The economics of publishing

Andrew Franklin of Profile Books opens up his accounts for inspection

Sir Stanley Unwin, who founded the great independent house of Allen & Unwin, was famous for his catchphrase that 'The first duty of any publisher to their authors is to remain solvent.' Sir Stanley wrote one of the better guides to the book trade, *The Truth About Publishing* (1926), and it is amusing that he wrote in his 'Introductory' that 'until recently a study of the columns of *The Author* left one with the impression that all publishers, at all times and upon all occasions, were activated solely and necessarily by evil motives. The publisher's task is no easy one and the whole process of publication is vastly more complicated than it was even a generation ago.'

At the risk of being a bore, it is worth stressing that to be solvent, publishers must be profitable and – obviously – to be profitable their books must make a profit. Even subsidised poetry publishers must adhere to the Micawber principle or they go under. Or, like Allen & Unwin, decades ago, get swallowed up and disappear. (Though it lives on as the leading Australian publisher, with a small presence in the UK.)

So this article is about numbers, because profit and cashflow are what keep us in existence. Like Stanley Unwin in his great book, it makes sense to follow the lifecycle of a book to see where it incurs costs and where it generates revenue.

Every manuscript has a long gestation before it enters a publishing house, but its existence for us begins when an editor wants to acquire it, frequently from a literary agent. Even before acquisition the editor is supposed to complete a financial appraisal. This is never a popular task. Our appraisal form at Profile is a five-page Excel workbook. Other publishers' appraisal forms are similar, though I have seen some that are much more intimidating. You have to enter the title and author (obviously), the advance proposed to pay the author, and a guess at the number of pages and format of the various print editions. That generates, with the aid of another spreadsheet, the print costs for the quantity you decide to print. The proposed retail price for each format is obviously vitally important. Then the editor has to hazard a guess at the home and international sales by key markets, the rights income and marketing costs. This is where most editors are inclined to cheat. If they want to acquire the title, they have a marked tendency to overestimate the potential sales while underestimating the marketing costs or length of the book. Such optimism drives the financial types insane.

Let's suppose the figures are believable. The house can now make an offer to the author or their agent for the book. Profile's offer is always for an advance against royalties (and rights income if the publisher is taking, say, translation rights). In theory, publishers pitch advances at a level that will be covered by the royalties the author earns. In practice the advance is frequently not 'earned out', so the author is taking a higher share of the total revenue from the book than the royalties would earn. The agent Ed Victor, who died in June, was proud of the fact his authors rarely earned royalties because the advances were always so large. And, of course, every publisher knows that you can publish perfectly profitably even if the advance doesn't earn out. It is better when it does, because that reduces the risk of failure (a big unearned advance spells certain loss) and improves the business's cash flow. (You pay royalties when the book sells copies, which means you have the money in from the bookshops to pay them; advances are all paid upfront and so you may need to borrow from the bank to fund them.)

Advances can be anything from a few hundred pounds, though rarely less than £1,000 for a reputable trade house, up to a reported eight figures for a recent multi-book contract signed by Bonnier with Wilbur Smith. In theory, advances are paid at a market price. But trade book royalties are almost invariably the same, with little real variation. As all authors know, the bog-standard hardback royalty is 10% of the RRP, often rising after specified sales thresholds to 12.5% and 15%. Similarly, 7.5% is the standard paperback royalty, generally rising to 10%.

But this is based on the RRP and not the money the publisher collects (or 'net receipts'). Bookshops and wholesalers invariably take more than half the RRP now. Standard discounts to booksellers are between 52 and 60%, and the biggest retailers, naturally, get the biggest discounts. So an author on a standard royalty for a £10 hardback is taking £1, or 10% of the total price. But if the publisher is selling the book at a 56% discount to the bookshop, then the author will receive 23% of the publisher's total net revenue. This is extraordinarily close to the 25% of net receipts that is now the gold standard for ebook royalties. (Yes, 25% is the gold standard – platinum, even; and I'm happy to battle it out in print with anyone who disagrees.) Of course, given the complexity of most author contracts, where the wording on royalty payments often runs to more than a page of close type, the detail – devilish as always – is more complicated as the discounts increase and the publisher's margins and author's royalties are squeezed.**(see footnote)*

In export, where royalties are invariably paid on net receipts, discounts can be even higher, and publishers' costs are greater because of the greater shipping costs, greater sales costs (whether in travel for the reps, or running overseas sales offices), and the significant, and now growing, exchange-rate risks.

