



Profitability Analysis of the Publishing Industry in Norway

*A Study of the Sources of Profitability Variations Between
Norwegian Publishers*

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Abstract

In Norway, sales of physical books are declining, while sales of books in digital formats, although increasing, account for only a marginal share of the total market (Norwegian Publishers Association, 2019; Ibenholt, 2017). With declining revenues, the Norwegian publishing companies are facing a situation where competition intensifies and operating profitably becomes increasingly tougher.

This thesis aims at developing an understanding of the profitability of the Norwegian publishing industry. We examine the competitive environment and the profitability of the industry as a whole. Moreover, we analyze potential sources of profitability variations between players and explore which business models can be profitable in the future, considering the impact of digitalization.

The thesis uses both qualitative and quantitative data sources. The profitability of the industry is studied based on financial statements from a sample of 76 Norwegian publishing companies. Moreover, factors behind profitability variations are explored using insights from in-depth interviews which were conducted for the purpose of this thesis. Thus, the thesis has both a descriptive and an explorative purpose.

The analysis shows that the industry is characterized by a high level of competition and strong profitability variations between players. Moreover, we find that specialized publishers (especially academic publishers) are significantly more profitable than publishers with wide selections of genres. Moreover, the interviews indicate that capacity utilization, exploitation of linkages, complexity of book projects and governmental procurement schemes are among important cost drivers.

Furthermore, we argue that publishers who focus on direct sales, as well as merged and specialized publishers have potential to be profitable in the future. However, we highlight the risk of overlooking the impact of digitalization and focusing on “business as usual” while disruptive changes can be around the corner.

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1. Introduction

1.1 Background

The publishing industry in Norway is experiencing a decline. The annual industry report prepared by the Norwegian Publishers Association (2019) shows that while the number of e-books and audiobooks sold increased from 2017 to 2018, the number of physical books sold declined with 1%. This accounted for a 7.7% fall in revenue among the publishers who are members of the Norwegian Publishers Association. A similar trend was visible from 2016 to 2017 (Statistisk sentralbyrå, 2019a). In other words, the industry is facing difficult times where the ability to operate profitably will be crucial for future survival.

The Norwegian book market is characterized by the presence of a few dominating players, and plenty medium-sized and small publishers. The biggest publishing companies are Cappelen Damm, Gyldendal and H. Aschehoug, which together accounted for as much as 72% of the total market revenue in 2018 (Norwegian Publishers Association, 2019). Their leading position has not changed over the past 5 years according to the report (Norwegian Publishers Association, 2019). Cappelen Damm has over the past two years acquired three medium-sized publishing companies. Worth noticing is the fact that there are also 24 medium-sized players, whose revenue ranges between 10-100 MNOK. The market share among those oscillates between 1-4% for each of the players.

Another important aspect that shapes the Norwegian publishing industry is the regulations of the book market, notably the Book Agreement. It is an arrangement between publishers and bookstores which allows publishers to determine a fixed retail price for a specific period of time after the publication (Regjeringen, 2019). In other words, it is an exemption from the prohibition of anticompetitive cooperation (Regjeringen, 2019). Notably, potential changes to this exemption are currently being reviewed by the Norwegian government (Regjeringen, 2019), and the Norwegian Competition Authority has expressed a negative view on the Book Agreement, pointing out that it reduces competition in the market and results in higher book prices (Regjeringen, 2019). If the Book Agreement is removed, the margins of publishers are likely to be pressed down. This possibility makes it even more relevant to look into the industry's profitability and sources of its variation.

1.2 Purpose and research question

Profitability analysis is an important tool which helps understand the overall profitability of an industry, as well as sources of profitability variations between players within the given industry. It gives a systematic approach to look at revenue and costs, allowing not only to understand past results (what the earnings were), but also to identify the potential result (what the earnings could have been). As such, profitability analysis can be a tool that allows to reduce activities that do not create value, thus freeing resources for ones that do (Bjørnenak, 2019).

The purpose of this thesis is to examine the profitability of the publishing industry in Norway. In other words, the thesis attempts to explore the factors that are important for the profitability of publishers in Norway, as well as explain the sources of profitability variations within the industry. Consequently, the objective of the thesis is to answer the following research question:

What can explain the profitability of the Norwegian publishing industry, and the variations between players?

To achieve this, it is essential to understand the competitive arena, before carrying out the analysis itself. With this in mind, the research question will be broken down into the following points:

1. What is the level of competition in the Norwegian publishing industry?
2. What is the profitability of the industry?
3. What are the potential sources of profitability variations between players?
4. Which business models can be profitable in the future?

1.3 Scope

The scope of this thesis is limited to Norwegian book publishers. In other words, publishers of newspapers, magazines and catalogues are excluded, as they provide products of a different nature than books, i.e. ones that have a different printing and binding process and are published with a different frequency, making it difficult to compare them with book publishers. Moreover, the book publishing companies that are within the scope of this thesis are not limited to fiction but also include non-fiction and textbook publishers.

Furthermore, this thesis analyzes only publishers with a revenue of at least 1 000 000 NOK in each year in the 2016-2018 period as reported on Proff Forvalt. This distinction is made in order to take into account only active publishers, who aim at the larger national market, rather than those who publish books for small, local audiences. This criterion is in place to make it possible to analyze book publishers with relatively similar business models. Lastly, the thesis is limited to the 2016-2018 time period.

1.4 Outline

This thesis consists of eight chapters, which follow the structure of the research questions. Chapter 2 presents the theoretical frameworks that form the foundation for the analysis, while Chapter 3 details the methodological approach. Next, Chapter 4 examines the competitive environment of the Norwegian publishing industry. Chapter 5 analyzes the current profitability of the Norwegian publishing companies using financial statements from a sample of publishers, while Chapter 6 looks into profitability variations between players, aiming at identifying sources of those variations. Furthermore, Chapter 7 discusses the future of the Norwegian publishing industry using the business model perspective. Lastly, Chapter 8 concludes the thesis by summarizing the main findings.

2. Theoretical framework

2.1 Introduction to the theoretical framework

This section presents the theoretical frameworks which will be applied in order to conduct the profitability analysis of the publishing industry in Norway.

Firstly, the objective is to understand the profitability potential of the industry, i.e. to analyze the competitive environment. For this purpose, Porter's five forces framework (1980) will be applied, as it for years has had a prevailing position in this type of analysis (Lien and Jacobsen, 2015). To achieve a broader view on the subject matter, Porter's framework will be supplied with the profitability tree introduced by Lien and Jacobsen (2015).

The second objective is to understand the factors which explain sources of differences in cost levels between players in the industry. In order to do so, the structural and executional cost drivers will be analyzed, using the framework of Shank and Govindarajan (1993), supplied by Porter (1985).

Lastly, the third objective is to examine which business models can be profitable in the future. For this purpose, Osterwalder and Pigneur's (2010) definition of business models and their business model canvas will be applied, as they provide a useful categorization of the elements that business models consist of.

2.2 Framework for industry analysis

Porter's five forces framework is a structured way to comprehend the competitive environment of an industry, which is the playground of each company operating in the given market. It allows to understand how companies capture value, by analyzing the level of rivalry in the industry (Lien and Jacobsen, 2015).

However, value capture is only one of two important aspects when it comes to analyzing an industry's profitability potential. The other one is value creation. As Lien, Knudsen and Baardsen (2016) point out, Porter's classic framework has one apparent limitation in that it is

missing the value creation aspect. Therefore, in order to complete the industry competitiveness analysis, the profitability tree will be included.

