their competitors to gain a significant competitive advantage.5 As competition gets more intense, consumer responses become different in behavior, which gives rise to the concept of sustainable competitive advantage. Different industries are using different techniques

to stimulate consumer responses and behaviours and encourage positive attitude towards their products and services. Companies are paying attention to all aspects of their product and how they can offer tangibility to the consumer while still contributing to the virtual world.

2.3 Business Models – The Book Industry

The traditional book retailing industry may be characterized by differentiated competition which has greatly been influenced by the internet. The Internet has intensified the cost competition forcing retailers to find ways to reduce inventory and fulfillment costs that has prompted partnerships with publishers and/or wholesalers (backward integration), including alliances with traditional brick and mortar stores and affiliation portals and sites like Yahoo!, AltaVista, AOL, Lycos, MSN etc. Competitive advantage in the online book retailing segment is being achieved by better supply chain management, which is the first to introduce substitute products if any and make better use of the technologies to provide superior service. The traditional distribution model in the book industry can be illustrated in Figure 2.1 below. A variety of distribution channels are currently used in book retailing marketplace. These include independent/small chains, large chain book stores, discount stores, food/drug store, used book stores, book clubs, mail order/catalog, multimedia stores, virtual/Internet bookstores, and price clubs.

The Traditional Book Distribution Model

![Diagram of the Traditional Book Distribution Model](image)

*Source: Laudon & Traver 2001.*
Most books begin with authors, who sell the rights to their works to publishers in return for a flat royalty rate. Publishers sell these books to wholesalers on a consignment business. The wholesalers sell the books to the retailers, who in turn sell the books to the end customer.

Online Book retailing is becoming popular with the growing conveniences of technological advancements. The primary reason is the Internet that has enabled online retailers to offer a host of customer services, such as collaborative filtering, searchable databases, and customer reviews. Other reasons include, the huge amount of effort involved in maintaining the large number of inventory units in traditional book selling, and the limited importance of physical superstore interactions. E-commerce has also reduced the procurement costs for the retailers, removed the information asymmetries, improved market accessibility, and reached and increased buyer power derived from the price comparison capability of the Internet. The retailers are able to virtually eliminate costly mass advertising and yet build a 'one-on-one' bond with the customer. Revenues for these E–tailers are derived from output of sales of goods, differentiating their business and attracting and retaining the customers that are very critical for their profits.

A study review of some prospective business models in the book industry will provide us with a better understanding of the dynamics and key interdependencies. This will later guide us to suggest adequate business models for the scope of the thesis and put forward recommendations and propositions based on this review.

2.3.1. Click & Brick (C&B) Model

Several brick and mortar⁶ (BAM) companies are moving towards new technology by introducing a digital business model that will offer them greater productivity. These companies are transforming into new economies as they use technology to reinforce their strength in the marketplace. According to the article on e-business in the Electronic AI journal, there are many BAM companies that have adopted the digital media model e.g. Merrill Lynch, Circuit City, Toys ‘R’ Us, Wal-Mart. This adoption of a Brick and Mortar concept integrated with a Click and Order process can be referred to as the Click and Brick Model which is really the hybrid of an online/ offline model that could incorporate both physical and digital assets and activities. This means that it also supports internet based companies looking to expand their market share by

⁶Brick and Mortar: A company that has an outlet, building or store for operations to demonstrate physical presence and offers face to face consumer experiences.
building a physical channel in addition to a virtual one. The C&B model (Figure 2.4 below) allows an offline business to co-exist with an online presence that offers the business more empowerment to strengthen its credibility and reputation.\(^7\)

Click and Brick Model

![Click and Brick Model](image)

**Figure 2.4** *Source: Kalakota & Robinson 2000: 28.*

2.3.2 The Stimulus Organism Response (S-O-R) Model

An interesting e-business model to gain sizeable consumer responses and influence emotional and rational effects on consumer attitudes, and intentions is by introducing online retailer sites to a technique referred to as image interactivity technology (IIT) on web portals and virtual centers. This technique could help in achieving a higher level of operational effectiveness on consumer behavior, and create intentions of buying the retailer’s virtual products. Algharabat in his literature study from Brunel University explains that “(IIT) technology will enable small companies and even large companies to achieve the following:

- Creating more tangible items
- Creating positive attitudes toward the organization and the products
- Enhancing customer intention to buy.
- Creating positive customer responses.
- Increasing word of mouth
- Adding hedonic and utilitarian values to the products.

According to (Childers et al, 2001) hedonic value is related to fun, enjoyment and utilitarian value is related to cognitive thinking approach where customers collect, understand, comprehend

\(^7\) Kalakota & Robinson 2000: 26-30.
and compare product attributes.” This component if introduced in a business model could prove to be very effective in gaining positive consumer responses on online products and services offered. Figure 2.7 below explains the role of the Stimulus Organism Response Model in explaining the effects of image interactivity technology (IIT) that is used to help customers create, build and sustain their responses towards online intention purchasing.

**The Stimulus-Organism-Response Model**

![Diagram](Image)

*Figure 2.5 Source: Algharabat 2007: 4.*

It basically enables creation and manipulation of a product or image on an online portal to simulate the actual experience of the consumer with that product or environment. This technique associates more tangibility to a product in the virtual world that can eventually influence consumer attitudes and decisions. It is a good yet simplistic example of e-modeling and to what

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8 Algharabat 2007: 2-5.
extent it is being used today. In the case of an online library or literature portal, this could be illustrated with a digital interactive book sample on the book retailer’s webpage. The customer could then turn over the pages virtually one by one, and experience a true feeling for that book synonymous to their experience of going through a book in a bookstore. This could greatly affect his purchase decision at the virtual book store. If the order is processed and completed in a timely fashion that too contributes to the satisfaction rate of a customer, which is as important as the initial interactive experience that leads to a purchase decision. It shows that customer service is valued in this business and efficient handling is a necessary element of the business operation.

2.3.2 The Affiliate Model

Another framework in e-business modeling that is observed in more innovative organizations is based on a partner network of affiliates that relies on a mesh of relationships, and represents a network where each firm plays a role against each relationship. This particular framework believes isolation in an organization to restrict innovation and that a healthy ecosystem is based on a multitude of relationships between different entities. Such a governance structure is referred to as the Partnership or Affiliate Model. Some species in such an ecosystem cannot be replaced and their desertion requires a reorganization of the entire system. These species are the fundamentals of the business universe. Other species are more expendable, and can be interchanged as one becomes rarer to be replaced by another. Isckia explains “An ecosystem is a business community that brings together firms from various interdependent industries. Ecosystems that were recently born around Apple’s iPod, Salesforce’s CRM platform, Facebook, or Google illustrate the wealth, complexity, and dynamics of these structures. These business communities are usually structured around one leader striving to share its commercial philosophy or its technological standard”. Amazon as an example, in its governance structure plays the role of a keystone which is that of a ring leader within its multitude of partnership firms as its ecosystem in terms of value creation and value sharing.

There is a gradual shift taking place from the industry economy towards service economy. This makes it clear that there is an increasing demand for services, and that the service economy plays a significant role in the present and future business world. Service ecosystems are marketplaces

\[9\] Isckia 2009: 333.
that allow entities like Amazon, Google, eBay and SAP to trade services in the business sense and involve actors from different legal bodies. Companies such as Amazon.com acknowledge web services beyond integration as a means to create value for customers. One major challenge for service ecosystems is the fact that services are different than goods. Services are intangible and cannot be stored, transported or resold. Goods are basically produced at some point and they can be stored, transported and even resold.\textsuperscript{10}

Two significant advances have been made in this field to modify the traditional conception of organization-environmental relations. Firstly, it is focusing on the input-output exchange relationships that determine an organization’s autonomy and control through its environment. Such relationships are open to redefinition for management to be interdependent with the environment. Secondly, the field has used the concept of stakeholder management where specific interest groups are critical to the organization’s functioning.\textsuperscript{11} This gives rise to a negotiated environment where each stakeholder has a vested interest in the ecosystem, where appropriate strategic interaction among different affiliates can take place. This environment divides them into three fundamental groups:

**Dominator**s: These entities dominate their entire ecosystem and try to control the whole network and its actors. Their objective is to control the maximum number of function points within their network.

**Keystones:** These actors play a significant role in both the creation and the redistribution of value created within the network. Contrary to dominators, they do not try to gain supremacy but rather position themselves strategically on a few nodes and assume leadership. The keystones often look for opportunities to benefit from the other partner actors’ contributions by facilitating access to some resources.

**Niche players:** Many actors who are small in size and play the market with a strategy to differentiate themselves from others form the niche players group. They contribute largely to the ecosystem. The keystones offer them a platform within the ecosystem to access resources that could provide opportunities to develop new products or services. Their bond with the keystones is a close one, and they actively contribute to the platform’s evolution and the dynamics of the ecosystem. This partnership concept creates a balance amongst all actors in a system where value


\textsuperscript{11} Astley & Fombrun 1983: 576-577.
is shared and distributed to the overall performance of the system rather than that of a single actor. Each participant contributes value to their network and affiliates, thus, defining the business ecosystem as a broader concept that involves complex distribution channels of value co-creation to combine input services of different types to produce a larger service or product.12

2.3.3 Porter’s Five Forces Model

Another model that strategically positions a business using five core concepts is the Porter’s five forces. Porter’s five force model is a framework used for industry analysis and business strategy development. As can be seen in Figure 3.3, the five force model draws upon five forces that determine the competitive intensity and therefore attractiveness of a market which refers to the overall industry profitability. As per the FMCG Marketing and retail blog, “The Porter’s 5 Forces tool is a simple but powerful tool for understanding where power lies in a business situation.

