EBook Rentals – Implications for the Book business

Ford MBA Project

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Acknowledgements

Executive Summary

The market for eBooks has truly taken off, and at this point, a paid eBook rental service appears to be a natural extension of the technology. While there is the public library system with its small collection and limited number of copies, and certain websites providing rentals on a smaller scale, a full-fledged "all you can eat" eBook rental service is not being offered at this time.

There are two issues that are central to the emergence of the eBook Rentals business – (1) the potential demand for such a service and whether it is large enough to justify the investment and (2) the concern over possible cannibalization of eBook sales and increased piracy. The following frameworks were used to analyze these issues in greater detail - Assessing future markets for new technologies, Commercializing emerging technology through complementary assets, and Scenario Planning.

The "assessing future markets for new technologies" framework provides a great structure to quantify the potential market for eBook rentals based on three approaches - diffusion and adaptation, exploration and learning, and triangulation for insights. For eBook rentals the early adopters could be students. Since textbooks have been rented in the print format from a long time, renting textbooks in eBook format would be a natural extension and less disruptive in the market. Other potential adopters are price sensitive customers who would have otherwise purchased a paperback version or a used book. Within this category, the eBook rental service would particularly appeal to frequent readers who would be economically better off with a

subscription model that provides a lower cost per book. A key determinant of whether the shift from early adopters to early majority is possible is the availability of content, and the price to performance measure of this new service.

To benefit commercially from this innovation, a firm must possess additional assets that enable it to uniquely bring the service to market. The "Commercializing emerging technology through complementary assets" framework provides a structure to precisely analyze this capability. The complementary assets include: Access to distribution, Service capability, Customer relationships, Supplier relationships, and Complementary products.

In addition to the two frameworks mentioned earlier, Scenario planning shall be used to paint concrete and vivid narratives of the future that hinge on key uncertainties whose outcomes will shape the future environment. Several key trends are looking to shape up the eBook rentals space; some examples are: eBook prices are falling, eBook retailers are vertically integrating into publishing, enhanced eBooks are being explored and e-reading devices/platforms are proliferating. This paper will look at two key forces to come up with four potential scenarios to describe the future of the eBook rentals landscape. Once these scenarios have been defined, the paper will present some strategies on how various players in the value chain can position themselves to best prepare for the potential scenarios. Although it is difficult to predict exactly which scenario will fully emerge, it is possible to create strategies to mitigate against a number of factors present in a number of potential scenarios.

E-Books Background

An electronic book (e-book) is a book-length publication in digital form, consisting of text, images, or both, and readable on computers or other electronic devices such as e-Readers. Early e-books were generally written for specialty areas (technical manuals, manufacturing techniques, etc.) and were intended for a limited audience. The availability of the Internet made transferring electronic files much easier, resulting in a broader emergence of e-books.

Writers and publishers have many formats to choose from when publishing e-books. The most popular e-book readers and their natively supported formats are shown below.

E-Reader	Supported Formats
Amazon Kindle, Kindle Fire, Kindle Touch, Kindle Keyboard	AZW, PDF, TXT, non-DRM MOBI, PRC, HTML, DOC, DOCX
Nook Simple Touch, Nook Color, Nook Tablet	EPUB, PDF
Apple iPad	EPUB, PDF
Sony Readers	EPUB, PDF, TXT, RTF, DOC, BBeB
Kobo Readers	EPUB, PDF, TXT, RTF, HTML

Digital Rights Management (DRM) technology is used by content providers to fight e-book copyright infringement, maintain artistic control, and ensure continued revenue streams. However, some argue that DRM makes buying and using eBooks harder. There are several different DRM schemes. EBooks with one DRM scheme can't be read on a device that uses a different DRM scheme. Some DRM schemes limit eBooks to a single device only, so if a user

wants to read that eBook on a different device, it's necessary to download the eBook again.

Other DRM schemes require new devices to be authorized by a central server on the Internet.

E-Book Publishing

The E-Book Publishing industry has thrived from 2007 thru 2011, and revenue is expected to keep growing in the years to come. With the introduction of e-readers, tablets and other internet-connected mobile devices, the demand for e-books has steadily increased. Over the last five years, internet access expanded, disposable income increased and more Americans enrolled in higher education. These factors influenced consumer access and affordability, and thereby affected the demand for e-books.

The industry has been able to increase profit margins as digital formatting of books has become more streamlined, increasing the overall efficiency. While eBooks have flourished, the industry has faced challenges with consumers accessing free e-books (copyright infringed) and publishers disagreeing with retailers about e-book pricing.

The outlook for the industry is good, with revenue projected to continue expanding over the next five years. As disposable income rises after the recession, consumers will buy more tablets and e-readers and increase their demand for e-books. Industry revenue is projected to grow an average of 16.5% per year from 2011 to $6.5 billion by 2016. There will be increased competition as new publishing firms are expected to start up as technology costs decline and demand soars. These firms will likely focus on niche audiences or genres, such as text books, professional e-books or children's books.

Some of the key drivers of industry performance are the proliferation of wireless computing devices, increased disposable income, broadband penetration, and number of college students.

Demand from wireless computing devices:

Wireless telecommunications carriers provide phone service and internet access to consumers. This technology enables consumers to buy e-books on the go, which is how a significant proportion of e-books are bought. Also, publishers' marketing campaigns already target consumers who use wireless connectivity services. For example, advertising in e-books is becoming an increasingly viable option for publishers. This technique directly targets e-book readers, with one-click purchases of content on the pages of other similar e-books. This driver is expected to increase during 2011, representing a potential opportunity for the industry.

Per capita disposable income:

Books are considered discretionary household expenditure; consumers generally read books for pleasure or for educational purposes. Therefore, a change in disposable income influences spending on books. This driver is expected to increase slowly from 2011.

Broadband Penetration:

The number of broadband connections indicates the availability of internet connectivity within the United States. Broadband connections facilitate quick downloading of e-books by consumers. E-books can be downloaded through cable and Wi-Fi connections at home or at public hot spots. Also, 3G and 4G mobile connections enable consumers to buy e-books on-the-

go. Increased broadband penetration adds to industry revenue by increasing e-book accessibility for consumers. This driver is expected to increase during 2011.