2.2.1 Porter's five forces

Porter's framework identifies five forces that influence an industry's state of competition (Porter, 1980). The strength of these forces dictates the profitability potential of the industry (Porter, 1980). Before going into more detail, it is worth noticing that Porter defines industry as "the group of firms producing products that are close substitutes for each other" (Porter, 1980, p. 5).

In more detail, the framework describes how the profitability potential of an industry is influenced by the intensity of rivalry and the distribution of bargaining power in the given industry (Bjørnenak, 2019). The intensity of rivalry is influenced by the number of current players, threat of new entrants, and pressure from substitute products, while the distribution of bargaining power has to do with how much power suppliers and customers have in relation to current players, as presented in Figure 1 (Porter, 1980). Thus, Porter's framework implies that competition in an industry is determined by much more than only the rivalry between existing firms (Porter, 1980).

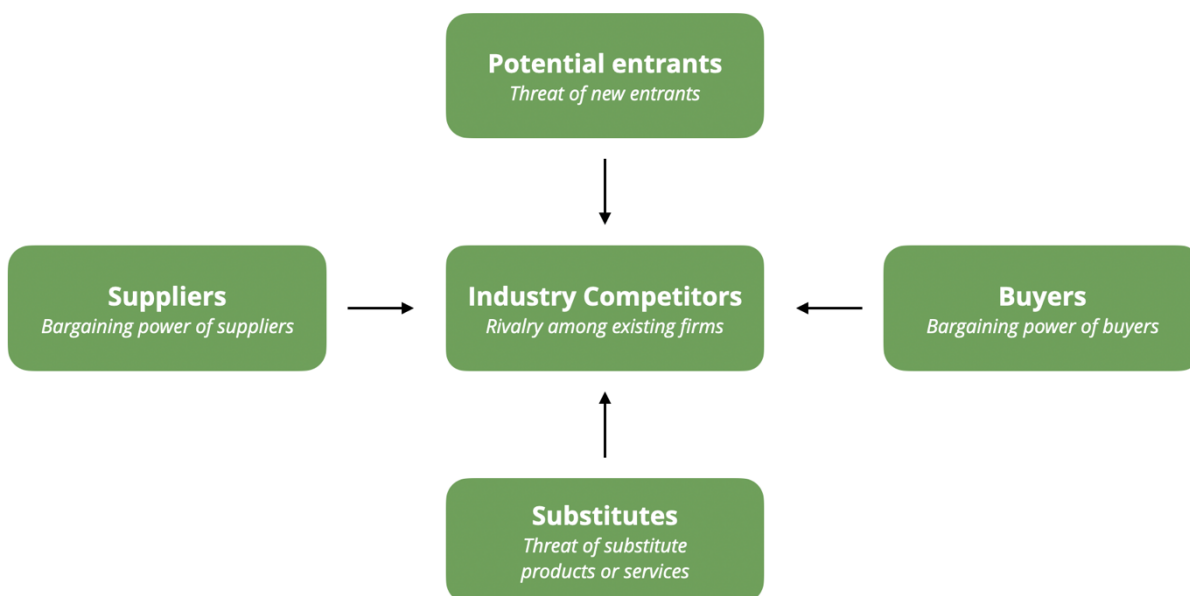


Figure 1: Forces Driving Industry Competition (Porter, 1980)

Threat of new entrants

New entrants to an industry bring new capacity and resources, intending to gain market share from the existing firms. As a result, prices can go down and costs can go up, thus reducing the profitability (Porter, 1980). Porter (1980) points out that the threat is especially substantial if an existing company diversifies into a new industry through acquisition, as they can use their existing resources to cause considerable change in the new market and gain market share. However, how strong the threat is, depends on the existing entry barriers, as well as the reaction that a potential entrant can expect from the established firms (Porter, 1980).

Porter (1980) identifies several entry barriers. *Economies of scale* among existing players is one of them, as it either implies a cost disadvantage for a small new entrant or forces the entrant to enter at a large scale, thus increasing the risk. *Product differentiation* is another barrier, as it implies that the new entrant will face difficulties related to overcoming customers' existing loyalties. Moreover, *capital requirements*, especially if large or unrecoverable, may pose a substantial barrier to entry (Porter, 1980).

Switching costs, i.e. costs incurred by buyer when switching to a new supplier are yet another barrier. The next example is *access to distribution channels*, related to the fact that the new entrant has to convince the distribution channels to accept its products – or build its own distribution channel, if this barrier is too high. Furthermore, *cost disadvantages independent of scale*, for instance the fact that the existing competitors have lower costs due to experience, have secured favorable locations or access to raw material, can create strong entry barriers. Lastly, *government policy* can limit entry to an industry (Porter, 1980).

In addition to entry barriers, if the new entrant can expect strong reactions from the established players upon its entrance, it can reduce the threat of new entry. This expectation can for instance be founded in existing players' past reactions to entrants, their excess resources or their commitment to the industry (Porter, 1980).

Threat of substitute products or services

Porter (1980) points out that in a broad perspective all firms in an industry compete with industries providing substitute products. He defines substitutes as “products that can perform the same *function* as the product of the industry” (Porter, 1980, p. 23) and states that substitutes have the potential to limit the profitability of an industry. Low price/performance ratio of

substitutes restricts namely the industry's potential to charge high prices for their products (Porter, 1980). Furthermore, Porter (1980) argues that substitutes that are exposed to trends that improve their price/performance ratio, or are produced by industries with high profits, pose the highest threat.

Bargaining power of suppliers

Suppliers can exercise power over an industry by threatening to reduce quality or increase prices. For this threat to be realistic, suppliers need to be powerful, which depends on several conditions. They include, but are not limited to: the supplier group being dominated by a few companies and being more concentrated than the industry it sells to; the industry not being an important customer of the supplier group; the suppliers' product being important for the buyers; and the supplier group's products being differentiated or having high switching costs (Porter, 1980).

Bargaining power of buyers

Similarly, buyers can exercise power over an industry by demanding lower prices, negotiating for higher quality and setting competitors against each other, thus driving the profitability down. Again, in order to be able to do that, they need to be powerful, which is the case when the following conditions apply: the buyer group is concentrated or purchases large volumes relative to seller sales, the products the buyer group purchases are standard or undifferentiated, the buyer group faces low switching costs, the product is unimportant to the quality of the buyers' products or services, and the buyer has full information, to name the most important ones (Porter, 1980).

Rivalry among existing firms

According to Porter (1980), internal rivalry in an industry exists because players see possibilities to improve their positions or are pressured to do so. He notes that companies are mutually dependent, so that moves of one player trigger countermoves of others. The intensity of this rivalry is influenced by several factors, including the number of players in the industry, growth in the industry, lack of differentiation or switching costs, high fixed or storage costs, overcapacity, diverse competitors, high strategic stakes and high exit barriers. Even though a company must accept many of these factors, there are also some it can influence, for instance by differentiating its product or increasing switching costs (Porter, 1980).

Limitations of Porter's five forces framework

Despite the framework's prevalence, it has several disadvantages. As already mentioned, Lien et al. (2016) state that its main limitation is how it overlooks the value creation aspect, focusing solely on value capture. Lien and Jacobsen (2015) also point out that businesses have potential to increase value creation through cooperation, but this aspect is wholly disregarded by Porter's framework.

Moreover, Dobbs (2014) notes the lack of depth and structured analysis that characterizes the typical understanding and application of the five forces. Porter (referred in Dobbs, 2014) himself regrets that the framework is commonly reduced to qualitative rather than quantitative assessments, often making the outcome arbitrary.