**Porter’s Five Force Model**

**The Five Forces That Shape Industry Competition**

![Diagram of Porter's Five Forces]

*Figure 2.6*  
*Source: Porter 2008: 80.*

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This is useful, because it helps you understand both the strength of your current competitive position, and the strength of a position you’re looking to move into.”\textsuperscript{13} This concept is interesting for the print media industry to use when there is a need of an electronic media component during its transition to the digital media industry. The model explains where the core strengths of a business are and, how to best utilize them to gain a competitive edge over direct and indirect competitors. Porter states that the Internet technology provides better opportunities for companies to establish distinctive strategic positioning than did previous generations of information technology. Gaining such a competitive advantage does not require a radically new approach to business. It requires building on the proven principles of effective strategy. So the Internet will rarely be a competitive advantage. Many of the companies that succeed will be ones that use Internet as a complement to traditional ways of competing, not those that set their Internet initiatives apart from their established operations. According to Porter the Internet may not necessarily be a blessing. He explains “It tends to alter industry structures in ways that dampen overall profitability, and it has a levelling effect on business practices, reducing the ability of any company to establish an operational advantage that can be sustained.” Basically the question here is ‘how to deploy Internet technology in companies that are using the digital medium to stay competitive’ as they are not following a consistent direction.\textsuperscript{14} Porter explains the way Internet influences industry structure with his five force model. These five fundamentals are as follows:

1. Threat of Substitute
2. Threat of New Entry
3. Supplier Power
4. Competitive Rivalry
5. Buyer Power

\textbf{2.4 Business Models — The Music Industry}

The Digital Music Industry is going through a classic distribution pattern where the middle tier or the intermediaries are being eliminated in the market channel. Just like other industries such as financial services, computing, merchandise and other goods and services, this industry is also

\textsuperscript{13} The FMCG and Retail Marketing Blog 2007.
\textsuperscript{14} Porter 2001: 63-71.
showing signs of a collapsing traditional model that needs to be re-defined. Figure 2.7a shows the classic distribution model where multiple intermediaries touch the music product from the artist to the consumer. Figure 2.7b demonstrates how online music distribution plays a role and adds value to the traditional music distribution chain.

**Music Industry Value Chain**

**The Traditional Music Distribution Model**

- **Artist & Publishing**
- **Record company**
- **Distribution**
  - Traditional retailer
  - Online CD retailer
- **Consumer**

**Music Value Chain with Online Distribution**

- **Artist**
- **(& Publishing)**
- **Record company**
- **Distribution**
  - Peer-to-peer network (e.g., Kazaa)
  - Online music provider (e.g., iTunes)
  - Traditional retailer (record store)
  - Online CD retailer (e.g., Amazon)
- **CDs**
- **CDs**
- **Consumer**

Figure 2.7a


The Traditional Music Distribution Model uses the print or recordable media where the industry started with the audio cassette format that was later succeeded by the Compact Disc format (CD). We see that the cost of the music product for the consumer gradually increases as each participant adds his share of the profit margin to the product. The Internet however (as we see in Figure 2.7b) has changed this distribution model forever where the consumer can completely bypass the traditional distribution network giving rise to a new distribution model that puts the music copyright owners in a vulnerable position. Their music cannot be that easily protected in this decentralized universe where users can find and access all kinds of data with little to no traceability.

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15 Styven 2007: 72.
2.4.1 Peer-to-Peer business Model

Using the internet these days, one can download online music for free using widespread Peer-to-Peer filesharing systems. The Peer-to-Peer approach basically uses a decentralized network for the sharing of files that are not stored on any one centralized system. This is referred to as a filesharing system. This system although less performing in searching requested musical content has little vulnerability since there is no central index server, and hence no traceability of any one instance or node that can be target of a legal action for illegal downloading of free musical content. Commercial online music offerings in order to compete with these free systems must define their services accordingly.

The digital music industry has tried to combat copyright infringements using different methods, technical restrictions, and legal sanctions till now to discourage illegal downloading of musical content but with little success. Napster, an online music store was based on this peer-to-peer free file sharing concept before its operations were ceased by courts due to legal difficulties over copyright infringement. It later re-opened with a newer business model to commercialize the ‘free lunch’ community as stated by the authors Gehrke and Anding in their article ‘A Peer to Peer Business Model for the Music Industry.’\(^\text{16}\)

Napster’s (www.napster.com) newer business model is based on a similar Peer to peer architecture, where music files are stored decentrally and not on a central server. However, they are no longer offered in the free encoded MP3 format, but rather the NAP format that prevents the files from unrestricted usage.

This is based on a concept called DRM (Digital Rights Management) that enables the provider to comply with the copyright of digital music files by controlling their usage. This could be in the form of restricting the playback time, limiting the number of playbacks or preventing files from being burnt on a CD, or in other ways depending on the usage rights granted.

\(^\text{16}\) Gehrke & Anding 2002: Session 5, Chapter 16, 243-248.
2.4.2 Music Service Provider (MSP) Model

Every commercial offering today employs the DRMS (Digital Rights Management Systems) for copyright protection. Another model that also applies the DRM concept is the MSP model. The MSP business model in contrast to the Peer-to-Peer technology uses a traditional client/server architecture, which means that a direct exchange of files between users does not take place. Companies like Pressplay (www.pressplay.com) and Musicnet (www.musicnet.com) could serve as good examples that follow this kind of model. The architecture as shown in this kind of model is centralized around a server. Users similar to the Napster model pay a monthly fee depending on the level of membership plan they choose, that allows them to consume musical content in different ways. All downloads are protected by DRMS and cannot be used freely as
common MP3 files. So in essence both these business models provide the user with an equal product.

**The Music Service Provider Model**

![Diagram of Service Offerings]

*Source: Gehrke & Anding 2002: 246.*

This could however greatly discourage the user from subscribing to one of their plans. So to stay competitive both these commercial offerings have to generate additional value in comparison with the free sources. This is something they can achieve by providing additional add-on content, information content/ metadata or taking strict measures of quality assurance by introducing a reliable download mechanism. There is however a risk where users could utilize the additional value offered by these providers and then move on to the free sources.17

**2.4.3 Economic Incentive Peer-to-Peer Model**

The business models discussed so far fail to address the important requirements of online music distribution. These requirements have been identified as follows:

1- Originators of music need to be remunerated or they won’t have an incentive to produce music which will eventually lead the music market to failure.

2- Provide consumers with some economic benefit to favor legal usage of music content.

3- Content provided to the consumer should be of high quality with a reliable download mechanism.

In this literature review, we have studied another business model that presents users with a unique opportunity of revenue-sharing on the digital music content being provided. It ensures that users are adequately compensated for their participation. This revenue model is based on a Peer to Peer architecture because of flexibility, independence and less technical restrictions free of DRM software; however the concept being a commercial approach, there is the use of a central server to store user and accounting data. This concept is based on similar fundamentals as the OMM (Open Music Model).

Shuman posted a scholarly article ‘Advanced Peer-based Technology Business Models’ in 2002 at MIT Sloan School of Management. It documented the Bain Analysis for a new pricing model that is similar to the concept being discussed. It demonstrates the differences between physical and digital economics and highlights the economic potential of digital distribution of content.18

**Physical vs. Digital Economics**

![Graph showing physical vs. digital economics](image)

*Source: Singh 1999: 5.*

This is the central element of the model where monthly users pay their membership fees every month and pay per download users pay their single download charges. The fees are then paid to the copyright owners, suppliers and users from where the music files are downloaded. This

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18 Ghosemajumder 2002: 34.
ensures a balance between supply and demand of the online music files. Users in a free filesharing system do not have this incentive which is why there are generally more users who request music files in that system than offer music files. The requirements defined for this Peer-to-Peer model for online music distribution can be summarized as follows:

Requirements for the Economic Incentive Peer-to-Peer Model

<p>| | |</p>
<table>
<thead>
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<tbody>
<tr>
<td>1.</td>
<td>Compliance with copyright and remuneration of the copyright owner</td>
</tr>
<tr>
<td>2.</td>
<td>Quality assurance</td>
</tr>
<tr>
<td>a.</td>
<td>of the service (performant search, reliable download, etc.)</td>
</tr>
<tr>
<td>b.</td>
<td>of the product (correct meta data, high quality of the music file)</td>
</tr>
<tr>
<td>3.</td>
<td>Incentives for users to participate in the service</td>
</tr>
</tbody>
</table>

Table 2.1 * Source: Gehrke & Anding 2002: 250.

This model enables the compensation of copyright owners on the basis of economic user incentives and does not need technical or legal actions to enforce copyrights. The users in this model not only participate in the revenue generation process but also the revenue sharing process. So basically users are not just music consumers, but also merchants that could generate monetary remuneration by sharing this peer to peer service.

In the example of the Peer to Peer Economic Incentive Model below, Peer Y downloads Song A from Peer X, location of which was based on a search by the central index server that is not shown in this figure. System deducts a nominal amount of 10 cents from Peer Y’s account which is pre-loaded with a deposit. The 10 cent fee is then shared by Peer X (5 cents) and the service provider (5 cents), out of which some share determined by the service provider is forwarded to the copyright owner. Amount credited to Peer X’s account can be spent on user downloads.¹⁹

Economic Incentive Peer to Peer model

As stated previously this model does not comply with DRMS to protect copyright owners. It relies on the revenue generation and sharing concept of users to participate in the system and pay for music, consumed while at the same time include potential to generate revenues from the downloaded music files. Users, whose downloads exceed their uploads to the system have to deposit new funds. This concept basically encourages uploads as much as downloads to balance the system. Furthermore, the system could be advanced to not limit users spending options of their collected funds. Users could be allowed to spend their collected funds on participating online retail stores to buy related products like CDs, DVDs or other music articles. The model can also establish a user rating for quality assurance enabling users to assess each other after download transactions. This could be related to performance and reliability of the download mechanism used to download that specific content. It could also be related to the integrity and completeness of meta-data (artist, release date, length of song etc.) for each music file offered. The business models in the literature review have provided a framework of how print media industries could sustain growth by capitalizing on digital media for cost, efficiency and market share. The need for these industries to re-define their existing business models has become a necessity in order to remain competitive. Chapter 3 discusses the methodology that this thesis follows and its view on data collection, scope and hypotheses that it intends to accomplish.