So bookshops take more than half of the total and publishers give almost a quarter of their revenue to the authors. In both 2015 and 2016 Profile paid out just over 22% of our total revenues to our authors. Where does the rest go?

Publishing accountants, like all others, split costs into two: the direct costs of selling each book and the overheads. The overheads are easy to enumerate but hard to control: salaries, heating, lighting, computers and desks, rent, business rates and the other essentials of every business, whether selling books or ice cream. They also include less obvious expenses such as staff training, libel insurance (most publishers cover their authors' costs in the event of a claim) and computer software. These are fixed costs and they have a way of rising that is beyond our control.

Like all publishers, we aim to keep them down, but salaries, like authors' remuneration, are not generous in the book trade – and horrible in bookshops – and costs continue to rise year on year. Any author who has been to the offices of one of the big four trade publishers will know that they have cut costs by cramming staff into huge open-plan offices that are not unlike old-fashioned factory production lines, no matter how elegant the space.

My company, Profile Books, employs 40 people and our offices in the Angel cost approximately £260,000 a year in rent. Business rates are on top and are about to increase significantly under new government rules this year. Fixed costs also include capital expenditure. So, for example, Profile Books, a medium-sized independent, has recently been quoted £100,000 for a new royalty system. Penguin Random House UK is currently installing new software systems at a cost of some tens of millions of pounds. All that has to be paid for from the net receipts of sales of books. Apart from some small share of income from the sale of rights, there is no other way for a publisher to pay for these things to provide the services that they do. To flesh this out, as our most recent (2016) accounts show, our payroll bill last year came to £2.45 million. Every year we pay out much more in advances and royalties than in salaries, by the way, and we are not a Gradgrind employer.

These costs do not change whether we sell one book or one million. All publishers like to think we manage our overheads tautly, but whether we do so or not, these are the inescapable costs of running our businesses before we start selling the books we publish. At Profile, our latest audited accounts show our administrative costs (not the whole overhead story) at 28% of our turnover.

And then there are the direct costs which attach to each book. These are the 'costs of sales'. They break into five categories: selling the book; returns (damn sale or return!); warehousing and distribution; marketing; and the cost of goods sold on production. Finally, and separately for the purpose of this article, there are authors' royalties.

For publishers to sell their books they must have a sales force, which never comes cheap. That means sales directors and sales reps ('travellers' in Stanley Unwin's day) on the ground in the UK, and international sales directors and agents for overseas sales. It means international offices too, in the case of the largest companies. It is the absence of such arrangements that thwarts self-published authors. Profile Books is part of the Independent Alliance, for which Faber & Faber provides some, but not all, of the sales arrangements. This all costs up to 12.5% of the total net sales revenue depending on the type of sale, with international sales being far more expensive than UK sales to service.

Unfortunately as every trade author knows, the entire UK book trade operates on sale or return, with the supermarkets being the most dangerous customers. Our total returns on UK sales run at approximately 14%, but that average hides some books with much worse rates. Sometimes, damn it again, over 40 or even 50%. Returns are a real cost, because the publisher has paid to print and deliver the books, and when the books come back they are generally pulped.

Distribution, that is warehousing and physically shipping books around the world, is one of the two costs attached to physical sales only. (They do not apply to ebooks, of course.) Those great sheds and pantechnicon lorries don't come cheap. We budget about 7% of our net sales revenue for distribution, delivery and invoicing. We spend a lot of time agonising over print-runs – the cost per copy is less the more we sell, but there are costs too for books sitting in the warehouse and those that have to be pulped. (The process of pulping costs roughly 2–3p per book, for those that are curious.)