Number of college students:

Students are required to purchase textbooks throughout their education. E-textbook revenue is expected to make up the largest share of industry revenue from 2011. In addition, individuals who complete college degree generally read more books on average, according to consumer studies and the US Census Bureau. Consequently, a higher number of college students results in more revenue for the industry now as well as in the future. This driver is expected to increase from 2011, but it will only increase slowly, indicating a potential threat to the industry.

It is estimated that in the US, Amazon has a 65% share of the e-book retail market, Barnes & Noble has 20-25% and Apple iBooks has an 8-10% share.

Framework Selection & Methodology

There are two issues that are central to the emergence of the eBook Rentals business – (1) the potential demand for such a service and whether it is large enough to justify the investment and (2) the concern over possible cannibalization of eBook sales and increased piracy. The following concepts can be used to analyze these issues in greater detail.

Core Issues	Concept Category	Potential Concepts
Potential Demand	Managing Markets	Assessing future markets for new technologies
		Commercializing emerging technology through complementary assets
Potential Value: Concern over cannibalization of eBook sales & increased piracy	Making Strategy	Scenario Planning

Assessing future markets for new technologies

Before the technology can be developed in a cost effective manner, it is imperative to assess whether the market for eBook rentals is large enough to warrant a development project. This spawns questions such as: Does the rental service for eBooks satisfy a need or solve a persistent problem of a significant group of customers better than the alternatives? Which segments will

be the most attractive – students, casual readers, or others? And in what order will they emerge?

It is crucial to determine the size of the prospective market with greater precision. This will call for assumptions about the value proposition to target customers relative to competing alternatives, and the collective investment of competitors in market development.

The "assessing future markets for new technologies" framework provides a great structure to quantify the potential market for eBook rentals based on three approaches - diffusion and adaptation, exploration and learning, and triangulation for insights.

Commercializing emerging technology through complementary assets

The technological skills necessary to develop an eBook rentals business are not really complex, and therefore success hinges on other factors. EBook rentals can possibly change the relevant complementary assets, relevant competitors, and relevant customers to various extents. Proactive management of these other areas, in addition to developing new technical capabilities, is crucial to survival.

The commercializing emerging technology through complementary assets framework provides a set of core questions that need to be answered to determine the degree of impact that eBook rentals will have on relevant complementary assets, relevant competitors, and relevant

customers. The analysis can help determine the strategy required to aggressively develop new complementary assets, understand new customers, and respond to new competitors.

Scenario Planning

With eBook rentals there is uncertainty around the collaboration of the publishing industry, authors, and other media stakeholders who are critical partners in this business. With concerns around possible cannibalization, piracy, and market interest given the free library system, one needs to think about various scenarios that could play out in the future and possible solutions to address them.

Scenario planning helps in planning for the future by painting concrete and vivid narratives of the future that hinge on key uncertainties whose outcomes will shape the future environment. The act of jointly developing stories about the future, in a disciplined but imaginative way, enhances both the learning about and the acceptance of these futures, in contrast to developing a bare-bones set of bullet points, and as a result this would be a useful tool in the analysis of the eBook rentals business.

Assessing future market for eBook rentals

Three approaches can be used to assess the future markets for new technologies:

•   Diffusion and Adaptation

•   Exploration and Learning

•   Triangulation from insights

Diffusion and Adaptation:

Some markets leap ahead while others languish for years before gradually taking off. Each path

is the outcome of the interplay between contending forces that inhibit or facilitate the rate of

diffusion.

The growth pattern can be largely explained by:

•   Perceived advantages of the new product relative to the best available alternative

•   The risk perceived by prospective buyers

•   Barriers to adoption

•   Opportunities to learn and try

While the main driver of the rate of diffusion is perceived relative advantage, the other three

factors can certainly dampen or impede this rate. For eBook rentals the best available

alternative is to either buy the eBook or rent it from the library or use a traditional print book

(either purchased or rented). The perceived advantages of rented eBook over a print book are

the same as those of a purchased eBook over a print book – portability, saving physical space,

convenience (e.g. easy disposal), saving money & time (no shipping cost, no travel cost to buy in store, no wait time), and ease-of-use (e.g. adjustable font size, searchable). In addition to these rented eBook offers additional advantages over purchased eBook such as lower price per book, convenience of automatic subscription payments, greater ability to try many books and potentially smaller storage requirements. The perceived costs of eBook rentals over purchased eBooks are a potential higher price per book for infrequent readers and the inability to keep the book for reference permanently.

The risks perceived by buyers would be uncertainty about performance, subscription contract lockdown and concerns about standards changing specifically with respect to the eBook formats and the compatible eReader devices on which the service can be used. Potential barriers to adoption are buyer's commitment to existing reading platforms such as print books or purchased eBooks, and publisher's reluctance to make a larger collection available for the service. Finally, in order to drive the adoption of the service it needs to be freely available for trial and purchase. This can be achieved through a free one month trial program that can attract users to try the service before making a commitment to it.

The innovation process is triggered by pioneers who act on the belief that being the first mover is advantageous. Consequently, the promise of an untapped or emergent market invariably attracts numerous competitors. Each entrant is likely to make investments in technology development, facilities, and entry programs that may not fully account for other entrants with similar plans. The intensifying competition eventually puts downward pressure on prices, as

cumulative experience helps to lower costs. It is the combined impact of these investments and real price declines that stimulates market growth by increasing the market potential and/or accelerating the rate of growth toward that potential. Among the stimulants of more rapid diffusion are:

Innovation

The smart revolution in the mobile and tablet/computer market is already well underway. This movement allows consumers to get content in places that were not addressable only a few years ago. Consumers on the go can now access books on their portable devices and consumers with time constraints can find content on demand via the internet. These two dynamics imply that consumers now have more time to consume media, which increases the quantity of media sold and the value of media as distribution platforms jockey to provide access to the media. The portable opportunity is immense with millions of smart devices in the market today, and expected unit growth of mid to high teens each year over the next two years (refer Figure 1). This growing installed base creates new opportunities for media applications such as eBook rentals. These devices create new platforms and enable novel ways to enhance interaction with traditional media.