3 Methodology

The methodology is based on review of the literature from different journals, scholarly articles, reports and academic sources. Contrary to the case study method, this study uses the historical research method that applies to the identified media industries. Here the objective of research questions is to provide some clarifications on what is happening by answering questions such as ‘How?’ and ‘Why the phenomenon of digitalization of content is affecting established forms of businesses?’21 This type of research aims at being logical (maintain a chain of evidence) and providing some investigation, but also being argumentative (such as testing rival explanations).22 The idea of this thesis is to explore the most optimal solution for distributing content in a manner that best suits customers’ needs, irrespective of the technological platform being used by the media industries. It examines the transformation of information from the printed to the digital platform by investigating the risks, implications and benefits of the two platforms. It further measures their effectiveness and operational methods, and studies the consumer behavior for each trend.

3.1 Data Collection

For this research, data will be sourced from secondary sources only. Data will be collected by means of some literature review and theoretical findings from various sources, which include academic journals, published articles, and internet citations. Statistical reports are consulted from different journals, articles from Business Week and Harvard Business reviews. Internet citations where relevant data can be acquired will also be consulted. There will be no interviews conducted or questionnaires distributed as part of a survey during the course of this thesis.

3.2 Scope

The scope of this thesis is limited to the distribution and retail selling of content in both the traditional aspect i.e. the printed media and its digital counterpart mostly in North America and specifically the United States market. It does not study or research any other region specifically;

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22 Yin 2009: 8, 134-135.
but may speak to its reference in the broader context. It may compare or reference another region or country from past case studies or statistics in the form of citations on a high level basis; however it is understood that those areas are left unexplored and deemed as constraints for the scope of this thesis, due to limited exposure on those regions that warrants further investigation. This thesis discusses the risks, implications and benefits of digital over printed media through the lens of two major media industries; books and music as the subjects of this research. It does not address a particular sector under any of these media industries (such as publishers, producers, content providers, educational institutions, schools, universities etc.), nor does it discuss the various forms of digital transmission methods (such as cable television, broadcasting, video conferencing, smart phones, satellite communications etc). It may however generally reference these industries from time to time.

3.3 Research Hypothesis

3.3.1 Situation

The distribution of print media, in general is slowly being replaced by digital media worldwide. Traditional means of distributing information such as newspapers, magazines and books have lost their quasi monopoly over the internet, and other sources of current information (television, radio, satellite etc). They are losing revenue to their digital counterparts and for them to sustain market share, they need to demonstrate active participation by introducing innovative solutions. Consumers see digital content as a viable alternative to printed content, as they can acquire it in any shape or form at a relatively lower cost. Digital content besides being more accessible and portable than printed content, can at times be acquired at no cost to the consumer.

3.3.2 Area of Inquiries

A. There is a lack of general understanding in terms of costs, effectiveness and market share of what implications digital media has over printed media.

B. To gain and keep market share today, the print media industries need to complement their printed content with digital content, and at the same time substitute the old business model for a newer and better e-business model that could accommodate the transition between printed and digital content.
4 A Statistical Overview

4.1 The concept of the digital evolution

The growth of internet-based businesses is truly meteoric. It has dwarfed the historical growth pattern of other sectors. Over the years, several organizations doing business through the internet have come up with their own set of unique propositions to succeed in the business. Some have substituted their traditional lines of businesses with internet-based income generation, while others have complemented their existing activities and market share by using the internet as a revenue generation process for positive cash flow. According to the Internet World Stats, the world internet population as we see today has grown massively in the past decade or so. Out of a population of 7 billion, internet growth has increased from 360 million users in Dec 2000, to almost 2.1 billion users by end of Q1-2011. Internet growth rate as shown here is at an exponential rate of almost 500%23.

World Internet Population

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<tr>
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<th></th>
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</thead>
<tbody>
<tr>
<td>Africa</td>
<td>1,037,524,058</td>
<td>4,514,400</td>
<td>118,609,620</td>
<td>11.4 %</td>
<td>2,527.4 %</td>
<td>5.7 %</td>
</tr>
<tr>
<td>Asia</td>
<td>3,879,740,877</td>
<td>114,304,000</td>
<td>922,329,554</td>
<td>23.8 %</td>
<td>706.9 %</td>
<td>44.0 %</td>
</tr>
<tr>
<td>Europe</td>
<td>816,426,346</td>
<td>105,096,093</td>
<td>476,213,935</td>
<td>58.3 %</td>
<td>353.1 %</td>
<td>22.7 %</td>
</tr>
<tr>
<td>Middle East</td>
<td>216,258,843</td>
<td>3,284,800</td>
<td>68,553,666</td>
<td>31.7 %</td>
<td>1,987.0 %</td>
<td>3.3 %</td>
</tr>
<tr>
<td>North America</td>
<td>347,394,870</td>
<td>108,096,800</td>
<td>272,066,000</td>
<td>78.3 %</td>
<td>151.7 %</td>
<td>13.0 %</td>
</tr>
<tr>
<td>Latin America / Carib.</td>
<td>597,283,165</td>
<td>18,068,919</td>
<td>215,939,400</td>
<td>36.2 %</td>
<td>1,037.4 %</td>
<td>10.3 %</td>
</tr>
<tr>
<td>Oceania / Australia</td>
<td>35,426,995</td>
<td>7,620,480</td>
<td>21,293,830</td>
<td>60.1 %</td>
<td>179.4 %</td>
<td>1.0 %</td>
</tr>
<tr>
<td>WORLD TOTAL</td>
<td>6,930,055,154</td>
<td>360,985,492</td>
<td>2,095,006,005</td>
<td>30.2 %</td>
<td>480.4 %</td>
<td>100.0 %</td>
</tr>
</tbody>
</table>

Table 4.1 * Source: Internet World Statistics 2011.

In North America alone, the growth in the past ten years has risen by more than 150% which brings the internet user community from a population of 108 million users in Dec 2000, to almost 275 million users by end of Q1-2011, in a total estimated population of 347 million North Americans.

23 Internet World Statistics 2011.
As seen in Table 4.2 below, the internet penetration in North America projected for 2011 is growing at a consistent rate, and will continue to grow with its evolution. At this growth rate, it is dramatically influencing the distribution of digital content that is becoming increasingly popular. Several organizations have tapped into this industry of streaming digital content over the internet, which has become one of the most powerful ways of acquiring cultural content easily, and sometimes at no cost. Furthermore, with the expansion of the internet technology, distribution of digital content has become much easier using e-media where users are able to download content such as music, and other electronic forms of cultural products (such as encyclopedias, games, applications, software) on their personal home computers and store it in plug and play storage media such as USB drives, iPods, mp3 players etc. Even the photo industry has moved towards a digital world of ultra-high resolution cameras that comprise of a large storage/flash memory (SD cards, flash drives etc.) to store and produce high-end digital images with excellent quality and finishing.

Table 4.2 suggests that the number of internet users in North America continues to increase every year. This pattern indicates a growing internet population is contributing to the market segment of digital content, thus becoming the target audience for continued growth and change of organizations that can accommodate such customers in their business models.

Changing organizations such as Amazon have taken advantage of this opportunity and tapped into the area of distributing e-media such as cultural goods, CDs and DVDs and most recently the Amazon ‘Kindle’, its signature e-book. It has also diversified its business by distributing other forms of digital and retail products such as electronics, gaming consoles, mp3 players, storage drives, and other mediums of storing and processing data.

This kind of digital distribution in any shape or form has liberated people from the traditional channels of distribution of information that are not so open, immediate and available like the internet. With this comes a commercial aspect of the massive distribution of digital content to the consumers. Digital content being portable and easy is presently the fastest way of sending and distributing information. It is the quickest and most effective way to communicate with the masses. Many areas in the digital age are currently being explored with frequent investigations from industries that are interested in tapping into niche markets. As the digital age evolves with time, so does its resources and the content it is capable of producing. Digital media today has given rise to the distribution of all kinds of content that were once only available in traditional forms. Movies, newspapers, magazines, novels and books, software products that we use to know as tangible products are now available in digital format. Digital streaming has become so powerful that it has given rise to new professions (like content managers, website designers,
website administrators, web masters and blog moderators to name a few), with its own industries creating internal economic cycles. Michael Porter explains in his article ‘Strategy and the Internet’ that if hype is created through the occurrence of internet technology, the market corrects itself sooner or later and returns to its fundamentals. Once these forces play their role, questions regarding organizational forms, profit sustainability and innovation inevitably arise that are more interdependent than ever before.

The creation of true economic value then becomes the final trendsetter of business success. According to Porter, for the digital age to create true economic value, “we need to look beyond the immediate market signals to the two fundamental factors that determine profitability:

- *industry structure*, which determines the profitability of the average competitor; and
- *sustainable competitive advantage*, which allows a company to outperform the average competitor.

These two underlying drivers of profitability are universal; they transcend any technology or type of business. At the same time, they vary widely by industry and company.24

4.2 An Overview of the Printed Media

The Internet being an extremely important and new technology has received massive attention from entrepreneurs, executives, investors and business observers. The major industry that has been affected by this change is the print media industry, which includes a subset of industries; the book industry, journals industry, newspaper industry, magazine industry to name a few. All these industries are going through a destructive phase where the digital media industry is slowly influencing consumer behavior and threatening to take over their market share. There are two forms of businesses that we could broadly consider in this market trend:

1. The established businesses who need to consider adapting to the internet because the way they conduct their business has dynamically changed and their competitors are promptly responding to that change, both of which could drive changes to their business models. A good example of this could be the newspaper industry where more and more subscribers

are moving towards open and either less costly or free news on the internet. Another example could be the post office industry, where more and more people instead of writing traditional letters, are using electronic media such as emails, offline instant messaging services, video services and even live and interactive chatting using different tools to communicate with the other party. This gives rise to a change in these traditional business models where these established businesses have to come up with ways to be able to complement digital content and use it to their advantage.

2. The E-business bubble in 1990, another phenomenon especially in the U.S. where people wanted to hit the last big market by having or starting up an internet business where some survived and others did not. A good example is Amazon, that worked but many other businesses died. These businesses are more based on innovative solutions and venture capitalism as they wanted to capitalize on the digital market.