Furthermore, Grundy (2006) observes that industries tend to have fluid boundaries nowadays, while Porter's framework encourages to look at industries as entities with defined boundaries. Along the same lines, Downes and Mui (1998) point out that Porter's framework assumes a fairly simple and static business environment, which is no longer the case in today's ever-changing world. They identify *digitalization*, *globalization* and *deregulation* as three new forces and emphasize that, in today's context, their importance and influence overshadow that of the original five (Downes and Mui, 1998).

2.2.2 Profitability tree

Having looked at Porter's framework's potential to analyze value capture, it is time to look at the value creation aspect through the profitability tree, presented in Figure 2. According to Lien et al. (2016), the total value creation in a market is simply a product of *value creation per unit* and *number of units*.

$$\text{Value creation} = \text{value creation per unit} * \text{number of units}$$

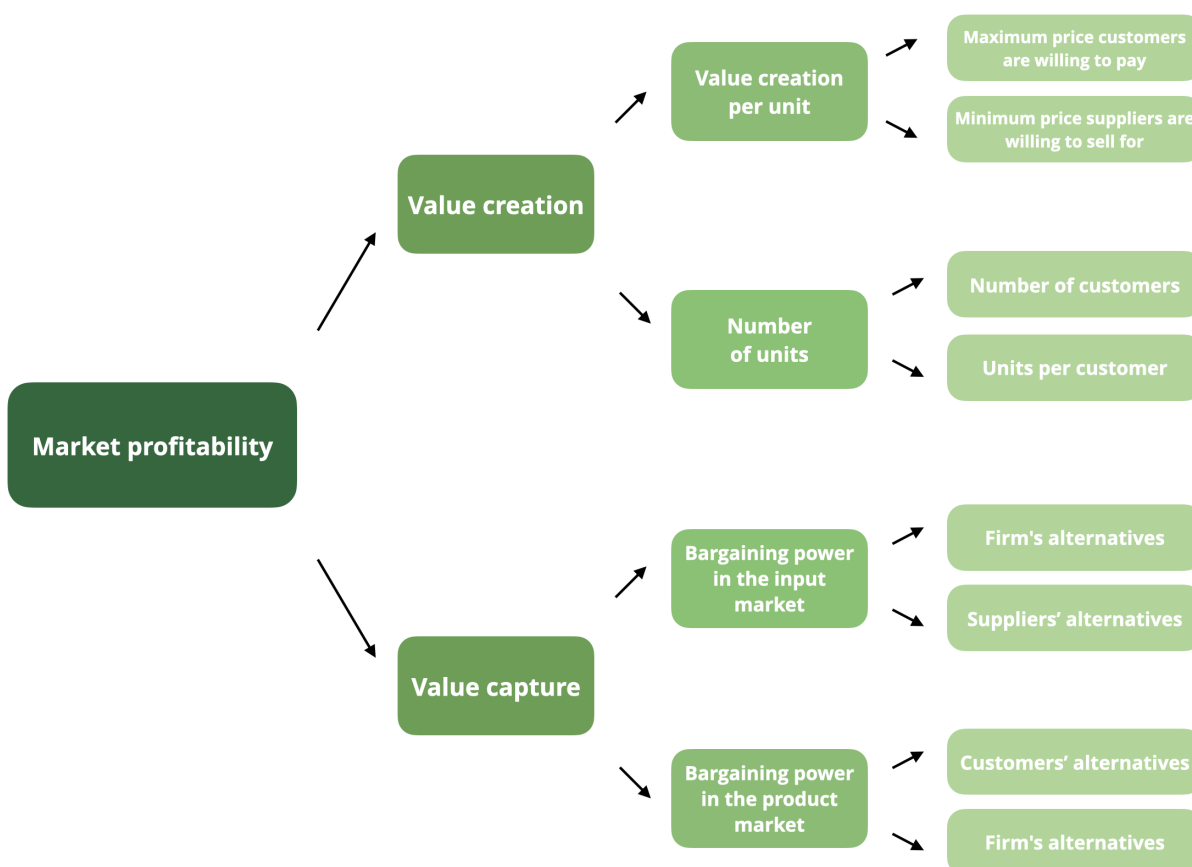


Figure 2: Profitability tree (Lien et al., 2016)

If one wishes to understand what the value creation in a market is and how it will change in the future, one has to look at these two components and their development (Lien et al., 2016). Breaking them further down allows to more easily analyze specific reasons for changes in value creation.

Value creation per unit

Value creation per unit is further defined as a difference between the *maximum price customers are willing to pay* and the *minimum price that suppliers are willing to sell for* (Lien et al., 2016).

$$\text{Value creation per unit} = \text{maximum price customers are willing to pay} - \text{minimum price suppliers are willing to sell for}$$

Maximum price customers are willing to pay

Naturally, the more a customer is willing to pay the bigger the value creation in the market is (Lien et al., 2016). According to Lien et al. (2016), one of the aspects influencing the maximum price customers are willing to pay is the customers' perception of the price and quality ratio of a product, especially when compared to substitutes. If the market players manage to keep the price/quality ratio low in relation to substitutes, the value creation of the market will go up (Lien et al., 2016). Similarly, if the goods complementary to the goods of current market players have a low price/quality ratio compared with the substitutes, the value creation of the market will also go up (Lien et al., 2016).

Minimum price suppliers are willing to sell for

According to Lien et al. (2016), suppliers are those players who deliver input into the market of our interest. Such input can take many different forms, for instance labor, IT solutions or raw materials. To avoid too high complexity, Lien et al. (2016) suggest focusing only on the suppliers of the most important inputs, i.e. inputs which account for the largest proportion of the total costs.

The value creation aspect is affected by the *minimum price suppliers are willing to sell the input for* due to the fact that suppliers often face new opportunities outside of the market of our interest (Lien et al., 2016). Simply, if the need for a certain input raises, the *minimum price suppliers are willing to sell for* rises, causing the value creation in our market to fall (Lien et al., 2016).

Number of units

Secondly, the *number of units* is simply a product of *number of customers* and *number of units per customer*.

$$\text{Number of units} = \text{number of customers} * \text{units per customer}$$

Number of customers

According to Lien et al. (2016), the most probable reason for changes in the number of customers in the market is their changing interest in substitutes. Another possibility, though less common, is changes in population growth (Lien et al., 2016).

Units per customer

The size of the market can also change due to customers changed preferences. In other words, as the ratio of price/quality goes up in our market, more customers are interested in substitutes causing the value creation in our market to fall (Lien et al., 2016).

Bjørnenak (2019) further develops the perspective on the changes in the size of the market by mentioning three leading trends affecting the final size of the market. The first one is digitalization, which makes it possible for the customers to choose from a broader spectrum of products (Bjørnenak, 2019). That in turn leads to changes in value creation in the market of our interest. The second aspect is globalization which works in two directions – it both brings more possibilities by scaling up the size of the market, but at the same it might create bigger pressure by increasing the number of rivals present in the market (Bjørnenak, 2019). Lastly, deregulation which removes the formal obstacles and allows several other competitors to join the market and respectively increase the market size (Bjørnenak, 2019).

Note that the same trends were also mentioned by Downes and Mui (1998) as forces that influence value capture. In the perspective of the profitability tree, one can see that they have just as much impact on value creation.

2.3 Framework for cost driver analysis

The next step after analyzing the competitive environment and profitability potential of an industry is to understand the sources of differences in cost levels between players. In order to do that, one can conduct a cost driver analysis. As Bjørnenak (2019) notes, the term *cost driver* can refer to two different things. In strategic management accounting, *cost drivers* are factors which explain cost differences between players in an industry, while in management accounting, a *cost driver* is a factor which shapes an activity's resource use (Bjørnenak, 2019). It is the former definition that is at the core of the cost driver analysis.