Marketing is a tricky one. Publicity, for Profile Books anyway, is a fixed cost because we employ four full-time publicists and three full-time marketers who work on however many (or few) titles we sell. But marketing – billboards, posters on the tube and buses, digital and social media campaigns, and yes, author parties, are variable costs. Publishers tend to budget 6 to 8% of expected net sales revenues for marketing. (This applies to books on the frontlist, not the backlist.) For the biggest titles each season, that can run into tens of thousands of pounds, particularly if television advertising is part of the mix. In reality we have to decide on the campaign, buy the media slots and send the party invitations before we have any idea how many books we will sell. So this is a risky business – a difficult judgement call for publishers.

Finally there is the cost of goods sold (or COGS) making the physical books. The printing and binding is relatively straightforward to calculate, and is generally between 8 and 12% of the retail price. (So 17–25% of the net sales revenue; in other words, slightly less than the author share.) Put another way, in 2015 and 2016, pre-press and printing costs were 21% of Profile's total revenues – just a little under our advance and royalty payments to authors. The big printers have scale rates (all subject to negotiation) for different formats, page length and quantity. In practice life is more complicated because special cover finishes (embossing, gold foil or spot varnish, for example) all add considerably to the cost, as do plate sections. Roughly 4,000 copies of a B-format paperback of 256 pages will cost between 50p and 75p per copy. Printing 3,000 copies of a jacketed Royal-format hardback of 320 pages will cost between £1.20 and £1.60 a copy. But that isn't the end of the production costs because there are also editorial and design costs. That 320-page hardback (let's assume it is non-fiction) will cost around £1,000 to copyedit and another £700 to proofread. Then there is the page design at £750 and perhaps an index (£700). Sometimes authors pay for or prepare the index, sometimes the publisher. Often the cost is split. Finally, and of the greatest importance, there is the jacket or cover design. At Profile we budget £1,000 to £1,500 for that, and employ a full-time art director and designer (overheads) on top of that. Trade publishers are investing very heavily in how their books look now.

Where have we got to? A complicated picture of fixed costs and variable costs. Some of those variable costs go up with each sale (delivery, sales commission and the royalty – if the advance is earned out). Others are really a risk that attach themselves to the first copy and are 'free' thereafter. So the editorial costs, fee for the jacket designer, index and marketing costs don't change if the title sells well or dies a painful death.

Publishing is a risky business – each book is a challenge that should cover its fixed and variable costs. Some do and are brilliantly profitable. These successes subsidise the disappointments. And most publishers will admit that when we contract books from authors, we don't really know which will work and which will fail. Choosing and publishing books is an art not a science.

At the end of all that, publishers must make a profit. Many of the biggest (Penguin Random House, Hachette and HarperCollins, for example) are subsidiaries of even larger entities who impose strict requirements on what must be achieved. But there is more than that. If you aren't making a profit or breaking even – which is like dancing on a razorblade – you are making a loss, and that is unsustainable. Most companies have good and bad years. The big publishing groups aim to make a profit of 10% on sales, but most only manage it in good years. Most independents dip into loss from time to time. At Profile – unusually for independents – we have been profitable every year since 1997 and for the last two years have made a pre-tax profit of 11% of sales. We do not forget that, like all businesses in a capitalist world, we must make a profit. If we do not, after a few years we go under – and we mustn't lose sight of our Duty To Remain Solvent. ●

**Editor's footnote:*
royalties are the gold standard. The SoA would observe that on the kinds of higher-discounted sales described here, some publishers' contracts (especially those offered to unagented authors) switch the royalty from a percentage of RRP to a percentage of net receipts. And in some areas of publishing all royalties are based on receipts. As Andrew Franklin rightly says, what is offered – and how reasonable that might be – all depends on the detail in the contract. Members can always ask the SoA for contract advice. See also
authr.uk/buying-choices.)

Andrew Franklin is founder and Managing Director of Profile Books.

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