Caught up in the hype of the internet age, many have rendered all the old business rules of competition obsolete which has led to bad business decisions. These decisions have eroded the attractiveness of the industries and undermined their own competitive advantages. For example, the Amazon business model of distributing books online through its cyber book store vs. Barnes & Noble or Borders Group using traditional retail distribution. Some have however, used this technology to shift competition away from quality, features, and service and towards price, making it difficult for anyone in the industry to make a profit. A good example of this is eBay, which is a retailer/bulk seller platform where you can find almost any product or commodity that can be comparatively priced against a number of retailers.25

The print media industry, like many other industries has been affected by the internet in several ways. Printed media in its traditional sense is the distribution of information in any printed format. It could be in the form of newspapers for entertainment, sports, business, financial and political news; magazines such as health, fashion, digest and consumer magazines or journals such as academic and scholarly journals. It could take the shape of printed brochures; flyers for advertisements, promotions or marketing campaigns; operation or equipment manuals for textual information and finally novels, educational books, course books, textbooks and entertainment books in terms of educational content.

Printed media is the most conventional and common means of distributing information. This medium has been around for centuries with a very successful track record of delivery. The future of this media however is a bit uncertain and sketchy. Printed media may be obsolete according to some to be able to survive in a digital world. The thesis in this section highlights some important findings that may help us reach conclusive results in proposing future business models for this media. With the future of the printed media relatively unknown, some suggest that the market looks optimistic for both printed and digital content to have consistent market share as they both entertain different market segments. Others find the future of the printed media to be bleak and eventually be replaced by digital content.

4.3 The situation in the discussed media: books, music

4.3.1 Situation in the Book Industry

Book retailing was traditionally dominated by independent local bookstores in the United States until large chain stores substantially increased their share of the market since the 1970’s. The first bookstore appeared as early as 1640 in Boston. Most of these early booksellers were also publishers and printers catering to their own local market. In fact, publishing as a profession independent of bookselling did not begin to emerge until about early to mid 1800s, with the advancements in technology when publishing started becoming a modern business. This transformation was driven by three major factors: big improvements in road, waterway and the railway infrastructure that facilitated a much wider distribution of books to a national then a local market. Firstly, important innovations in the print technology enabled publishers to print large number of books quickly and inexpensively and secondly there was a rapid expansion of the literate consumer market after the institutionalization of education in the United States through schools and churches.26

The book publishing industry increased steadily from 1820-1870. Between 1830 and 1842, about 100 books per year were issued by U.S. publishers; by 1853 the number had jumped to 879; and by 1860 more than 1,300 American books were published. The first post-Revolutionary War advancement in bookselling came in the 1840s, when the invention of rotary press technology.

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26 Madison 1966.
made possible a mass market for books. In the late 1860s, most large publishers began operating their own bookstores and offering volume discounts in competition with independent booksellers. School textbooks by 1860 in the United States accounted for almost 40% of the total book market.\textsuperscript{27}

The development of chain stores and discount stores in the 1970s brought more perspective to volume discounts within the consumer bookselling market. Chains mostly grew through the 1980s by adding mall based bookstores, but shifted their focus in the 1990s to adding “superstores,” large stores with more titles and space. By mid 1990s, superstores continued to dominate the market.\textsuperscript{28}

The present market of retail bookselling is changing, however, with a new form of competitor rapidly gaining market share- the online bookstore. The surge in online sales has forced drastic changes in the industry. Independent booksellers/ superstore chains are trying to fight the encroachment of these online services. Online book sales that accounted for about $6 million in wholesale trade back in 2002 almost a decade ago, now contribute about $350 million in 2010 as per the industry statistics from IDPF (International Digital Publishing Forum).\textsuperscript{29} Some smaller specialty bookstores are getting out of storefront operations altogether and opening up on the Internet. As we will observe in the next section, market data suggests an upward trend for consumer exposure to digital content but displays little growth in the printed media within the past few years.

4.3.2 Situation in the Music Industry

The United States music industry is worth about $12 billion out of the $40 billion music industry revenue worldwide. Most of the world’s major record companies are based out of the United States and are members of RIAA (Recording Industry Association of America). By mid 1900s record companies were the largest players in the United States music business. They became so influential that the music industry started gaining popularity as the recording industry. They first introduced the LP (Long Playing) record albums in the 1950s as the recordable media in studios followed by the compact audio cassette in the 1960s that later became the standard format for

\textsuperscript{27}Charvat 1959.
\textsuperscript{28}Lehmann-Haupt, Wroth & Silver 1951.
\textsuperscript{29}IDPF 2011.
tape recording. These audio cassettes continued their journey in the music industry till the mid 1980s after which the CD (Compact disc) took over as the most popular recordable media of its time. Its successor the DVD (Digital Video Disc) came around the late 1990s and exists till today as the most efficient and high capacity recordable media of the entire century.

Consumers spent less money in the 21st century than they did in the 1990s. According to IFPI (International Federation of the Phonographic Industry) the total revenue for all recordable media (CDs, vinyl, cassettes) combined including digital downloads, decreased worldwide by 25% from $38.5 billion in 1999 to $27.5 billion in 2008. In the United States alone, it dropped from a high of $14.5 billion in 1999 to about $10 billion in 2008. This dramatic decline in revenue drove many music retailers out of business and forced record companies to rethink, and redefine their business models. It is expected that the downward trend for paid music will continue in the foreseeable future according to Forrester Research that predicts, music revenue in the United States will fall around $9.2 billion by 2013. This could be largely driven by the copyright infringement act taken up by the record industries to prevent illegal file sharing. In 2001, their success in shutting down Napster, a leading distributor of free musical content, sent a message of legal action to many other entities. This however failed to bring up the music revenue. After the introduction of the ITunes store in 2003, legal digital downloads became widely available, and an increase in music distribution was observed from this digital stream that accounted for almost a quarter of the entire music revenue in 2009. However as The Economist reports “Paid digital downloads grew rapidly, but did not begin to make up for the loss of revenue from CDs.”

According to the 2008 British Music Rights survey, 80% of the participants wanted a legal P2P service based on the Open Music Model (OMM, subscription-based peer-to-peer system) but half of the respondents were not in favor of paying the music creators. These results were consistent with an earlier survey conducted in the United States.

The current music industry situation is out of balance that is creating gaps between artists, recording companies, promoters and retailers. Big box stores such as Wal-Mart and Best Buy are taking over the retail music industry which is not just specific to music-only stores anymore. Music artists at present are not relying on album sales as their mainstream income but more on

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30 McCardle 2010.
32 The music industry: From major to minor 2008.
34 Orłowski 2008.
live performances/ concerts as their source of revenue. The self-recording home studios and businesses with the technological advancements, and the inexpensive music-related hardware and software have given rise to a new revenue stream for companies such as Apple Inc. This shift has put a significant impact on recording companies who are now only playing the role of music distributors in the artist’s income.

4.4 Sales Data for the Book Industry

The book industry is one of the most major print industries affected by the revolution of the digital age. It is important to understand how digital media has affected its growth, and the repercussions this industry is facing today. The retail bookstore industry in North America has consistently been changing in recent years due to digital influence. When specifically talking about the US market, it is dominated by two large chain/ mortar stores - Barnes & Noble and Borders Group.

The possibility of E-commerce however fostered the growth of a third upstart competitor, Amazon.com with its inception in 1994. The chain stores fearing its initial success and potentially a loss in their sales quickly established their online presence particularly, Barnes & Noble which has been the largest book seller in the United States. In 1997 Barnes & Noble opened its online bookstore to join the battle against Amazon. Amazon however presently remains the country’s largest online retailer, and by far the most popular and successful online bookstore.

Barnes & Noble:

Barnes & Noble, Inc. operates the largest chain of bookstores in the United States. The company revolutionized the concept of bookselling by introducing giant, supermarket-style stores with deeply discounted books in the 1970s. These stores are typically referred to as brick and mortar stores. Barnes & Noble also operated the chain of B. Dalton bookstores in malls until that chain was liquidated with its last store slated to close in January 2010.35

Currently the company operates 717 stores nationwide in addition to 637 college bookstores. The brick and mortar chain now carries over 2 million titles. It launched its online store (www.bn.com) in 1997 when it formally introduced itself as an online retailer to the book industry.

35 Barnes and Noble.com 2011.
market.\textsuperscript{36} Its online bookstore includes an in-stock selection of in-print book titles, with access to over two million title supplemented by more than 20 million listings from its nationwide network of out-of-print, rare and used book dealers.\textsuperscript{37}

**Borders:**

Borders Group is the second largest operator of chain bookstores in the United States with about 510 superstores nationwide. It also operates around 175 mall-based bookstores under the brand Waldenbooks. Borders Group, through its subsidiary Borders Online, Inc., (www.borders.com) is also an online retailer of books, music and videos. As of February 2011, Borders Group Inc. has filed for Chapter 11 bankruptcy protection and is looking to liquidate more than 200 of its superstores.\textsuperscript{38}

**Amazon.com:**

Amazon.com Inc. is a US based online retailer incorporated in 1994. While the company started out as a cyber bookstore it later expanded and developed into an internet marketplace offering all kinds of retail products such as DVDs, CDs, MP3 downloads, computer software, video games, electronics, apparel, furniture, food, and toys.\textsuperscript{39} The company has different partnerships and affiliates through its merchant network that can offer an individual to sell almost anything to Amazon’s customers using its platform. The Company operates six global Websites: www.amazon.com, www.amazon.co.uk, www.amazon.de, www.amazon.fr, www.amazon.co.jp and www.amazon.ca. Key features of Amazon.com Websites include product reviews and other information, Web pages tailored to individual customers' preferences, including recommendations and notifications, 1-Click technology, secure payment systems, browsing, searching and the ability to view selected interior pages of its books on sale using the ‘Look inside the Book’ feature. The Company's community of online users creates feature-rich content, including product reviews, favorite products and online lists that others can reference for gift-

\textsuperscript{36} Barnes and Noble.com 2011.
\textsuperscript{37} Barnes and Noble.com 2011.
\textsuperscript{38} Amazon.com 2011.
\textsuperscript{39} Krishnamurthy 2002.
giving purposes. The success of Amazon and the advantages posed by online book retailing prompted the traditional book retailers to adopt an online offensive mode.40

The retail book industry in the United States is going through a phase where book sales have been continuously declining for the past few years. Retail book sales in 2010 have fallen in the US.41 Table 4.3 displays information about US book sales that was recorded by the US Census Bureau for their 2010 accounts.