The core idea of the cost driver analysis in the strategic perspective is that cost is driven by many, often interrelated, factors (Shank and Govindarajan, 1993). This stands in opposition to the conventional management accounting perspective where cost is driven by only one cost driver, namely output volume (Shank and Govindarajan, 1993). According to Shank and Govindarajan (1993), output volume does not capture much of the richness of cost behavior and is strategically uninteresting. For this very reason, it is important to identify other cost drivers.

Blindheim (2010) notes that many lists of cost drivers can be found in literature. Among the first ones were Porter's (1985) list of 10 structural cost drivers, as well as Riley's list (referred in Blindheim, 2010), which included 19 cost drivers in the following categories: environmental, inherent, structural and execution. These are presented in Table 1 and Table 2.

| Structural cost drivers | |
|--------------------------------------|---|
| • Economies or diseconomies of scale | • Level of vertical integration |
| • Learning curve effects | • Timing |
| • Pattern of capacity utilization | • Location |
| • Linkages | • Institutional factors |
| • Interrelationships | • Discretionary policies independent of other drivers |

Table 1: The list of ten structural cost drivers developed by Porter (1985)

| Environmental | Inherent |
|--|--|
| <ul style="list-style-type: none"> • Union/non-union • Volumes (scale economics) • Product line complexity • Demand uncertainty • Product life cycle duration | <ul style="list-style-type: none"> • Product design • Process technology • Product line structure |
| Structural | Execution |
| <ul style="list-style-type: none"> • Capacity utilization • Vertical integration • Product/process complexity • Offshore manufacturing • Transportation charges and plant locations | <ul style="list-style-type: none"> • Manufacturing flows • Work practices (experience) • White-collar productivity • Purchasing effectiveness • Materials management effectiveness • Salary wage rates |

Table 2: The list of nineteen environmental, inherent, structural and execution-oriented cost drivers developed by Riley (referred in Blindheim, 2010)

Based on these two contributions, Shank and Govindarajan (1993) developed a more generic set of 11 cost drivers, categorizing them as either structural or executional, as presented in Table 3. The structural cost drivers refer to the structural choices of the firm, such as choosing a specific technology; whereas the executional drivers reflect the firm's ability in executing activities (Blindheim, 2010).

| Structural (choices) | Executional (skills) |
|--|---|
| <ul style="list-style-type: none"> • Economies of scale • Economies of scope • Level of product complexity • Experience/learning • Technology | <ul style="list-style-type: none"> • Work force involvement • Total quality management • Capacity utilization • Process design (plant layout efficiency) • Product design • Exploiting linkages |

Table 3: The list of eleven cost drivers developed by Shank and Govindarajan (1993)

Furthermore, Shank and Govindarajan (1993) note that many consultants have a bigger focus on the latter, as insights from structural cost drivers are considered too dated. Still, there is no agreement as to what the fundamental cost drivers are, perhaps except for the general understanding that structural choices and executional skills are more helpful in explaining the cost position of a firm, than output volume (Shank and Govindarajan, 1993).

As the list of Shank and Govindarajan (1993) is based on the contributions of Porter and Riley, offers a useful categorization in structural and executional cost drivers, as well as is more generic, i.e. applicable to a wider range of companies, it will be used as the point of departure in this thesis. It will also be supplied by Porter's (1985) inputs where it is constructive. Note that the different scholars label some of the cost drivers differently. However, the crucial aspect is not how they are labeled, but how they can help explain cost differences between players (Bjørnenak, 2019).

2.3.1 Structural cost drivers

Economies of scale

Economies of scale relate to the cost advantages obtained when producing a larger volume, where unit price decreases due to increasing scale. This takes place as a result of increased efficiency in operations, as well as the fact that infrastructure and overhead costs are often not proportional to output volume (Porter, 1985). It is essential not to misinterpret economies of scale as capacity utilization. Higher capacity utilization allows to spread the fixed costs over a larger volume, while economies of scale entail that an activity at full capacity is more efficient at a larger scale (Porter, 1985).

The opposite phenomenon is called diseconomies of scale and relates to the fact that increased complexity and coordination costs can lead to cost disadvantages when producing a larger volume (Porter, 1985).

Economies of scope

Economies of scope relate to the degree of vertical integration (Shank and Govindarajan, 1993). With a higher vertical integration, a company can avoid the costs of using the market (Porter, 1985). Moreover, the company does not have to deal with suppliers or buyers with substantial bargaining power (Porter, 1985).

On the other hand, vertical integration can also lead to higher costs if it creates inflexibility in the company, or if performing the activities in-house is more expensive than outsourcing it (Porter, 1985). Vertical integration can also weaken incentives for efficiency and raise exit barriers (Porter, 1985).

Product complexity

Product complexity refers to how wide a line of products is offered to the customers. Larger product lines require more coordination and can thus increase costs, compared with leaner product lines (Blindheim, 2010). A higher number of products may also lead to higher product-specific investments (Bjørnenak, 2003).

Experience

Experience refers to how many times the company has done a given activity in the past (Shank and Govindarajan, 1993). Learning which results from repetition can namely lead to lower costs (Bjørnenak, 2019). This can relate to e.g. improved scheduling, better procedures, but also reduced cost in constructing facilities (Porter, 1985).

Porter (1985) notes that learning can spread to other companies in the industry, e.g. through suppliers, former employees or consultants. Consequently, cost advantage will only be obtained if the learning does not spread from one company to the rest of the industry. Otherwise, it will simply reduce cost for the whole industry (Porter, 1985).

Technology

Another cost driver listed by Shank and Govindarajan (1993) is technology or, more specifically, what technologies are used in each step of the value chain (Shank and Govindarajan, 1993). As Blindheim (2010) explains, the reason why a firm has a cost advantage or disadvantage in relation to its rivals can lie in their choice of technology in the different steps of the value chain. This can for instance be related to automation or digitalization of the processes (Bjørnenak, 2019).

Institutional factors

Institutional factors are included in Porter's (1985) list of structural cost drivers but were omitted by Shank and Govindarajan (1993). Porter (1985) notes that institutional factors can relate to government regulation, unionization, financial incentives such as tax holidays, and more, while Bjørnenak (2019) adds that this category can also include norms and contracts which lead to higher costs for some players in the industry.

Location

The last structural cost driver, again omitted by Shank and Govindarajan (1993) but mentioned by Porter (1985), is localization. Porter (1985) arguments that it should be considered a

separate cost driver, because as much as it can be a policy choice, it can also be a result of the location of inputs or the firm's history. Bjørnenak (2019) points out that location can impact differences in salaries or distribution costs, thus having the potential to be an important driver for cost differences between players.

2.3.2 Executional cost drivers

Workforce involvement

Workforce involvement, or workforce participation, relates to the employees' commitment to continual improvement (Shank and Govindarajan, 1993). It can be argued that such motivated workforce can improve operations through quicker awareness of problems in the different activities of a firm, as well as easier detection of potential improvements and solutions. Thus, workforce involvement can potentially lead to a cost advantage (Blindheim, 2010).

Total quality management

Total quality management (TQM) has to do with beliefs and achievement related to product and process quality. More precisely, TQM relates to the idea that everyone in a firm is responsible for the quality of the output, as opposed to only workers having this responsibility. Thus, TQM offers a more holistic perspective on quality, acknowledging that quality problems can start well before the operations stage, and can for instance be a result of poor inputs or inadequate equipment maintenance (Shank and Govindarajan, 1993).