In addition, several companies are making investments in eBook content as well as delivery platforms and technologies. Amazon, the leader in the eBooks market continues to invest significantly in its digital media strategy in an effort to capitalize on the digital shift in media (eBooks, online video, etc.) and protect its $18 billion global media segment. Google acquired

eBook Technologies, a provider of eBook products and services, in January 2011. The company launched its books project in 2004 and has now scanned (and enabled searchers to discover) more than 15 million books. In the past year, Google expanded its scanning efforts to encompass other kinds of physical content, such as Yad Vashem's Holocaust archives, Nelson Mandela's personal documents, and minutely-detailed scans of some of the world's greatest paintings as part of the Art Project. The Google Books platform, including reading applications, an electronic bookstore (eBookstore), book search, and personal library management, enables people to discover, search, and consume content from printed books online. Since progress in technology is largely driven by the competitive need to match what the rivals have already achieved while finding new edges that the rivals can't easily imitate, it is likely that the innovation in this space could lead to an eBook rental service.

Price

In conjunction with the launch of the iPad and iBooks in 2010, Apple, Simon & Schuster, Penguin, Macmillan, Hachette, and HarperCollins created the "agency model" for e-books. Under the agency model, the publisher sets the price of e-book titles and retailers receive a 30% commission for the sale. The agency model does not permit discounting. Under the traditional wholesale model, retailers purchase titles at the wholesale price and set the retail price. The agency model was supported by publishers because they were concerned that Amazon was gaining too much power in the e-book market. In addition, publishers were worried that Amazon was devaluing content by pricing new releases and popular titles at $9.99 or below. The implementation of the agency model resulted in an immediate increase in eBook

prices for agency model publishers. The DoJ has recently filed suit against Apple and five of the six largest US publishers for colluding to raise e-book prices. If publishers are forced to abandon the agency model, it is expected that companies would likely resume their strategy of pricing popular e-book titles and new releases at $9.99 or below. In such case, an eBook rental service could become a viable option as publishers would be more willing to participate given that the high margin agency model is no longer permitted.

Collective investments in education and access

The acceptance of an innovation will be hampered if the target customers are not aware of it, do not fully understand the benefits, are not persuaded of its merits, or cannot find it. Investments in overcoming these barriers are critical in achieving the market's growth rate potential. The greater the levels of collective spending on advertising, personal selling, promotional support, and distribution coverage, the greater the impact on the perceived value of the product, which in turn accelerates market growth. Currently Amazon offers a small collection of eBooks through its Kindle Owner's Lending Library to Amazon Prime users (a subscription service with an annual fee that provides 2 day shipping for eligible retail purchases). There are also several small internet eBook lending sites such as ebookfling. The awareness of these services is relatively low and for eBook rentals to fully pickup additional promotional support may be needed.

U.S. Numbers ('million)	2010	2011E	2012E	2013E
Smartphones	66.6	90.0	110.0	135.0
Tablets	10.5	26.7	37.6	54.0
Apple	9.0	14.6	18.9	24.9
Kindle Fire		4.5	7.0	14.0
Nook Tablet/Color	0.8	3.1	4.7	5.1
Others	0.7	4.5	7.0	10.0
E-reader	10.2	12.0	10.7	10.7
Kindle	4.3	7.7	5.5	5.0
Nook e-reader	1.8	1.6	1.6	1.6
Others	4.1	2.7	3.6	4.1
Desktop	26.1	25.2	26.1	24.4
Laptop	45.6	45.6	47.4	51.1
Connected TVs	8.0	13.0	21.0	28.0
Gaming Consoles	18.2	16.6	11.3	9.8
PlayStation 3	4.3	4.8	4.0	3.5
Wii	7.1	4.5	2.3	1.7
Xbox 360	6.8	7.3	5.1	4.6
Total Connected Units	185.2	229.0	264.1	313.0

Global Numbers ('million)	2010	2011E	2012E	2013E
Smartphones	299.6	461.0	570.1	712.6
Tablets	17.7	54.2	90.0	121.0
Apple	14.8	38.2	54.0	71.0
Kindle Fire		4.5	10.0	20.0
Nook Tablet/Color	0.8	3.1	4.7	5.1
Others	2.9	8.4	21.4	24.9
E-reader	12.8	16.0	17.8	17.8
Kindle	6.2	11.0	11.0	10.0
Nook e-reader	1.8	1.6	1.6	2.2
Others	4.8	3.4	5.2	5.6
Desktop	146.5	146.4	152.0	154.7
Laptop	204.4	217.8	251.9	299.2
Connected TVs	42.0	61.0	82.0	100.0
Gaming Consoles	36.3	33.1	22.7	19.6
PlayStation 3	8.7	9.6	8.0	7.0
Wii	14.1	9.0	4.5	3.5
Xbox 360	13.5	14.5	10.1	9.2
Total Connected Units	759.3	989.5	1186.4	1424.9

Growth Rate	2011E	2012E	2013E
Smart Phones	35.1%	22.2%	22.7%
Tablets	154.7%	40.8%	43.8%
Apple	62.2%	29.5%	31.7%
Kindle Fire	na	55.6%	100.0%
Nook Tablet/Color	296.8%	51.2%	9.7%
Others	542.9%	55.6%	42.9%
E-reader	17.2%	-11.1%	0.0%
Kindle	77.4%	-28.6%	-9.1%
Nook e-reader	-13.9%	1.3%	0.0%
Others	-33.1%	31.1%	14.0%
Desktop	-3.4%	3.6%	-6.5%
Laptop	0.0%	3.9%	7.8%
Connected TVs	62.5%	61.5%	33.3%
Gaming Consoles	-8.9%	-31.5%	-13.5%
PlayStation 3	10.5%	-16.4%	-13.0%
Wii	-36.4%	-49.5%	-23.5%
Xbox 360	7.5%	-30.3%	-9.5%
Total Connected Units	23.7%	15.3%	18.5%