**Total US Book Sales 2002-2010**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan</td>
<td>2,072</td>
<td>2,178</td>
<td>2,214</td>
<td>2,301</td>
<td>2,222</td>
<td>2,225</td>
<td>2,075</td>
<td>2,148</td>
<td>2,056</td>
<td>1,973</td>
</tr>
<tr>
<td>Feb</td>
<td>1,051</td>
<td>962</td>
<td>985</td>
<td>1,157</td>
<td>1,040</td>
<td>1,101</td>
<td>1,086</td>
<td>1,108</td>
<td>992</td>
<td>1,001</td>
</tr>
<tr>
<td>Mar</td>
<td>962</td>
<td>961</td>
<td>1,026</td>
<td>1,029</td>
<td>1,092</td>
<td>1,101</td>
<td>1,073</td>
<td>1,073</td>
<td>926</td>
<td>1,009</td>
</tr>
<tr>
<td>Apr</td>
<td>871</td>
<td>929</td>
<td>1,005</td>
<td>931</td>
<td>987</td>
<td>997</td>
<td>1,023</td>
<td>976</td>
<td>968</td>
<td></td>
</tr>
<tr>
<td>May</td>
<td>1,032</td>
<td>1,071</td>
<td>1,159</td>
<td>1,135</td>
<td>1,176</td>
<td>1,020</td>
<td>1,112</td>
<td>1,109</td>
<td>1,118</td>
<td></td>
</tr>
<tr>
<td>Jun</td>
<td>1,040</td>
<td>1,058</td>
<td>1,077</td>
<td>1,162</td>
<td>1,238</td>
<td>1,154</td>
<td>1,206</td>
<td>1,182</td>
<td>1,046</td>
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<tr>
<td>Jul</td>
<td>1,025</td>
<td>1,056</td>
<td>1,124</td>
<td>1,221</td>
<td>1,135</td>
<td>1,214</td>
<td>1,172</td>
<td>1,130</td>
<td>1,038</td>
<td></td>
</tr>
<tr>
<td>Aug</td>
<td>2,183</td>
<td>2,337</td>
<td>2,435</td>
<td>2,330</td>
<td>2,142</td>
<td>2,219</td>
<td>2,119</td>
<td>2,142</td>
<td>1,799</td>
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<tr>
<td>Sep</td>
<td>1,448</td>
<td>1,548</td>
<td>1,481</td>
<td>1,579</td>
<td>1,555</td>
<td>1,553</td>
<td>1,560</td>
<td>1,574</td>
<td>1,491</td>
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<tr>
<td>Oct</td>
<td>949</td>
<td>975</td>
<td>1,032</td>
<td>1,129</td>
<td>1,055</td>
<td>1,064</td>
<td>1,069</td>
<td>1,047</td>
<td>998</td>
<td></td>
</tr>
<tr>
<td>Nov</td>
<td>1,030</td>
<td>979</td>
<td>1,044</td>
<td>1,227</td>
<td>1,143</td>
<td>1,150</td>
<td>1,088</td>
<td>1,037</td>
<td>1,060</td>
<td></td>
</tr>
<tr>
<td>Dec</td>
<td>1,982</td>
<td>1,938</td>
<td>2,029</td>
<td>2,179</td>
<td>2,134</td>
<td>2,256</td>
<td>2,199</td>
<td>2,065</td>
<td>1,949</td>
<td></td>
</tr>
<tr>
<td>Total (year)</td>
<td>15,662</td>
<td>16,051</td>
<td>16,870</td>
<td>17,184</td>
<td>16,983</td>
<td>16,898</td>
<td>16,877</td>
<td>16,236</td>
<td>15,450</td>
<td></td>
</tr>
</tbody>
</table>

Table 4.3

* Source: U.S. Census Bureau 2010.

This table depicts a downward trend in book sales since 2007. Apparently in the past 4 years, this economic data suggests there has been little to no growth in the book retail industry. Between 2002 and 2003 there was literally a jump in book sales of almost $1 billion which then increased gradually till 2007 after which, numbers started falling and retreating back to what they were almost a decade ago. The present 2010 sales of $15.6 billion from Table 4.3 are almost

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40 Isckia 2009: 338.
41 U.S. Census Bureau 2010.
comparable to the historic sales of $15.5 billion back in 2002. Numbers here suggest that the book retail industry may be collapsing. The $15.6 billion estimated by the US Census Bureau for 2010 retail book sales also includes the other non-book goods sold by those retailers, but does not include any book sales from mail-orders. This figure may be about $10 billion lower than total book sales estimates from other industry surveys that include categories such as, the Elhi (Elementary through High School) market for textbooks that accounts for about $5 billion in sales per year, mass merchandisers like Wal-Mart and supermarkets with limited selections, book clubs, Indy booksellers, specialty bookshops accounting for another $1 billion in sales a year, and a few more billion dollars in professional books being sold through non-traditional channels.

**Total North American Book Sales by Major Vendors**

<table>
<thead>
<tr>
<th>Company</th>
<th>North American Sales (Books, Media plus coffee, etc :-</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Barnes &amp; Noble / B. Dalton¹ - (to Q1 2010)</td>
<td>$4.30 billion (Not including $836 million from the newly acquired college book store division)</td>
<td></td>
</tr>
<tr>
<td>Borders / Waldenbooks - (to Q1 2011)</td>
<td>$2.25 billion (Down 16% in 2010)</td>
<td></td>
</tr>
<tr>
<td>Amazon Media (excludes electronics, services - books, includes books, music, DVDs) - 2010 full calendar year</td>
<td>$6.88 billion (Amazon International stores sold $8.01 billion in 2010, and growing much more rapidly than North America for the second year in a row).</td>
<td></td>
</tr>
<tr>
<td>BN.com - 2009</td>
<td>$573 million (Up from $466 million in 2008)</td>
<td></td>
</tr>
<tr>
<td>Total - 2009</td>
<td>$13.483 billion (Note: This total uses 2009 Amazon sales, 2010 reported above)</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Foner Books 2011.*

Table 4.4 gives us a breakdown of the economic data for three major book providers across the US. This information is extracted from the annual reports, SEC filings and company press releases for the full year from Barnes & Noble, Borders, Amazon.com, and BN.com where Barnes & Noble annual report for 2010 is not yet available. BN.com as mentioned earlier is the online portal for Barnes & Noble.

It is interesting to see that as the traditional concept of print distribution started shrinking and phasing out, that was the turning point where Amazon became an interesting player in this industry turning its first profit end of 2001. The concept of online print distribution then
exchanged hands with the traditional method of book distribution. According to sales data in Table 4.4, Barnes & Noble has total North American sales revenue of $5.6 billion until Q1-2010 including revenue from its college bookstore division, and the bn.com portal (Full annual sales of 2010 to be expected) where as total North American sales revenue of Amazon for the year 2010 comes to about $6.9 billion. Border’s Inc has significantly lower sales revenue of $2.25 billion dropping 16% in sales revenue in 2010. It has filed for bankruptcy protection as of Feb 2011. Amazon now claims to be the world’s largest bookstore.

Amazon North America and Amazon International Book Sales

![Graph showing sales comparison between Amazon North America and Amazon International (Media Only after 2001)](image)

Figure 4.2


Figure 4.2 shows a graphical representation of the sales volume growth by comparison for the past decade between Amazon North America and Amazon International. Furthermore, it provides yearly sales breakdown of the three major US book retailers for the last ten years. Note

43 Borders Inc. 2011.
the upward trend as the market shifts towards Amazon online sales in the past few years. During that period the internet economy served as a great boost to the distribution of printed content through online stores. This figure clearly states that Amazon outsold the brick-and-mortar retail chain stores in the US through its online bookstore.

**North American Sales profit (or loss) in % by Year**

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Barnes &amp; Noble Bookstores</td>
<td>-5%</td>
<td>-3%</td>
<td>+2%</td>
<td>+2%</td>
<td>+8%</td>
<td>+7%</td>
<td>+4%</td>
<td>+3%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Borders / Waldenbooks</td>
<td>-16%</td>
<td>-15%</td>
<td>-9%</td>
<td>-1%</td>
<td>+2%</td>
<td>+2%</td>
<td>+4%</td>
<td>+1%</td>
<td>+3%</td>
<td></td>
</tr>
<tr>
<td>Amazon Media (books, music, DVDs) North America</td>
<td>+15%</td>
<td>+11%</td>
<td>+29%</td>
<td>+17%</td>
<td>+18%</td>
<td>+14%</td>
<td>+21%</td>
<td>10%</td>
<td>-1%</td>
<td></td>
</tr>
<tr>
<td>BN.com</td>
<td>+24%</td>
<td>-2%</td>
<td>+9%</td>
<td>-1%</td>
<td>+5%</td>
<td>-2%</td>
<td>+4%</td>
<td>+4%</td>
<td>+21%</td>
<td></td>
</tr>
</tbody>
</table>

Table 4.5

*Source: Foner Books 2011.*

On the other hand Barnes & Noble saw sales drop around 5% in 2009. Table 4.5 offers a textual representation in percentage (%) of similar data from Figure 4.2. Sales growth for Amazon North America is the highest among the three providers. Notice the spike of an increase in sales figures for the year 2007 demonstrating a healthy pace of growth and vitality. Amazon expanded its operations that year to Japan, Germany and the U.K and also released its eBook reader, the Amazon Kindle.