Capacity utilization

Capacity utilization is the extent to which the available capacity is used. It is defined as an executional cost driver by Shank and Govindarajan (1993), yet Porter (1985) and Riley (referred in Blindheim, 2010) see it as structural. Porter (1985) highlights that capacity utilization is influenced by fluctuations in demand and supply, as well as seasonal and cyclical variations. Moreover, keeping a constant utilization level is less costly than changing it over time. Therefore, Porter argues that the correct cost driver is the pattern of utilization over a cycle, rather than the average utilization over a cycle or the utilization at a given point in time (Porter, 1985).

Capacity utilization is an important cost driver especially when there are considerable fixed costs related to an activity. The fixed cost acts namely as a penalty for low utilization, increasing the unit cost of the output (Porter, 1985).

Process design (plant layout efficiency)

Process design relates to how efficient the plant layout is, against existing norms (Shank and Govindarajan, 1993). Porter (1985) does not include this cost driver, while Riley (referred in Blindheim, 2010) has both process technology and product line structure as inherent cost drivers.

Product design

Product design refers to whether the design or formulation is effective (Shank and Govindarajan, 1993). Naturally, a non-effective design or formulation can drive up costs. Like with process design, Porter (1985) omits product design in his list of cost drivers, while Riley (referred in Blindheim, 2010) defines it as inherent.

Exploiting linkages

Activities are very often interrelated, meaning that the cost of one activity is rarely unaffected by how other activities are carried out. Linkages between activities relate both to linkages within the company's value chain, as well as to upstream linkages with suppliers and downstream linkages with customer channels. Such linkages have the potential to lower the total cost of the interrelated activities, yet are not easy to achieve as they may be hard to recognize and require joint coordination and organization. When exploited, they can be a source of cost advantage (Porter, 1985).

To notice internal linkages of one activity, a company needs to identify all other internal activities that affect its cost performance. For external linkages, a company needs to look into how the cost of their activities is impacted by suppliers and channels and vice versa. In all linkages, lower cost is achieved by coordination or joint optimization. This requires openness and transparency (Porter, 1985).

Limitations of the cost driver framework

As mentioned, analyzing cost drivers can give insight and understanding of differences in cost levels between players in an industry. This is an important question in and of itself. However,

Shields and Shields (2005) point out that the cost driver models, including the above-presented framework of Shank and Govindarajan (1993), do not provide a full understanding of profit, because they fail to notice the importance of revenue drivers, focusing solely on cost drivers.

It is a point to keep in mind, yet it does not overshadow the importance of cost driver analysis, which is central for the research question posed in this thesis. Therefore, given the scope of the thesis, we see it as adequate to focus on cost driver analysis only.

2.4 Framework for business model analysis

After examining sources of profitability variations between publishing companies, it is time to look at the last research question which aims at examining which business models can be profitable in the future.

In order to answer this question, we first need to define the notion of business models. Osterwalder and Pigneur (2010, p. 14) state that “a business model describes the rationale of how an organization creates, delivers and captures value”. Furthermore, they present the business model canvas, a framework which identifies nine elements that business models comprise of. Each of these elements is introduced in the following.

Value creation

Value creation consists of one element, namely *value proposition*, i.e. the offer that the company provides to the customers. Whether it is a product or a service, the offer usually centres around solving a problem that a customer faces or fulfilling his or her need (Osterwalder and Pigneur, 2010).

Value delivery

In order to deliver the proposed value, the company needs certain resources, activities and partners. Osterwalder and Pigneur (2010) refer to these elements as *key resources*, *key activities* and *key partners*. The first element represents the assets that are central to make a business model work, the second stands for the actions that a company has to take in order to successfully operate, while the third signifies the network of partners and suppliers that a company cooperates with in order to deliver its offer (Osterwalder and Pigneur, 2010).

Furthermore, value delivery needs to be directed towards customers. Therefore, it also includes *customer segments*, *channels* and *customer relationships*. *Customer segments* refer to the people or organizations that the company wants to serve. *Channels* describe how the company reaches and communicates with its customers. Lastly, *customer relationships* focus on the types of relationships that the company forms with its customers, for instance acquisition, retention or upselling (Osterwalder and Pigneur, 2010).

Value capture

Finally, value capture defines how the company makes money, given the *revenue streams* and *cost structure*. The former naturally refers to the revenue that the company obtains by delivering its offer, while the latter refers to all the costs that are incurred in the process (Osterwalder and Pigneur, 2010).

The nine elements grouped into the three categories of value creation, delivery and capture can be visualized as the business model canvas, presented in Figure 3.

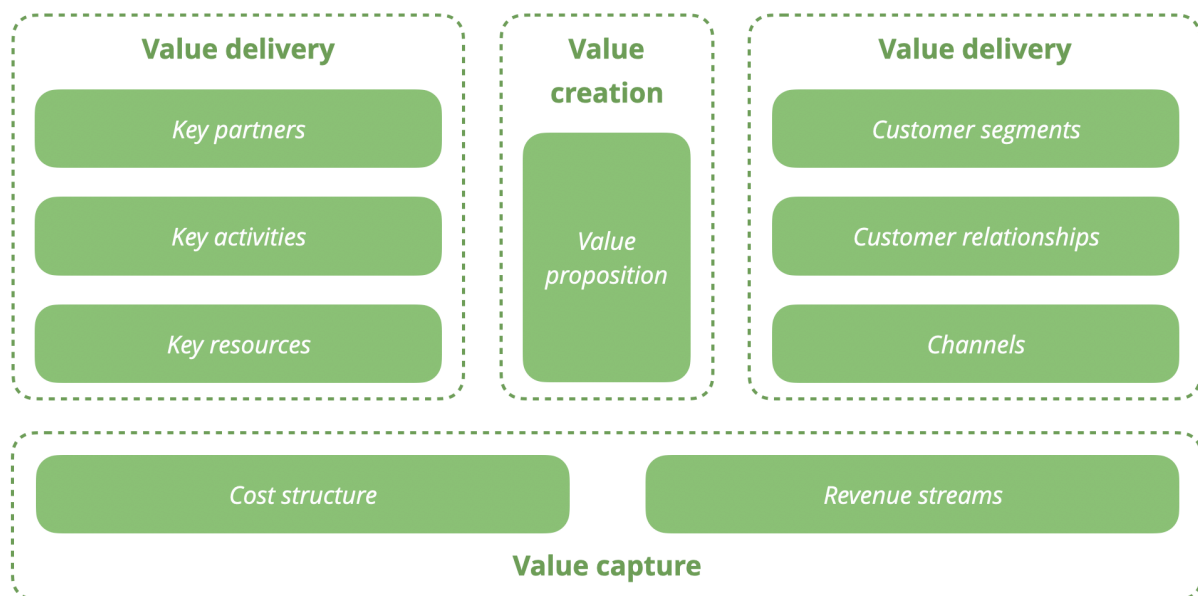


Figure 3: Business Model Canvas (Osterwalder and Pigneur, 2010)

2.5 Summary of the theoretical framework

The purpose of this thesis is to conduct a profitability analysis of the publishing industry in Norway. The theoretical framework is summarized in Figure 4. In order to analyze the industry as whole, we will look separately at value capturing and value creation. Porter's five forces framework allows to look at the value capturing aspect by analyzing the competition level in the industry. The analysis looks at elements such as threat of new entrants, rivalry among existing firms, threat of substitute products or bargaining power of suppliers and buyers. Such detailed distinction allows to find specific causes explaining profitability drivers in the publishing industry. Further on, the analysis is supplied by the profitability tree. Here the focus is directed towards value creation aspect, defining the size of the market.