Growth Rate	2011E	2012E	2013E
Smart Phones	53.9%	23.7%	25.0%
Tablets	206.5%	66.1%	34.4%
Apple	158.2%	41.4%	31.5%
Kindle Fire	na	122.2%	100.0%
Nook Tablet/Color	296.8%	51.2%	9.7%
Others	191.4%	153.4%	16.6%
E-reader	25.0%	11.1%	0.0%
Kindle	77.4%	0.0%	-9.1%
Nook e-reader	-13.9%	2.8%	32.3%
Others	-28.2%	50.7%	9.2%
Desktop	-0.1%	3.8%	1.8%
Laptop	6.5%	15.7%	18.8%
Connected TVs	45.2%	34.4%	22.0%
Gaming Consoles	-8.9%	-31.5%	-13.5%
PlayStation 3	10.5%	-16.4%	-13.0%
Wii	-36.4%	-49.5%	-23.5%
Xbox 360	7.5%	-30.3%	-9.5%
Total Connected Units	30.3%	19.9%	20.1%

Figure 1 – Source: The Hyper Connected Consumer – Investing For the Next Decade

The Adoption model categorizes prospective customers into segments based on degree of risk aversion and intensity of need. This leads to differences in time of adoption that can be represented as a bell-shaped curve when plotted over time. After a slow start, an increasing number of people adopt the innovation; this number reaches a peak, and then declines as fewer non-adopters remain, as illustrated in Figure 2.
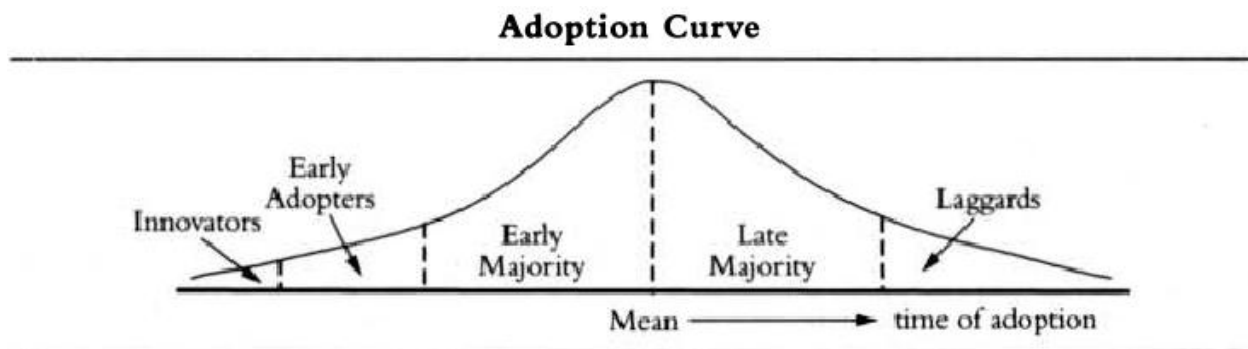

Figure 2: Source: Wharton on Managing Emerging Technologies

There are five types of customer segments: innovators, early adopters, early majority, late majority, & laggards. The immediate implication of this model is that markets for discontinuous innovations should be developed by proceeding from one segment profile to the next.

For eBook rentals the early adopters could be students. Since textbooks have been rented in the print format from a long time, renting textbooks in eBook format would be a natural extension and less disruptive for this segment. Another set of early adopters would be price sensitive customers who would have otherwise purchased a paperback version or a used book. Within this category, the eBook rental service would particularly appeal to frequent readers who would be economically better off with a subscription model that provides a lower cost per

book. A key determinant of whether the shift from early adopters to early majority is possible is the availability of content, and the price to performance measure of this new service.

Exploration and Learning:

Most successful discontinuous innovations follow a halting development path, marked by stop-and-go metamorphoses, before "emerging" from a series of market experiments with a feasible application.

Winners are able to surface opportunities faster, invest in more attractive options, and shape the market to their benefit. The following iterative model can be used to learn about the market: framing the inquiry, collecting market information, disseminating the information to the management team, interpreting, using the market information to make decisions, evaluating outcomes, and back to framing the inquiry.

In order to probe and learn the market eBooks rentals can start as a smaller peer to peer service. An example of such a service that is already in the market is ebookfling.com. The way the service works is as follows: *Step 1: Customers list the eBooks they own. Any Kindle or Nook books can be listed. The customer's collection is what makes up the website's collection. Step 2: Customers send their listed book(s) along to any requesting borrower and earn credits for each successful "fling". Step 3: Borrow any eBook for 14 days by spending 1 credit or $2.99. Step 4: The borrowed eBook can be downloaded to a Mac, PC, Kindle, Nook, iPad, iPhone, Blackberry, or*

Android smartphone. After 14 days, the book disappears and is automatically returned to the original owner.

In order to be able to scale the business two critical customer concerns need to be addressed – safety and choice. With peer-to-peer scheme there is still some perceived risk of legality (copyright violation) and safety (corrupt eBooks that could damage the eReader or other devices used to consume the content) among the users. Eventually a service that does not rely on only customers to upload their purchased eBooks to build a collection would be desired to achieve greater scale. In terms of monetization, in addition to the revenues collected from customers purchasing credits, the providers can experiment with advertising. Customer response to such a model can be subsequently used to refine the monetization strategy for the future. Finally, it would also be important to ensure timely delivery of the requested eBooks and a wider platform compatibility to gain greater adoption. This would not only require additional investments and persistence for growth, but also acceptance from publishers, many of which have not yet enabled lending on their entire catalogs.

In addition to the peer-to-peer service, another approach to probe and learn about the market would be to develop a service that offers a smaller collection of books on an author-by-author basis or a genre basis. This will limit the number of interested customers in the beginning, but the innovator can use the lessons learned to eventually develop a full-fledged service. The service can also experiment with various pricing models such as membership fee only (similar

to Netflix), membership fee plus charge per book or charge per book only. All of the lessons can then be used to refine the delivery methods, pricing, marketing and other business strategies.