Book sales were continuous falling at the B.Dalton mall-based stores operated by Barnes & Noble that eventually forced them into liquidation. The last B. Dalton bookstore closed back in Jan 2010. Sales for Barnes & Noble chain bookstores dropped around 5% in 2009. The 2010 annual results are yet pending. Barnes & Noble is presently trying to create a new book selling trend with their Nook eBook reader. Sales since 2006 have continued to decline for Borders stores as well. This has significantly accelerated in 2010 by 16% from its smaller decline of 1% back in 2006, which has resulted in the closure of many Walden bookstores in malls.
4.4.1 Amazon vs. Barnes & Noble

**Amazon:**

Amazon, known for its innovation realized the potential to diversify its business opportunities further by creating complementary products to its core activities. It took an initiative to get serious about eBooks in 2007 with the release of their Kindle reader. This concept of marketing innovation brought Amazon into the forefront with the huge success of the Kindle. In addition to its online retail business as a cyber market place, Amazon transformed into a true Application Service Provider with the introduction of its web services. 30% of Amazon sales come from the e-commerce and software solutions offered to its partners.44

“The Internet is providing access for people who just can't find the book they are looking for in a store.” quoted Nora Rawlinson, former editor of Publishers Weekly.45

Amazon gains a key competitive edge by offering its clientele increased product variety through its nearly unlimited virtual inventory by simply using its partner resources, their distribution channels and inventory. It uses the drop shipping concept where a virtual shop front never actually holds its own inventory. Once an order is placed, an email is sent to the distributor to process the order. The only minimum inventory that Amazon deals with is based on JIT (Just in time) which ensures it keeps a minimum amount of stock editions to be able to compete with its partners, thereby treating itself as one of the partner retailers than just a solutions provider.

Saul Hansell in a 2002 edition of The New York Times quotes “The average book may sit on the shelf of a store for six months or a year before it is bought. The cost of this inventory in a chain of hundreds of stores is huge. Amazon can keep just one or two copies in its warehouse - and still make the title available to the whole country - and restock as quickly as customers buy books.”46

Amazon from time to time in its evolution has applied a concept what we call ‘technological trajectory.’ It evolved from a cyberstore to a cyber market and then an application services provider. These different junction points demonstrate a concept known as ‘technological trajectory’ by which future technological evolution is influenced.47

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46 Hansell 2002: 3.  
47 Kim & Kogut 1996: 283.
Amazon as an e-retailer works on minimum marginal profit and requires much less working capital for retail business than traditional bookstores. Since Amazon orders most of its products once they are sold, it rotates its inventory much faster than its competitors. This significantly reduces its business overheads and results in positive cash flow. By selling its products to customers before they can be ordered, Amazon limits the risk of keeping outdated editions in terms of books and obsolete technology in terms of other commodities such as appliances, electronics etc. Traditional retailers however have to constantly keep up with the trend of the latest technology and the most recent editions of books available, by continuously re-stocking their shelves and communicating with manufactures on newer products that have been released. This pre-sales system that Amazon follows reinforces that trend of mitigating obsolescence risks.

The huge and increasing sales volumes between the years of 2005 and 2009 as noted in Table 4.2, have helped Amazon sustains its low operating costs and maintain a much higher gross margin than its competitors. Amazon’s financial results (From Table 4.6) have been very staggering in the past five years. Net income in 2010 rose to $1.15 billion from $0.9 billion in 2009 which is an increase of almost 30%. Total sales increased from $24 billion in 2009 to $34 billion in 2010 resulting in an increase of almost 42%. We observe from Table 4.2 that Amazon has consistently grown in terms of business growth and value between 2001 and 2010. Total sales revenue has increased every year starting from only $3.1 billion in 2001 to a whopping $34 billion in 2010.

48 Msn.com 2011.
Table 4.6      * Source: Msn.com (money central) 2011.

The launch of Amazon’s web services in 2002 greatly boosted its sales resulting in a gradual increase in revenue every year. There are some peaks during certain periods where the technological growth has been exponential. Between the years of 2006 and 2007 we notice an increase of almost 40% from $10.7 billion in 2006 to $14.8 billion in 2007. Another peak is between 2009 and 2010 where sales revenue has grown from $24.5 billion in 2009 to $34.2 billion in 2010 and still growing. Amazon complemented its existing market share by leveraging its e-services in 2005 and then the launch of kindle in 2007 further advanced its sales revenue from $10.71 billion to $14.83 billion. In 2008, Amazon reached a point of operating leverage. Amazon has a high commission rate of 15% through its web services that is significantly higher than the traditional commission of 4-5%. The strength of a retail giant like Amazon lies in the swiftness and the volume of sales it delivers. By merging its web services of several merchants,
Amazon has made it possible to access untapped markets representing several million consumers. This strategy is extensively contributing to its business success and growth in the recent years. Amazon has constantly evaluated the market to understand whether it should engage in a certain business recognizing the costs and the quality of service or product to be delivered. At the same time, understanding the response of its competitors as the barriers to an entry of innovation and its attributes (price, quality etc) has been equally important. These two decisions then determine the capabilities and the marketing strategy.49

**Barnes & Noble:**

Barnes & Noble, a mortar retailer requires a lot of working capital for its retail business. It has huge business overheads with some positive cash flow. As a traditional retailer, Barnes & Noble have to constantly keep up with the latest technology and continuously re-stock their shelves with the most recent editions of books available, and then communicating with manufactures on newer products that have been released. Data from table 4.7 suggests there has been little to no sales growth within the past ten-year history of the company. In 2002, the company made negative sales growth of almost 20% from its preceding year. However, net income still went up from $64 million in 2001 to $66 million in 2002. It took 4 years from beginning of 2002 to end of 2005 for the company to recover its sales growth of $4.87 billion in 2001. It finally contributed to positive sales revenue of almost $5 billion in 2005 that accounted for a 2.5% increase from its sales growth in 2001. Sales plummeted again to negative growth in 2008 sending the numbers lesser to what they were in 2006. Barnes & Noble’s financial results (From Table 4.750) have been a bit disappointing in general showing a very gradual sales increase in the last decade. In terms of net income, the company has been gradually improving with some peaks and valleys during this period; however its digital sales are picking up. A statement released by Barnes & Noble in Feb 2011 announces that the chain stores’ electronic book version based on the Android platform known as ‘Nook’ now owns one quarter of all US e-book market sales. The Nook went in production in Nov 2009. It may have not have reached the success of ‘Kindle,’ Amazon’s electronic book as yet but this e-reader has gained a lot of popularity and traction from

50 Msn.com 2011.
the readers. Data suggests that the millennium was a year of negative net income for Barnes & Noble even though sales revenue was reasonably high. Net income in 2009 has been below par sending the company almost back to its net income figures of 2001/2002. Results for 2010 are not out as yet. As of Q1–2011, the company’s profits went down 25% from the previous quarter last year. Barnes & Noble has continuously been investing in its flagship ‘Nook’ e-reader product line to compete against giants like Amazon, Google and Apple in digital services. Economic data in Table 4.7 indicates the company is not growing as fast and expansion in sales growth may be stalling. It perhaps needs to redefine its direction and market segment. Barnes & Noble’s share price stands at $20 compared to Amazon’s stock price of $187. The difference in market premium and EPS (Earnings per Share) between the two companies demonstrates the business value and growth that Amazon offers its shareholders.

**Barnes & Noble Financials**

<table>
<thead>
<tr>
<th>Income Statement - 10 Year Summary (in Millions)</th>
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</thead>
<tbody>
<tr>
<td><strong>SALES</strong></td>
</tr>
<tr>
<td>05/10</td>
</tr>
<tr>
<td>01/09</td>
</tr>
<tr>
<td>02/08</td>
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<tr>
<td>02/07</td>
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<td>01/06</td>
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<td>01/04</td>
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<td>02/03</td>
</tr>
<tr>
<td>02/02</td>
</tr>
<tr>
<td>02/01</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Balance Sheet - 10 Year Summary (in Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CURRENT ASSETS</strong></td>
</tr>
<tr>
<td>05/10</td>
</tr>
<tr>
<td>01/09</td>
</tr>
<tr>
<td>02/08</td>
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<tr>
<td>02/07</td>
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<td>01/04</td>
</tr>
<tr>
<td>02/03</td>
</tr>
<tr>
<td>02/02</td>
</tr>
<tr>
<td>02/01</td>
</tr>
</tbody>
</table>

Financial data in U.S. Dollars Values in Millions (Except for per share items)

* Source: Msn.com (money central) 2011.

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51 Carnoy 2011.
4.4.2 The Electronic Book Market

According to the AAP (The Association of American Publishers), sales of e-books doubled in January 2011 in the United States to $69.9 million, an increase of nearly 116% compared with $32.4 million for the same period a year ago.\(^52\) The AAP has 300 members including major U.S. commercial, education and professional publishers as well as smaller and non-profit publishers, university presses and scholarly societies.

While the total US book sales in Jan 2011 on all platforms in all categories declined by 1.9% from $822 million a year ago to $806 million dollars, E-book sales surging to its current level represented the most significant growth.

A further breakdown of printed book sales by categories compared to last year results for the same period showed adult hardcover sales drop by 11.3% from $55.4 million to $49.1 million, adult paperback sales fall by 19.7% from $104.2 million to 83.6 dollars, children hardcover sales decline by 1.9% from $31.8 million to $31.2 million, children paperback book sales decrease by 17.7% from $30.9 million to $25.4 million, higher class book sales fall by 1.4% from $387.6 million to $382 million, professional and academic book sales surged by 1.3% from $51.2 million to $51.8 million, university hardcover sales fall by 14% from $430 million to $390 million and university paperback sales fall by 7.8% from $670 million to $620 million. This continuous trend and year-to-year decline in almost all major categories of printed book sales indicates the difficulties and barriers the traditional book industry is facing today.