In order to achieve deeper understanding of the profitability in the publishing industry, the focus is directed from the industry level towards selected players in the market. Here, cost driver analysis is applied, shedding light on which structural and executional cost drivers characterize the profitable companies.

Lastly, in order to gain an insight into how the industry can develop in the coming years, we examine which business models can be profitable in the future. Here, Osterwalder and Pigneur's business model canvas is applied to look at potential changes in value creation, value delivery and value capture.

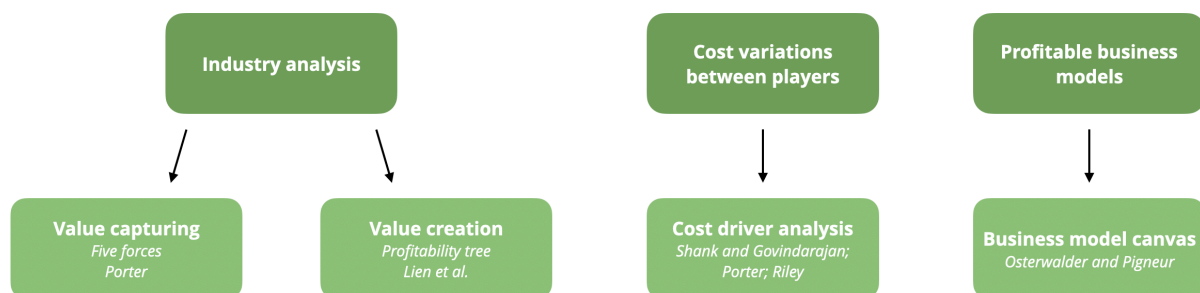


Figure 4: Summary of the theoretical framework

3. Methodology

This section presents the methodological approach used in order to answer the research question. Decisions regarding methodology are crucial for the outcome of any research, as methodology impacts how data is collected and analyzed (Grønmo, 2004).

The section is structured as follows. Firstly, the research object and sample are defined, before the research design is presented. Next, the methods for data collection and analysis are discussed. Lastly, the collected data is critically evaluated.

The choices taken regarding the methodology are meant to serve the purpose of answering the research questions posed in the thesis, namely:

What can explain the profitability of the Norwegian publishing industry, and the variations between players?

1. What is the level of competition in the Norwegian publishing industry?
2. What is the profitability of the industry?
3. What are the potential sources of profitability variations between players?
4. Which business models can be profitable in the future?

3.1 Research object and sampling

3.1.1 Research object

The research object of this thesis is limited to established Norwegian book publishers, aiming at the larger national market. Both publishers with wide assortments, and those who specialize in a specific type of books, are included, as we see it as important to look at a broad specter of companies. However, there are several groups that fall outside of the scope of this thesis.

Firstly, newly established publishers are excluded, as companies in early phases of their lifecycles tend to have different revenue and cost structures, which are likely not to be representative for the industry as a whole. Secondly, we leave out publishers of magazines, newspapers and other materials, as they provide products that are different from books both in nature, function, production process and publishing frequency. Lastly, publishers who only

aim at a smaller local market are excluded, as we consider them not comparable with the nationally minded players, who are the focus of the study. With a research object defined in this way, the study encompasses comparable firms.

3.1.2 Sampling

The research questions in this thesis are of different natures, with the first two focusing on the industry as a whole, requiring a general overview of the publishing industry in Norway, and the third and fourth concentrating on company-to-company basis, requiring a deeper insight into what happens on a company level. Therefore, two different samples will be used. The first one will contain a large number of book publishers, while the second one will be limited to only a few companies.

Sampling for industry analysis

The profitability analysis of the industry will be based on financial data. The point of departure for defining the first sample is Proff Forvalt, a website offering extensive accounting information about Norwegian businesses. Filtering for the NACE code 58.110 “Publishers of books”, one obtains a list of 1184 companies registered under this industry. In order to obtain a representative sample which is in line with research object defined above, this list will be reduced according to the following criteria.

1. Revenue of minimum 1 MNOK a year in the time period 2016-2018
2. Availability of financial data from 2016-2018
3. Publishing books for the national market being the core business

Revenue

The criterion of revenue amounting to at least 1 MNOK over three consecutive years is applied to ensure that the study looks at established publishers only. Moreover, after a thorough analysis of the list, we concluded that companies below 1 MNOK tended to publish for small, local audiences. Therefore, this criterion also allows to exclude small publishers who do not aim at the larger national market.

Time period

Studying a longer time period allows to notice trends and development which happens over time. However, this concern needs to be balanced with the fact that when one looks at a longer

time period, there are fewer companies that fulfill the data availability requirement. At the same time, the objective of this thesis is to study the current situation in the industry, and older data might be outdated when it comes to assessing the present. This is especially important due to the potential impact of digitalization on the publishing industry. With this in mind, we found it optimal to choose 2016 to 2018 as the time period of this study.

Applying the above criteria reduces the list of publishers to 102 companies.

Core business

Lastly, to ensure that the sample indeed included companies whose core business was book publishing for a larger audience, each of the 102 companies was checked manually. In order to do this, we went through the companies' websites and removed publishers with only local publications, and wrongly categorized companies such as printing companies, streaming services, producers of marketing material such as brochures and flyers, marketing consultancies etc. This process secured the removal of companies whose core business was in fact different, and they only happened to be assigned under the NACE code 58.110 "Publishers of books".

Thus, the final sample ended up including 76 companies. They are presented in Figure 5, with the size representing the accumulated revenue over 2016-2018 for each of the players.

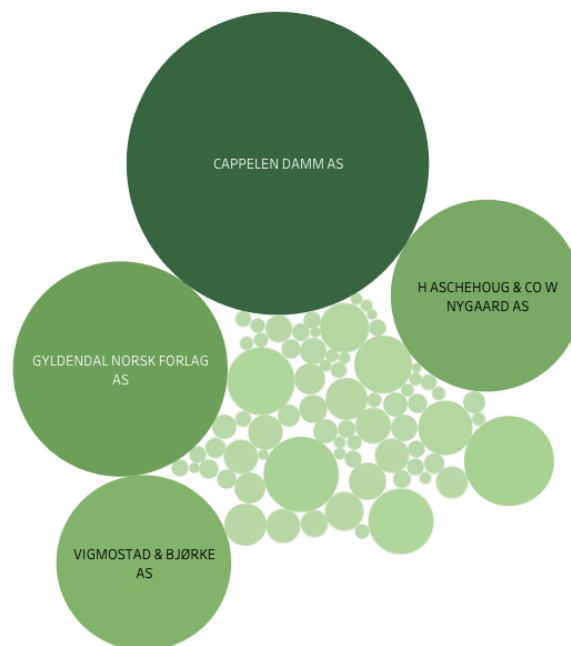


Figure 5: Accumulated revenue from 2016-2018 for the sample of 76 publishers

Sampling for analysis of profitability variations

In order to answer the research question concerning the potential sources of profitability variations between players, the second sample will be narrowed down to only a few players. As mentioned before, the main focus will be directed towards the cost driver analysis. This kind of research question requires a deeper insight than what Proff Forvalt is able to offer, so that it is necessary to supply the analysis additional data sources. Hence, interviews with chosen publishers will be carried out, resulting in a smaller sample, but much higher detail. The findings from the cost driver analysis will at the same time lay a groundwork to consider profitable business models of the future.

As described above, the first sample consists of observations from 76 players. Here, due to the level of detail required, we will look at a small sample of 3 players. Originally, we intended for a slightly bigger sample, aiming at 5 publishers, but after the Covid-19 outbreak we faced declines and cancellations of already scheduled interviews. Nonetheless, the final size of the sample allows for obtaining perspectives from different publishers and is big enough to spot factors that come up repeatedly.