Triangulation for Insights:

Insights come from a process of triangulation that looks for convergence of conclusions across the different methods. We can combine methodical guesswork with the tracking of lead indicators to triangulate results. Some indicators to consider are:

- Customers' perceptions of barriers to adoption and level of risk.

- Rate of competitive entry and collective investments in product availability and market access.

- Progress in building the infrastructure and resolving issues about standards, and complementary products. This relates to eBook format standardization as well as the possibility of exclusive content development specifically for rentals.

Commercializing emerging technology through complementary assets

To benefit commercially from an innovation, a firm must possess additional assets that enable it to uniquely bring that innovation to market.

These complementary assets include:

• Access to distribution

• Service capability

• Customer relationships

• Supplier relationships

• Complementary products

When complementary assets are difficult for other firms to acquire or replicate, an innovating firm is much more likely to benefit commercially from its innovation. By thinking about the complementary assets using this framework we can clearly identify sources of competitive advantage and then map strategies to best leverage them. The exercise would also allow the eBook rental firm to focus not on competitors that were relevant in the old technology and instead identify and track the activities of a much broader range of potential rivals.

Access to distribution

Access to distribution should not be a major obstacle for most service providers. EBook rental service would be provided over the internet which is available for any provider to use as a

means for distribution. Given the low barriers to entry for an online venture, competition could quickly accelerate if the market generates a positive response to the idea. As a result, providers of this service should focus more on developing some of the other competitive assets to secure a competitive advantage.

In terms of distribution alone, leveraging an existing user base so that the service is considered an add-on as opposed to a brand new portal with its own customer accounts would give a significant advantage. For example, tying eBook rentals with Facebook would ensure a greater reach and a more seamless distribution mechanism that would be attractive to customers.

A similar case can be made for securing as many eBook format delivery technologies as possible. There is a possible risk that if certain proprietary formats used by eBook readers are restricted on the service then the value proposition for the rental service would be considerably reduced. Therefore it would be important to gain access to the technologies used to support various kinds of eBook formats with a stronger focus on the most popular formats such as AZW and EPUB. In this relationship the integrated eReader makers/eBook retailers such as Amazon and Barnes & Noble have more power and should they pursue a full-fledged eBook rental service of their own, other service providers may find it difficult to compete. Standardization of the eBook format would be beneficial for these players as well as for customers who will likely prefer to deal with a single format for maximum usability.

An eBook retailer can secure distribution by flooding the market with e-Readers and creating an integrated purchase and reading experience. These e-Readers will eventually be used for consuming rented eBooks and will thus give the innovator a competitive edge.

Service capability

A key factor for the success of eBook rentals would be to ensure correct and timely delivery of the requested books. It would also be crucial to develop capabilities that create a superior customer experience both during and after the transaction. Firms that can invest significant resources in customer service to provide book recommendations, swift payments resolution, content issue resolution, etc. will be able to quickly gain mind share, and can then use this as an edge to keep other players out. Building these relationships and capabilities may take a while but they can be difficult for new entrants to replicate and can provide a buffer for established firms.

Customer relationships

Building relationships with customers by creating a sound ecosystem of products can give the existing players a significant competitive advantage. Apple and Amazon in particular have strong ecosystems that can be leveraged to cement relationships with current eBook buyers who are the most promising candidates for the eBook rental service.

The depth and breadth of eBooks, content, and other parts of the Kindle ecosystem have expanded very dramatically since Kindle was launched in November 2007. Figure-3 shows the

monthly trends for Kindle's ecosystem and compares May 2011 to different points in time, starting with the time of launch.

	At Launch 11/22/07	6 Months Post	1st Year Anniversary	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11
Amazon Kindle Ecosystem															
Books	90,000	122,000	200,000	300,000	350,000	385,000	450,000	602,746	690,829	770,186	804,250	845,156	870,118	897,668	945,026
M/M Change	–	--	–	--	–	–	--	80,963	17,475	13,301	34,064	40,906	24,962	27,550	47,358
Audio/Video	0	0	0	0	0	0	0	0	114	151	193	252	270	310	600
M/M Change	–	--	–	--	–	–	--	--	-5	13	42	59	18	40	290
Magazines	10	15	20	30	35	40	50	60	73	83	76	80	80	86	94
M/M Change	--	–	–	--	–	–	--	2	8	-1	-7	4	0	6	8
Newspapers	14	21	30	40	45	75	110	134	138	148	154	160	160	164	167
M/M Change	--	–	–	--	–	–	--	2	3	2	6	6	0	4	3
Blogs	250	370	690	5,400	7,100	7,600	8,800	9,277	10,054	10,610	11,208	11,835	12,244	12,511	12,982
M/M Change	–	--	–	--	–	–	--	130	294	186	598	627	409	267	471
Accessories	0	7	27	130	210	285	335	469	556	3,492	9,153	8,910	8,702	1,310	1,320
Covers	--	7	25	100	180	250	305	350	397	1,306	1,295	1,300	1,304	567	519
Lights	--	--	1	1	2	5	5	13	8	32	109	100	94	20	28
Other	--	--	1	30	30	30	25	106	151	2,154	7,749	7,510	7,304	723	773
Kindle Price by Version															
Kindle 1	$399	$359	$359												
Kindle 3G				$359	$299	$259	$259	$259	$189	$189	$189	$189	$189	$189	$189
Kindle DX				$489	$489	$489	$489	$489	$379	$379	$379	$379	$379	$379	$379
Kindle Wi-Fi											$139	$139	$139	$139	$139
Kindle with Special Offers															$114
Source: Company website; Caris & Company															

Figure 3: Amazon Kindle Ecosystem, Source: Company website; Caris & Company

Book titles reached 945,026 in May '11, increasing by 47k over April '11 (5% M/M increase) and by more than 740k since Kindle's first anniversary. EBooks with embedded audio and video clips increased by 290 in May '11 (their 11th month in Kindle Store) and that number reached 600. Magazine titles increased by 8 to 94 while newspaper titles increased by 3 and reached 167. US newspapers' count was at 81 and international at 86. Blogs increased to 12,982 in May (up 4% M/M) from 12,511 in April.