The IDPF (International Digital Publishing Forum) is another organization that collects quarterly US trade retail eBook sales like the AAP. According to the IDPF US electronic books sales have surged dramatically with estimated sales of $119 million in Q3 of 2010.\(^53\)

\(^{52}\) Association of American publishers 2011.
When we compare the electronic wholesale trade sales of Q1-Q3 2010 that is estimated at $304.6 million compared to annual trade sales from 2002-2009, we notice a huge variation. Figures have more than doubled; Take for example results from 2008, 2009 and 2010. 2008 total annual electronic book sales hit $53.5 million whereas 2009 annual sales were at $165.8 million and 2010 results up till beginning of Q4 topped at more than $300 million. This data represents only wholesale trade of electronic book sales within the United States market. Retail numbers may be double or higher due to industry wholesale discounts. This data does not include any library, educational or professional sales.
Electronic books sales define all books delivered electronically over the Internet OR to handheld reading devices. The IDPF and AAP both collectively have contributed to the gathering of this data since 2006.

**US Trade Wholesale Electronic Book Sales 2002 - 2010**

<table>
<thead>
<tr>
<th>Quarters</th>
<th>Revenues</th>
<th>Quarters</th>
<th>Revenues</th>
<th>Quarters</th>
<th>Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1 02</td>
<td>$1,556,499</td>
<td>Q1 06</td>
<td>$4,100,000</td>
<td>Q1 10</td>
<td>$91,000,000</td>
</tr>
<tr>
<td>Q2 02</td>
<td>$1,258,989</td>
<td>Q2 06</td>
<td>$4,000,000</td>
<td>Q2 10</td>
<td>$88,700,000</td>
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Table 4.8

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4.5 Sales Data for the Music Industry

The music industry is another big industry that has been re-shaped with the massive distribution of digital content. This media industry has transitioned from analog recordable media like tapes and audio cassettes that were used to store and distribute cultural content, to digital recordable media such as CDs and DVDs with the evolution of the digital age.

Figure 4.5 according to the IFPI’s (International Federation of the Phonographic Industry) annual report states that global music sales totaled $15.9 billion in 2010 which represents a decline in sales of 8.4% from $17.4 billion in 2009. Decline in physical music sales continues with 2010 numbers down by 14.2% to $10.4 billion from $12.2 billion in 2009. U.S and Japan being the world’s two largest music markets contributed about 57% to the global decline of sales in 2010 as compared to 80% in 2009. The United States market recorded a decrease in music sales of 10% to $4.17 billion from $4.63 billion in 2009. The music industry has recorded fewer sales each year since 1999. Global digital revenues that accounted for almost 30% in 2010 went up by 5.3% to $4.6 billion. The same category of revenue accounted for about a quarter of global music sales in

54 IFPI 2010.
In the United States, digital revenue accounted for almost 49% of music sales in 2010 which is a significant increase from 43% back in 2009. Performance rights also experienced significant growth in the U.S moving up to $90 million in 2010 from $70 million in 2009. This initial sales data suggests there is a shift in the consuming pattern of cultural goods. Music lovers are moving more towards digital sales since its popularity soared in 2004 and 2005.

**Global Recorded Music Sales 1997-2010**

With the increase in digital sales, the digital music industry has acquired a larger slice of the market share within the North American music industry. However in general, music sales data in the North American market shows a pattern of continuous decline highlighting an entire industry in turmoil. Apple Inc’s iTunes Store, the world’s largest music store after its launch in 2003 in the US has largely boosted sales of digital music and is now the biggest music retailer in the US, growing to over a quarter percent of all music sales in the United States. Digital purchases of music at the iTunes store make up about 36% of its total digital sales. This revenue has significantly contributed to the U.S digital growth in the music industry. Even with a decline in
total music sales of 10% from last year, digital revenue improved from 43% of US music market share of $1.99 billion in 2009 to 49% at $2.04 billion in 2010. These statistics show signs of some improvement in the US music industry with reasonable optimism for this market shift to continue going forward.

Performance rights in the US music industry continue to grow with this year’s increase at almost 29% to $90 million as compared to $70 million in 2009. This data shows that consumers are not demonstrating a growing buying trend for music sales, but performance rights continue to grow within North America that has one of the world’s strictest anti piracy laws enforced in its society.

The IFPI report stated that ‘music subscription services expanded their audiences significantly in the past year,’ estimating 10 million consumers worldwide signed up for a music subscription service. Sweden also follows in North America’s footsteps after introducing the home grown Spotify (www.spotify.com) platform where an increase in subscriptions resulted in an increase in music sales for 2010. Also a new law in Sweden compels internet service providers to identify freeloaders to copyright owners. (IFPI, Digital Media Report 2011)

Where the music picture maybe looking better for the Swedish market, it is much worse in Spain, where P2P (Peer to Peer) use in 2010 is double the Europe-wide rate (as highlighted in Figure 4.6 below) and the market is worth not even half of its original value. So the industry still has a lot of piracy issues to deal with globally. Labels are encouraged by new legislation enacted in the UK and France that levels education and sanctions against freeloaders, but these controversial measures haven't yet been implemented and still face opposition from the masses. According to Nielsen SoundScan numbers, album sales in the United States market for 2010 fell by 12.8% to 326.2 million units from 373.9 million units the previous year driven by a sharp decline in CD sales of almost 20% in a fourth straight year.55

55 Solters & Loynes 2011.
Sales of Debut Albums

Figure 4.6

Overall music unit sales (each sale of an album, digital track and music video as one unit) fell 2.4% to 1.51 billion music units from 1.55 billion units in 2009. Album sales have continued to decline in the US due to illegal downloading of free musical content from filesharing systems or Peer-to-Peer networks. The music industry is primarily dominated by four major corporate labels in the United States that serve the recording music sector. Universal Music Group, Sony Music Entertainment, Warner Music Group and EMI. Universal Music Group is leading both the US and the Global music market.

Physical music sales are distributed mostly through large retailers like Wal-Mart, Best Buy, Amazon, Target and others. Digital music and album downloads in most cases are distributed by Apple Inc. through its ITunes store. The year-end Nielsen SoundScan numbers tell us that Universal Music Group remains the market-share leader for 2010. It annually gained 31.4% market share in albums beating Sony Music Entertainment share at 27.4% and Warner Music Group at 19.8%. EMI gained a market share of 9.6%, while the indie sector collectively acquired
11.6%. At the end of Q1-2011 Sony reported a loss in revenues across its music, film and play station divisions. Revenue fell by 12.9% by end of Q1. The company perceives the fall of music sales due to currency exchange issues between the Yen and the US Dollar and the continuous shrinking of the physical music sales.

4.6 Market Share: books, music

4.6.1 Market Share in the Book Industry

The retail bookstore industry is dominated by several large chains such as Barnes & Noble, Borders Group and Books-A-Million. Barnes & Noble is the largest chain bookstore in the United States. Barnes & Noble CEO William Lynch in a letter to the shareholders in Sep 2010 stated his strategy for the book business and expects the company to grow from its present 18 percent U.S. book market share to about 20 – 25 percent by 2013.

At another meeting he pointed out “We now represent 25 percent of the e-book market in the U.S., larger than our share in physical books. We sell twice as many e-books as all formats of physical books combined on BN.com.”56 This puts Barnes & Noble in second place in the U.S. e-book market after Amazon which claims to have roughly 70% of the electronic book market share. The Nook also competes with other electronic e-reader versions in the market such as Sony reader, Apple’s iBooks for the iPhone and iPad. It would be interesting to see Apple’s iPad sales data for 2011, where it is expected to take over 83% of the tablet computing market share in the United States. However, it is more than just an e-reader so the sales may not account towards the electronic book market share.

Borders Group has been second to Barnes & Noble since 1992. Borders Group operates around 700 retail stores across the country under the names Waldenbooks, Borders, and Planet Music (CDs) but is now down to 400 stores since filing the Chapter 11 bankruptcy protection in Feb 2011. The company has already liquidated 225 of its total stores nationally.

56 Carnoy 2011.
Books-A-Million is the third largest chain store retailer operating over 200 stores in the US. Its e-commerce portal opened up in 1998 under the name “booksamillion.com.” As of 2010, sales revenue is about $0.5 billion. Besides these three big mortar chain stores, there is an online retailer Amazon that has acquired a major component of the market share.

Amazon roughly controls about 40-45% of the US book market share putting it on the top of the list as the largest traditional and electronic book retailer in the United States, including third party and partner affiliate book sales. The Kindle, Amazon’s flagship e-book product has been declining in sales reducing Amazon’s share in the electronic book market to about 70% by end of 2010 largely due to the launch of the iPad, Apple’s electronic e-reader and tablet computing device. Amazon is positioning itself for a 50 percent market share of the entire book business in the United States by end of 2012.

According to an article dated back in 2008 two online cyber stores have been fiercely competing with each other in North America. EBay is the online equivalent of an auction house and Amazon is a true internet marketplace. EBay has been losing ground to Amazon where its losses are turning into Amazon’s gains. Michael Brush in this article states that Amazon’s everyday low pricing and cheap shipping is coming into play, unlike eBay’s time consuming auctions. In 2008 when this article was published, Amazon’s North American sales for Q2 of that year jumped by 35% whereas eBay’s revenue went up by only 12%. Even today Amazon’s battle with eBay continues, and reinforces the concept introduced in the published article. In 2010 eBay’s total sales revenue grew by 5% to $9.15 billion; whereas, Amazon’s total sales went up to $34.2 billion demonstrating an outstanding growth of 40%.

Publishers that initially have been conservative in moving into the e-book market are now promoting e-books to compete with online book distribution. US data from the International Digital Publishing Forum tells us that electronic book sales that only accounted for $5 million back in 2002, now account for over $350 million. This shows the tremendous growth opportunity that the digital book market has to offer and that this market is surging exponentially.

57 Brush 2008.
4.6.2 Market Share in the Music Industry

The music industry is also facing similar circumstances in the digital arena. In 2000 Eric Boehlert in his book ‘The Death of Music retail’ proposed that “confronted by the apocalyptic mix of blank CDs and Napster, the record shop faces extinction in 12 months.” In 2004, Pim Fox reinforced this issue by suggesting “Call it the neutron-bomb effect: In less than a decade, the aisles of music retailers will be empty. I predict that online music sites such as Apple’s iTunes, Napster and Sony’s Connect will have drained Virgin Megastores, HMVs and Tower Records of their customers.”58 Of the latter three above, the Tower retail chain filed for bankruptcy in 2006 and liquidated all its retail stores in the United States. Currently, it operates its online music store as an international e-retailer. Wal-Mart that used to be the world’s largest music retailer just got pushed second place, in 2008 within just 5 years of the launch of Apple’s iTunes music store that now claims to be the world’s largest music store. This marked a milestone in the digital distribution of music.