In order explain the profitability differences between players, we find it meaningful to include both players with a broad specter of products and those who publish only specialized literature in the sample. Secondly, we see it as expedient to look at players who perform differently, in terms of operating profit in 2016-2018.

We find it important to indicate that the players vary substantially in terms of size. Four of the biggest players, namely Cappelen Damm, Vigmostad & Bjørke, Gyldendal, as well as H. Aschehoug hold together 74% of the accumulated revenue between 2016-2018, whereas the 81 remaining players only 26%. In other words, the competitive situation is relatively different for these two groups of players. Therefore, it would be reasonable to include at least one of the big players in the sample. Regretfully, only one of the companies showed interest in participating in the study but cancelled due to the pandemic. Hence, the sample for the analysis of sources of cost differences, includes 3 small and middle-sized players, but the biggest publishers are not represented.

3.2 Research design

Research design outlines the strategy for how the research questions will be answered. More specifically, it entails detailing what the purpose of the research is and which approach will be taken to answer each of the research questions, i.e. whether one takes theory or empirical observations as the point of departure.

3.2.1 Research purpose

Research purpose refers to the objective which guides the research. The purpose can be either *explorative*, *descriptive* or *causal* and is often dependent on the amount of literature resources related to the research question. The first design, *explorative*, is especially practical when the researcher does not have a clear idea about the theoretical background to begin with. In order to examine the topic, one shall therefore look up specifically at available literature sources as well as at secondary sources, that is data collected by other researchers. Based on this background a hypothesis can be developed (Gripsrud, Olsson and Silkoset, 2010).

In contrast, in the *descriptive* design the researcher is already familiar with the background of the problem. Hence, the main purpose is to describe a problem in a structured way, often by the use of questionnaires. The researcher picks up relevant variables and tries to outline covariance between them. Worth noticing is the fact that this design does not aim at explaining cause-effect relationship between variables. The *causal* design is responsible for examining such relationships (Gripsrud et al., 2010).

The purpose of this thesis is to examine the profitability of the publishing industry in Norway, by looking at the competitive environment, the level of profitability and sources of variations between players. Research question 1 and 2 have a *descriptive* design. The former's objective is to depict the competitive forces in the industry, using theoretical frameworks, while the focus of the latter falls on describing the profitability level, based on financial data. On the other hand, research question 3 and 4 can be defined as *explorative*. The purpose is to examine the sources of profitability variations between publishers, through interviews, as well as explore which business models can be profitable in the future.

3.2.2 Research approach

Further on, the aspect of research approach needs to be specified. One distinguishes between two main research approaches – *deductive* and *inductive*. The *deductive* approach is used when one wishes to deduce a certain conclusion or formulate the problem matter using theoretical literature. Thus, in this approach, one goes from theory over to the empirical point of view. On the other hand, the *inductive* approach starts with the idea development and then goes over to finding relevant theoretical literature that fits the proposed idea. Thus, one goes from the empirical point of view over to theory (Grønmo, 2004).

As Saunders, Lewis & Thornhill (2009) supply, the more literature resources there are in a certain topic, the more advisable it is to rely on a *deductive* approach. On the other hand, when the topic is not sufficiently elaborated yet, it is reasonable to collect new data and match the results with an existing theoretical literature afterwards.

It is advisable to combine those two research methods when working on a specific research source (Saunders et al., 2009). Hence, in this thesis we are going to follow this rule. The first and second research question regarding the industry analysis, namely describing the competitive environment as well as the profitability level, are going to be answered using the *deductive* approach. This approach will allow us to formulate the problem matter using theoretical frameworks first, and then reach empirical conclusions.

The third research question, regarding the potential sources of profitability variations, is going to be answered by the use of *inductive* approach. Here, the starting point is an empirical perspective obtained through conducted interviews. This research will further be supplied by the cost driver theory. Similarly, the last research question will also be answered using the *inductive* approach, as the topic of future business models in publishing is not sufficiently explored. The insights from the interviews and relevant data gathered from reports and other sources will lay the groundwork for the analysis and the business model canvas will be applied to structure the findings in a meaningful way.

3.3 Method of data collection

After having laid out the strategy for how the research question will be answered, it is time to look into the data collection. In this section, data sources and methods for data collection will be outlined.

3.3.1 Primary and secondary data

When conducting a research, one has to first clarify what type of literature sources are going to be used. According to Saunders et al. (2009), data sources range from primary, secondary to tertiary. Many other methodology books, however, exclude the latter (Saunders et al., 2009). In accordance with this, the focus will be put on primary and secondary sources.

As shown in Figure 6, the distinction between primary and secondary literature comes from the time of publishing, as well as the level of detail of the source. Primary sources are published first by the researcher himself and hold high level of detail. Secondary sources, on the other hand, are the consecutive sources, and use primary sources as an input. In contrast to the primary sources, secondary sources have better availability and lower level of detail. Researches point out to be cautious while using secondary data – both due to unknown data quality and the fact that the original purpose of the data collection was different. Thus, it's presentation might not be suitable for other research works (Saunders et al., 2009).

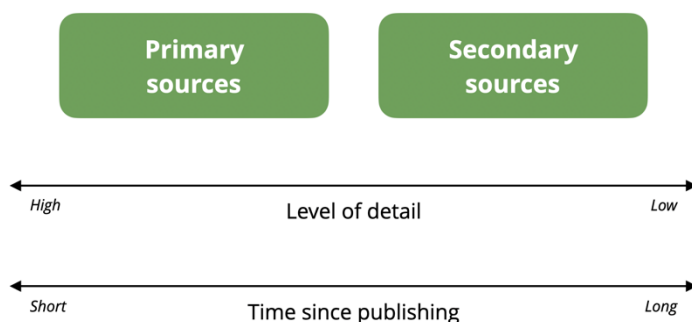


Figure 6: Primary and secondary sources (Saunders et al., 2009)

In this thesis, both primary and secondary data will be used. Since the objective is to analyze the industry as a whole, it is advantageous to have a large number of observations, and thus it is appropriate to use secondary data. Therefore, we will collect data from Proff Forvalt. Other secondary data sources will include publishers' websites, news articles, relevant reports and

statistics about the book market, as well as the website of the Norwegian Publishers Association.

At the same time, another aim of this thesis is to gain a deeper understanding of the industry and the variations between publishers. This implies that it would be beneficial to supply the data collection with primary sources, as they can be formed in a way that tackles the research question more precisely and with a higher level of detail. Therefore, interviews with publishers will be used as a primary source for this study.

3.3.2 Qualitative and quantitative methods

Data collection is a crucial aspect in order to successfully answer any research question. Methods of data collection can be either quantitative or qualitative. Quantitative data consists of numerical values, whereas qualitative builds on text (Saunders et al., 2009). Grønmo (2004) describes four aspects which distinguish those two types of data collection in depth.

Firstly, the *relevance of the method* – the qualitative methods suit best analytical descriptions and oftentimes work well in order to describe the total picture. Here, one does not go into specific details of theory, but instead shows a generalized view. Quantitative methods, as they build on numbers, offer a statistical generalization of the research question (Grønmo, 2004).

Secondly, one talks about the *methodical approach*, namely flexibility versus structure aspect. Qualitative methods score high on the flexibility part, making it possible to introduce changes during the data collection as new information comes up. In contrast, quantitative methods are highly structured, making it difficult to implement any changes during the research process. According to Grønmo (2004), both of the methods face the same disadvantage, namely that they might not capture necessary information at first. Though the qualitative methods offer flexibility, it might still be a challenge not to lose the main perspective on the research question.