Apple has a very powerful music and apps ecosystem and is slowly gaining share in the eBooks space. By giving publishers better control over the pricing of their content and a chance to play a bigger role in the online boom, Apple has been able to bolster its eBook collection for

purchase. This has given Apple a chance to give its mobile ecosystem a more complete feel with the publishers' support for eBooks. In addition, building deep customer relationships through features such as reviews, social networks, online discussion forums etc. can also be a useful mechanism to pose barriers for other entrants.

Supplier relationships

Another source of competitive strength for the eBook rental firm can be existing relationships with the other participants in the value chain, specifically the publishers who are the content suppliers. For a retailer already selling eBooks and regular books, there are deep ties with publishers that are already in place that can be advantageous. In this case the size of the firm will play an important role in negotiating with the publishers. Here, Barnes & Noble which has been in the books business from a longer time may have some advantages due to its historic relationships in the industry.

It is possible that a publisher could decide to vertically integrate and rent books through its site. However that is less likely as other publishers would be less willing to collaborate with a direct rival on the service which would make the selection restricted to the publisher's own catalog. This may limit the number of users interested and therefore not scale as well. A neutral third party vendor would be able to form relationships with a variety of publishers and bring the product to scale.

Complementary products

Using complementary products is another way for eBook rental providers to establish a competitive advantage. Offering a wider range of products & services such as the ability to purchase the eBook that the user rented (if desired by the user as a permanent reference source for later) or the ability to rent music or an audio book is another option that can be investigated to increase customer stickiness.

The firm can also develop assets such as own direct publishing business. This can give the rental firm access to its own content in the beginning in case there isn't much support from the publishers. An example of such a system is Amazon's Kindle Singles program. In January 2011, Amazon launched its "singles" initiative. The stated goal was to present "compelling ideas expressed at their natural length," with shorter-form works at lower prices. In the past 14 months since the singles were announced, Amazon has managed to move over two million of these little books, netting some authors hefty profits.

Another example of such a system is the Kindle Direct Publishing (KDP) platform. More Amazon customers are reading independently-published books, with over 1 million KDP Select books borrowed through the Kindle Owners' Lending Library since the program launched for indie authors in December 2011. KDP authors participating in the Kindle Owners' Lending Library have earned $1.8 million from the KDP Select fund so far, which is an incremental 24% on top of their royalties from paid sales. Patricia Hester, a semi-finalist for the 2009 Amazon Breakthrough Novel Award and who authored The Clover Mystery Series, was one of the top

ten KDP Select authors in January, earning $5,850 from the KDP Select fund. She also earned

over $31,000 from paid sales of her books that were enrolled in KDP Select.

Scenario Planning

Scenario planning helps in planning for the future by painting concrete and vivid narratives of the future that hinge on key uncertainties whose outcomes will shape the future environment. It addresses three challenges that are inherent in emerging technologies and often befuddle other planning or strategy techniques:

- Uncertainty

Unlike most other tools, scenario planning embraces uncertainty as the central element in its process. It could not do without uncertainties, which we distinguish from risks that can be quantified using objective probabilities.

- Complexity

Scenarios focus on the confluence of a diverse set of forces-from social to technological to economic and explore how they combine, intermingle, and dynamically influence each other over time as a complex system.

- Paradigm shift

Scenarios aim to challenge the prevailing mindset, surface core assumptions, and create intellectual turmoil to see things anew by amplifying weak signals that would otherwise remain unnoticed among the pressing day-to-day issues of the firm.

Ultimately, scenarios will be used in a variety of ways, from helping challenge the managers' mental models and key assumptions about the industry to better risk analysis. They will be used to test the robustness of the existing strategies and to create better strategies to cope with the full range of scenarios.

Taking inputs from the frameworks discussed earlier – Assessing future markets for eBook rentals and Commercializing emerging technology through complementary assets, as well as recent forces from around the eBook industry, scenario planning can be used to isolate the most significant forces and come up with key trends that will work to shape the future landscape of the industry. Through research, the following list of forces has been created:

EBook prices are falling

Vertical integration of eBook retailers into eBook publishing

Virtualization of public library system

Enhanced eBooks and the desire for mixed media

Network connections are becoming increasingly common

Proliferation of mobile devices and reading platforms

EReader prices are declining

Developers are migrating to web and mobile platforms

Persistence of geographic restriction on eBook rights

Movement for a unified eBook format

Direct Publishing by authors

Consumers increasingly comfortable with streaming rental models for movies and games

Rise of eBook piracy

Consumers viewing DRM as nuisance

Increased availability of alternative entertainment choices to reading

Social media has reached mainstream

Contextual upsell capabilities within eBooks rising

Increased need for monetization strategies within EBooks such as sponsored messages in books

E-First publishing

Bundled eBooks are gaining popularity

The above twenty forces describe a great deal of what is currently transpiring in the eBooks space. Many of them are interrelated and there is uncertainty around their potential outcomes. However, there are two drivers that I believe are playing the greatest roles in creating these forces and shall have a significant impact on the future landscape. These two drivers are – the falling price of eBooks and the proliferation of mobile devices & reading platforms.

Falling price of eBooks

On the whole, eBook prices are falling. A study conducted by the market research firm, Yankee Group, found that, the average price of a consumer digital book had fallen to $8.19 by the end of 2011 from $9.23 in 2009. It is also forecasted that the average eBook prices will drop to $7 from the current $9 over the 2012 year.

Furthermore, it is expected that the DoJ's lawsuit against Apple and the subsequent publisher settlements will significantly impact eBook pricing for the future. Department of Justice announced proposed settlement with Hachette, HarperCollins, and Simon & Schuster regarding the collusion over e-book prices. These publishers and retailers will have to observe more restrictions. For example, for two years, e-bookstores must be permitted to discount retail prices of books at their own discretion. The proposed settlement states that "These provisions do not dictate a particular business model, such as agency or wholesale, but prohibit Settling Defendants from forbidding a retailer from competing on price and using some of its commission to offer consumers a better value, either through a promotion or a discount." Apple, Penguin, and Macmillan have not accepted these settlement terms. Department of Justice will continue to litigate antitrust suit against them and the outcome will have significant impact on the future of eBook prices.