The NPD group, a leading market research company released reports that show iTunes to control just over 25% of the recorded music market share in the United States which is about 6% of world market share in recorded music as per numbers in 2010. According to the International Federation of the Phonographic Industry, sales of online music in the United States and Europe increased tenfold between 2003 and 2004.

Informa Media Group in 2007 forecasted online music globally to account for 15.2% share of sales by 2010.59 Today online music represents almost 30% of global sales.

Figure 4.7 below compares the US music market sales of iTunes with other vendors as published by Billboard (www.billboard.com) from the NDP reports.60

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60 Dilger 2010.
U.S. Music Market Sales Comparison among Major Music Vendors

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</tr>
<tr>
<td>Total Physical sales</td>
<td>57.5</td>
<td>49.3</td>
</tr>
</tbody>
</table>

Figure 4.7 *Source: Dilger 2010.

The DMR (Digital Media Report) 2011 report released from the IFPI splits the global digital revenue across multiple sectors. Figure 4.8 elaborates on the different digital markets that are present today, and where further potential can be explored.

A Forrester research report titled “US Music forecast, 2009 to 2014” by Sonal Gandhi indicates that the downward trend in overall music sales in the US market may continue for the next few years, where revenues may stabilize at around $5.5 billion by 2014. Recorded music sales in the US have declined by more than half in the past decade. CD sales will continue to decline at an
exponential rate however, growth in digital music sales being modest would not offset the strong decline in recorded music revenues in the United States market.\footnote{Gandhi 2010.}

**Global Digital Revenue Share**

![Global Digital Revenue Share](image)


Where physical music sales is the most traditional way of storing music, our sales data from section 4.5 suggests that the digital market is evolving with potential for exponential growth. According to the NPD group, surveys conducted in the two biggest digital markets, US and UK reflect results of positive and prospective growth. Only 16.5% internet users aged 13+ purchased digital music in Q3 of 2010 which means, there remains a whole niche market to explore with these demographics.

According to the Digital Media Report for 2011, there are 400+ licensed digital music services worldwide, and the increase in the value of the digital music market between 2004 and 2010 has been more than 1000%. It summarizes the fact that digital piracy is the single most important factor holding back further development in this industry. Legitimate viable alternatives to piracy could help flourish music industry figures globally. According to the DMR 2011 report, the record industry is more open now to new business models than it has ever been. It states that lower music sales are inadvertently affecting employment of musicians showing a continuous decline in recorded music shipments since 1999. According to numbers released by the U.S
department of labor, recorded music shipments estimated to about $13 billion in 2000 have now declined to only $9 billion today.

**Digital Roadmap of the Music Industry**

![Figure 4.9](image)


Figure 4.9 indicates that digital music is flourishing with licensed based services gaining momentum from fewer than 60 about 6 years ago to more than 400 today. That is a progress of almost 600%. Selection of digital tracks within catalogs has also increased exponentially, indicating a growth in music composing and recording of 1200%. Digital revenue has now become almost a $5 billion industry.
5 Proposition of business models by industry

5.1 Books

After studying various business models relevant to the book and music media industries, I have come to the understanding that different business models studied can be applied to related circumstances.

For example, in the case of a start-up, the business can be established as an e-retailer by exploring some e-commerce options. A start-up business could adopt the virtual merchant model for online presence in the internet marketplace, fused with a partnership affiliate model to build a stronger brand through networking. At the same time, this partnership would add value proposition and expand on a revenue sharing, banner exchange or pay-per-click program. This would result in a healthy ecosystem community for a new business that is trying to establish a small to medium sized network by generating multiple revenue streams.

In the case of large chain store establishments, such as brick and mortar retailers, the Click and Brick Model from Section 2 could be applied. This model seems to work well with large offline businesses. It facilitates the transition of their traditional retailing businesses to e-modeling, that is from offline book sales to online book selling and distribution.

There may be a case where large e-retailers or virtual merchants, of book distribution may want to open offline bookstores for a tangible and physical presence to the consumer. These e-businesses having been well-established in their current e-tailing line of business, may want to integrate with the traditional book distribution model that is generally applied in mortar and independent bookstores. This could result in a new mix of hybrid model where a large virtual merchant that operates solely over the web, will have traditional retail establishments for its book distribution, business operations, and client storefronts.

The three concepts mentioned above could be delivered through the online mechanism of book distribution, over the internet, and the offline mechanism of book distribution through traditional
retailing; both of which would apply to the traditional printed books, and their electronic e-reader counterparts as well.

5.2 Music

The music industry in line with the book industry also offers many business models that could be applied to different establishments of music retailing. Of them, one which seems to stand out is The Peer-to-Peer Economic Incentive Model that may prove to be an optimal fit for digital musical content. Music retailers who want to complement their traditional music media (CDs, DVDs, Blu-ray discs), with an e-business component can use this model. This model is a viable opportunity, as it encourages partnership between copyright owners, and consumers by offering a revenue sharing program.

Firstly, current business models like the Music Service Provider model or the Napster music model face heavy competition from free filesharing peer-to-peer services.

Secondly, this model based on its revenue component encourages, the sharing of popular music files over unpopular music files (as those files would be downloaded more frequently), hence generating more revenue. Users therefore could not just potentially equalize their individual downloads against their uploads; but infact, sustain a net gain depending on the number of music files they have in store that are in demand. The result is, that this revenue sharing model is no longer in place just for the user’s interest in music itself, the users may even download music files having no personal interest in it for its re-sale value and additional demand that can generate more income. In the same way, users who collect large content with the idea of reselling and generating income, will no longer offer their content on free filesharing systems, and thus, discourage free sources altogether that would become less attractive with less popular content. Also, users engaged in this revenue sharing program will not act illegally based on their partnership with the copyright owners as a commercial service.

According to the IPI (Institute for Policy Innovation, www.ipi.org), global music piracy causes $12.5 billion in economic losses every year. With music piracy at its peak in many European
countries, and billions of dollars in lost revenue in music sales from piracy attacks, it is important to understand how this revenue could impact the global music industry in terms of growth. This model in its purest form, balances the market instability by minimizing the loss of revenue from free distribution of musical content and mitigating the risk of lost sales based on the Open Music Modeling concept. The pricing structure may need more work according to different market calculations of what an average consumer can afford in subscription/download fees; or what is the right price point for this product in the marketplace given its market value; or how does it add value for the consumer to start a subscription service. This model may not however prove to be a legal solution to the free filesharing systems. It is just driven by a revenue model where incentives presented to the consumers to participate in this program outweigh, the ones offered in free filesharing systems.
6 Conclusion

6.1 Conclusion

We have explored some innovative and convenient alternatives that cater to a growing digital market. At many junctures throughout this thesis, it has built an understanding that digital media could have over printed media and its implications on it as a whole. This transition is not just limited to the books and music media industries covered in this thesis. The digital world has conquered many other industries such as newspapers, journals and magazines.

Through the course of this dissertation, I have explored the fundamental principles of business modeling that support the framework of this literature review. From this I then brought forth to the readers, a clear concise understanding of the significance of transitioning traditional media industries, to a digital platform so as to expand on revenue streams and gain competitive advantage.

As traditional book and music businesses continue to evolve and expand their operations, a key thing to remember is the audience they cater to and its dynamics. For example, in the book industry electronic books that were introduced to the market a few years ago, have captured the hearts of many, they require a continuous adaptation with supplement digital book technology and re-thinking of new platforms as a way to evolve. This allows traditional establishments to complement their print editions of books with e-books, so they can co-exist and neither can threaten the survival of the other.

Another key feature observed, is the strong barrier for competitors to enter where traditional established operations such as Amazon or Barnes & Noble who have rich knowledge, diversity, and their credibility outshines new entrants from entering this market. Among others; the proven and powerful brand of an incumbent and its existing distribution channels, an international portfolio and huge upfront setup costs, could pose a serious competition for new arrivals.

Overall, we have learnt that in the print media industry, traditional book and music businesses should complement their existing business models with an e-model, so both can complement each other rather than face the threat of one substituting another. This would ensure the long term success of both media. Printed media is still engrained in a much larger subscriber base, and for it to fail and be replaced completely by another media, does not seem to be happening at this time. The print media industry due to its tangible nature and the obvious time frame it has spent with us has been constantly reinforced in consumer minds. It has however yet to survive through these tough times for a
promising future ahead. Also, a typical business model regardless of its nature of industry; book, newspaper, magazine, music etc has to go through continuous adaptation, innovation and diversification of one’s businesses for an effective long term strategy, and to ensure a firm’s survival, prosperity and growth.

6.2 Next Steps

The effect of the digital age on various industries is one that has provoked much curiosity and probing. To that effect, the scope of this thesis could be broadened, and some information perhaps re-used to cover more media industries to see if the conclusions remain constant. More countries could be added to the study to do a full comparison. A comparison between developed and emerging markets could also be undertaken to analyze the differences in industrial growth, and development; perhaps provide recommendations to still developing nations to alter their business models and strategies. More economic theories and analytical models could be applied to this literature review to come to more conclusions and a deeper analysis. The information in this thesis could be helpful for primary and secondary stakeholders in the media industries, and their investors and shareholders.
7 References


Appendix:

The following entities are included in the survey in Table 4.3:

**4512111 Book Stores, General**
Establishments primarily engaged in retailing a general line of new books. These establishments may also sell stationery and related items, second-hand books, and magazines.

**4512112 Specialty Book Stores**
Establishments primarily engaged in retailing specialty books, such as general reference, religious, and professional books.

**4512113 College Book Stores**
Establishments primarily engaged in retailing textbooks, generally on the college level. Most of these establishments are located on or near college campuses and some sell more apparel than books. These establishments may also offer second-hand textbooks. School book stores, other than college, are included in this industry.