As a result of the current settlement, it is unclear whether Amazon, the market leader, will heavily discount the eBooks and take a hit on another profitable category to gain share. It is also unclear whether authors or publishers would at some point decline to sell to a retailer that seems intent on dramatically devaluing content. Ultimately publishers will face a significant threat, if the content is devalued to such an extent that they can't pay sufficiently to authors for books. All of this could have a more dramatic impact on publishers than retailers over time. This will push publishers to go for packaged deals on e-book and physical books. It could also potentially lead to a greater acceptance for the eBook rental model by publishers as a means to generate additional revenues, given that the high margin agency model is no longer viable.

Overall, the extent to which publishers will participate in an eBook rental service depends on their ability to charge significantly higher prices for eBook sales or lack thereof, and as such pricing is a key determinant of future success.

Proliferation of mobile devices and reading platforms

Media consumption habits are being transformed for enhanced personal use as mobile connected devices such as tablets, smart phones, and e-readers proliferate in the home. In 2011, manufacturers shipped about 30 million e-book readers over all, up 108 percent from 2010. It is estimated that this will grow to 38 million devices in 2012 and 43 million by 2014. Then in 2015, some predict that the reader market will shrink to 38 million, presumably because consumers will be attracted to tablets. Mobile reading devices could continue to proliferate or consolidate around few key brands. Furthermore eBook formats could remain proprietary or evolve into a single uniform format across all platforms.

Larger players such as Amazon and Barnes & Noble are able to cut prices on the eReaders partly due to more sophisticated chip sets that integrate the applications processor and the display controller, and partly due to scale as large manufacturers have reached quotas that qualify them for discounts. They also have the added advantage of being in the eBook retail business and can thrive even if they have to offer their hardware below cost. In fact, the race to control the biggest slice of the e-book-buying public may bring even greater price cuts. It's not hard to imagine a future where you get an e-reader for free. If this happens, there would be consolidation around few brands such as the Kindle and the Nook, and the rental service would

be a less viable option for a third party to develop due to proprietary format lockdowns. It would be more realistic for one of the existing vertically integrated players such as Amazon to offer the eBook rental model.

Potential Scenarios

Given that the falling price of eBooks and the proliferation of mobile reading devices & platforms appear to be two of the most influential trends facing the eBooks industry, a two-by-two matrix can be created demonstrating the potential scenarios which may occur between any combination of pricing and device/platform proliferation.

	EBook price decline continues	EBook prices level off
Proliferation of eReaders/platforms	"Fragmented Future"	"For purchase rules"
Consolidation of eReaders/platforms	"Netflix for eBooks"	"Going Niche"

Scenario "Fragmented Future"

In this scenario, the mainstream eReaders/tablets have made printed books seem antiquated but have already begun to face a serious challenge from a slew of other all-in-one connected devices and smartphones that can run e-book reading software or apps. In this case the future

of eBooks will be all about apps. EBook retailers will continue to rapidly expand the availability of e-reading apps to every platform that consumers chose to adopt. Reading devices also may not settle on a limited number of formats and therefore transfer technologies and support for multiple formats would become necessary. The fragmentation will lead to intense competition further deteriorating margins on the hardware. It will also leave consumers confused and worse off due to the lack of format standardization and thereby the lack of freedom to rent/purchase content from any source. Switching costs will increase and consumers will be forced to pick a platform and stay there.

Along with the proliferation of devices and platforms, eBook prices will continue to fall. Antitrust forces shall prevail and publishers will no longer be able to collude to fix the final selling price to consumers at a higher level. Large eBook retailers will offer steep discounts to gain share and consumers will come to expect to pay less for digital books. Eventually publishers will see the downward selling price trend erode their earnings and will look for other ways to generate revenue.

For integrated players (device manufacturers and eBook retailers) such as Apple, Amazon, and Barnes & Noble, this scenario is fairly easy to handle as it is the scenario that best allows them to protect their respective silos and maintain business as usual as much as possible. Publishers will have to adopt newer strategies such as enhanced eBooks and sponsored messages within eBooks to drive revenue growth. Publishers will stretch the definition of what constitutes a book, with books straddling the digital divide that is transforming the publishing world—by

becoming both a novel and a digital app. Enhanced e-books will have multimedia features such as audio, video, pop-up graphics, 3D images and animation. Due to the price pressure on eBooks for purchase, publishers will also be more open to a rental model. However, it is difficult to envision an "all you can eat" subscription model; publishers will likely put a limit on the amount of content that could be rented per time period.

Scenario "For purchase rules"

In this scenario, the status quo will remain fairly intact. Publishers will continue to set final selling prices for the eBooks for purchase, and ensure high value for the content. EBook revenues will continue to soar, and print revenues will level off. Publishing industry will behave like a legacy industry that is content to rest on its laurels. They will be making a nice profit with a system they understand, so there won't be a reason to potentially undermine it by introducing rentals to the market.

The proliferation of reading devices and platforms will keep competition intense and companies will focus on becoming the preferred retailer for consumers and driving down costs wherever possible. Since there isn't a single dominant platform with a large user base, sufficient scale won't be available to develop several independent rental services.

For consumers the best bet to rent eBooks would be from the library. However the value will be limited as most large publishers will refuse to sell critical portions of their digital catalogs for library lending, and those that do are imposing stiff fees and onerous rules. Publishers have

never been thrilled about public institutions lending out their products for free, because it might undercut total sales. The nature of digital books now gives publishers a new opportunity to assert greater control through technology, terms of service and pricing power. Libraries cannot just buy the virtual books and hand them out in the way they can with physical ones. The argument is that lending e-books is a graver threat than physical ones, demanding a different set of restrictions, because of the lack of "friction" which exists when borrowing and returning a physical book – the user has to go to an actual library at least two times. With digital, it's just as easy to download a free book from the library, as it is to get a full-priced version from Amazon. Unless there are legislative changes to protect the role of libraries, consumers will be able to borrow eBooks from libraries but the choice will be limited by publishers.

Due to the relatively unsophisticated nature of the rentals market, there will be an opportunity for smaller peer-to-peer services to grow further. External e-book loan services such as Booklending.com and eBookFling.com that take advantage of the current eReaders' built-in lending service by connecting bibliophiles across the web and allowing them to share e-books without violating copyright. These services are mostly free, widely accessible, and presented without risk, but will need to be marketed better to reach critical mass.

Scenario "Netflix for eBooks"

In this scenario one or two key brands will emerge as the go-to retailers for eBooks, with their proprietary e-reading platforms dominating the space. The e-book will continue the process

started off by mass market paperbacks and transform the idea of what we call a "book" into something much more transient. People will want to subscribe to books – in effect, renting them instead of buying them. This is analogous to services like Spotify and Rdio for music consumption, which is moving gradually to streaming-only via the cloud. A similar cloud-based subscription option for books could work too.

The consolidation will set the path for a dominant player such as Amazon or Apple to launch a Netflix-style subscription service in which users would pay a monthly fee for access to a virtual library of e-books. EBook prices for purchase will continue to decline and publishers will look for other ways to boost revenue. They will have warmed up to the idea of eBook rentals since in many ways, the book as we know it has already evolved to the point where it's more like renting a movie than buying something to treasure forever.

Publishers may not entirely like the idea of submitting even further to Amazon's or Apple's dominance in the e-book world, however they would be better off playing along with the companies in return for access to their user base. An "iTunes for books" would potentially allow them to make some money from their older titles, and Apple could handle all of the billing.

With virtualization of libraries it's possible that a similar service would be available to consumers at no cost, and it remains to be seen whether consumers would then still sign up for a paid eBook rental service. It is likely that the library collection will be limited, restricted and will impose much longer wait times. A rental service can do much more than just lend eBooks;

it would provide a combination of convenience, low prices, electronic delivery, reviews and recommendations. Such a combination would work particularly well in Amazon's favor, since many people already have Amazon accounts and strong relationship and buying history with the company.

Scenario "Going Niche"

In this scenario there would be less buy in from the publishers on the eBook rental model, however due to the consolidation of e-reading devices and platforms to one or two key brands, sufficient scale will be achieved for these brands to experiment with niche rentals through vertical integration in publishing.

Consumers will use a combination of eBook rentals and purchased eBooks to satisfy all of their reading needs, and will have to optimize the choice for the best cost/benefit outcome. Companies such as Amazon and Apple will have their own publishing houses, which aim to publish bestselling books by big-name authors. The venture would be similar to an in-house laboratory where authors and editors and marketers can test new ideas, and authors can find new ways to connect with more readers.

Exclusive content will be a major differentiating factor for the rental service providers. With their own publishing houses and direct publishing units, companies will be able to get exclusive rights to unique content. Avid readers would look to new avenues for entertainment and will be drawn to this value proposition.

EBook rentals would become the norm for certain categories of books such as text books and trade publications. With the advent of enhanced eBooks and their ability to combine various forms of media, students would get a superior learning experience from the rented eBooks. Universities will have formed partnerships with major text book providers and could start their own rental service that would still allow their students to access content on the dominant e-reading platforms of the time.

Scenario Planning Conclusions

The four scenarios presented above are possibilities that have very different implications for the players in the EBook value chain. As a management team, the difficulty is to determine which of these scenarios to plan for. It is difficult to predict which of these scenarios will materialize and how everything will play out. However, there are certain strategies that can two or three of the four scenarios and are better bets than strategies that cater to individual scenarios. A few of these strategies are examined from the point of view of a major player in the retail business, Amazon and the point of view of a major publisher such as Penguin.

Amazon:

Amazon should continue to put price pressure on eBooks for purchase through heavy discounting and loyalty programs. This will achieve several objectives – help the company to gain share, further consolidate the e-reading platforms to the Kindle brand, and put pressure on the publishers to find novel ways to boost revenue through eBook rentals. The company

should also vertically integrate into publishing. In addition to the Kindle Direct Publishing business, the company should look to develop a full service publishing house in New York that can bring forth bestselling books by big-name authors.

In the meantime, Amazon should also continue to expand upon its Kindle owners' lending library to condition the market for a full-fledged rental service if and when it becomes available. The company should also experiment with various pricing options - a flat rate subscription fee or a small rental fee on a book-by-book basis. The payment on a book-by-book basis would particularly work well if the rental service caters to a niche segment such as textbooks, specific genres or specific authors. Amazon should also tightly integrate the social experience through its website by offering book clubs, webinars, online classes etc. A tightly coupled consumer base will position the company to take advantage of the network effect and quickly expand its rental service when it gets launched.

Publishers:

Publishers need to prepare for a future where books would be consumed like other forms of media such as movies, music and games. Enhanced eBooks would offer publishers an opportunity to create a unique value proposition for consumers and could potentially enable publishers to charge more for eBooks.

Publishers need to experiment in the eBook rental space to mitigate the risk of becoming irrelevant especially if companies such as Amazon are successful in building their own

publishing houses. One way to achieve this is through the concept of windowed releases. EBooks can be made available for rentals after a certain window of time. This would mitigate the potential lost eBook sales and the total cannibalization of the high margin product. The concept could be similar to the windowed releases of paperbacks, which are typically release after the hardback versions. Publishers can also differentiate by creating bonus content for purchased eBooks (vs. rented eBooks) to incent consumers to buy their product. The exclusive content could be in the form of additional features in the purchased copies or opportunities to interact with authors.

 Publishers could also focus on international markets which are currently very underpenetrated. In the UK, e-books make up about six percent of sales, but that's as close it gets to U.S. levels. In Germany, Spain, France, and Sweden, e-books account for only 1 percent of book sales; e-book sales in most of Latin America, Asia and Africa are negligible. Publishers with a global reach should look to these markets to boost revenues if eBook rentals threaten their margins.

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