Thirdly, there is the aspect of *relation to the data sources*. The researcher usually works directly with the qualitative sources, and thus his relation to them is characterized by more proximity and sensitivity. On the other hand, working with quantitative sources is characterized by more selectiveness and a bigger distance to the data. This has an effect on which data is central in the studies. For quantitative studies, the question of which data is

central is to a greater degree decided in advance, while for qualitative studies, it depends more on the data sources (Grønmo, 2004).

Lastly, there is the *interpretation* aspect which distinguishes between relevance versus precision. Grønmo (2004) points out that qualitative data allows easier access to relevant conclusions, due to the greater flexibility and sensitivity of the data collection method. On the other hand, the quantitative data open for more precise conclusions (Grønmo, 2004).

In this thesis, the collected data will consist of both quantitative and qualitative sources. As the main research question is related to profitability analysis, the core quantitative source are financial statements obtained from Proff Forvalt. This data offers numerical description in a highly structured way. At the same time, it gives an ability to be selective, by allowing to concentrate only on those parts of the financial statements which help us answer the main research question. Lastly, the quantitative sources offer a high level of precision. This may be of great relevance as even small differences in financial measures can be important.

Secondly, we supply the analysis with qualitative sources, both in form of publishers' homepages, news articles, statistics about the book market and the industry report published by the Norwegian Publishers Association, as well as interviews carried out with three publishing companies. The latter is of high relevance, as the numerical data does not provide us full information about the specific industry situation. Such specific knowledge is however available when contacting the individuals working in the industry. It is advantageous that qualitative data is a flexible data source, allowing us to obtain missing information with much higher ease than from quantitative data. Lastly, the relevant conclusions are also easily accessible.

3.4 Data collection

3.4.1 Collection of quantitative data

Financial statements from Proff Forvalt

In order to answer the second research question regarding the profitability level of the industry, we take in use the financial data supplied by Proff Forvalt. Both the income statement as well as balance sheet present aggregated figures, which narrow the possibility of a very detailed analysis. At the same time, the service allows to sort and obtain the basic, necessary data.

Quantitative questionnaires

In order to answer the third research question, we also sent short questionnaires regarding collection of quantitative data to chosen players. The questionnaire form is presented in Appendix A. The questionnaires were sent to the interviewees before conducting the interviews.

3.4.2 Collection of qualitative data

Information about the industry

In order to address the first research question, i.e. to understand the industry and to conduct the competitive analysis, it was crucial to gather qualitative data from different sources. Here, we used both the publishers' websites, the industry report prepared by the Norwegian Publishers Association, Kunnskapsverket's report on the development in the Norwegian book industry, other relevant reports, as well as news articles.

Moreover, in order to answer the fourth research question, it was necessary to gain a picture of the future developments in the industry, including potential changes in the business models, the impact of digitalization and the implications of the Covid-19 pandemic. Similarly, relevant reports including the above-mentioned report from Kunnskapsverket, news articles from the Norwegian Publishers Association and Bok365 (a website dedicated to the Norwegian book industry) and other relevant sources were used.

Interviews

Choosing interviewees

In order to answer the third research question regarding the profitability variations between players, we interviewed several publishers. The choice of interviewees was carefully deliberated. We looked at the average revenue in 2016-2018, the average operating margin in the same time period, as well as the scope of business, i.e. if the publishers focused on all types of literature or only on a specialized segment.

The goal was to interview players with different characteristics. Hence, we created a list of 18 most interesting players out of the 76 observations in the final sample. The chosen players were informed about the thesis and invited for an interview by email. In many cases, we did not receive an answer or were rejected due to lack of time on the interviewee's side. In the end, we conducted interviews with three players which represent the variety that we were aiming for. Table 4 presents the interviewed players and their characteristics.

| | Size | Profitability | Scope |
|--------------------|--------------------------------------|---|------------------------|
| | <i>Average revenue 2016-2018</i> | <i>Average operating margin 2016-2018</i> | <i>Range of genres</i> |
| Publisher A | Around 4 MNOK | 0.65 % | Many genres |
| Publisher B | Around 5 MNOK | - 5.39 % | Specialized |
| Publisher C | Around 25 MNOK | 1.17 % | Many genres |

Table 4: Interviewed publishers

Preparing an interview guide

The third research question aims at examining potential sources of profitability variations between players in the publishing industry. In other words, the research is of an explorative nature. According to Saunders et al. (2019), an explorative study often benefits from conducting semi-structured interviews. A standard interview guide includes opening comments, a list of topics that the researcher wishes to examine, key questions related to each part, as well as a closing part (Saunders et al., 2019).

Appendix B shows the interview guide which has been prepared in order to examine sources of profitability between chosen players. The topics as well as specific questions were developed based on the cost driver framework presented in Chapter 2. While developing the

interview guide, we focused on clarity by avoiding specific terminology, as well as by arranging the questions in a logical order. The structure of our interview guide allowed us to relate the answers to the theoretical framework in a simple and convenient way afterwards. Additionally, due to the fact that the semi-structured interviews open up for flexibility, we were able to ask supplementary questions when necessary.

Conducting interviews

The chosen publishing companies were first contacted by email. After receiving a positive answer, the date and time were scheduled. Before the interview, a short quantitative questionnaire, as well as the interview guide were sent to the interviewee.

All of the interviews were conducted by phone and lasted, as stated in the email sent beforehand, around half an hour. In the introduction, we asked for the possibility to record the conversation in order to use the information for the thesis. Moreover, we informed each interviewee that the answers were going to be anonymous. We also clearly stated that not all of the questions needed to be answered if the interviewees preferred not to address some topics.

The questions were asked in the same order as they were written on the guide sent to the publishers. This order was most logical, known by the interviewee in advance, and allowed us to relate the publishers' answers to the theory during the transcription process.

Transcription

After the interviews had been audio-recorded, each conversation was transcribed shortly afterwards. According to Saunders et al. (2019), during the process of transcription one should focus both on the message itself, but also on trying to indicate and convey the tone of the speaker, in order to present his/hers most important thoughts.

The process of transcription is a time-consuming task due to the fact that written and oral expressions are very different. Hence, as Saunders et al. points out (2019), it is reasonable to limit the transcription only to those sections which give necessary answers to previously defined questions. As the questions were defined based on the cost-driver theory, we focused specifically on extracting information on this particular topic during the transcription process.

Each transcribed file was saved as a separate, easy recognizable file. At the same time, we made an effort to preserve the anonymity of the interviewees, by not using the publishing company's name in the further analysis, but instead changing it to a letter, e.g. "Publisher A".

3.5 Evaluation of the data

After the data has been collected, it needs to be evaluated, so that it is possible to judge the quality of the research. In the following, reliability and validity of the collected data will be analyzed, as they are central in such assessments (Saunders et al., 2019).

3.5.1 Reliability

Reliability is related to stability and consistency (Sekaran and Bougie, 2013). If several researchers study the same problem and receive the same results, or if the same research is repeated on the same sample at two different points in time and the results are consistent, then the research can be said to have high reliability (Johannessen, Christoffersen and Tufte, 2011). This requires that the research design is unambiguous, and that the data collection is done thoroughly and systematically (Grønmo, 2004).

Several threats to reliability exist, including participant or researcher error and participant or researcher bias. The former two refer to factors that alter the performance of the participant or the researcher. For instance, lack of time can affect the way a participant answers, while tiredness may influence the researcher's understanding. On the other hand, bias refers to factors that may lead the participant to answer untruthfully or the factors that may make the researcher interpret the answers unobjectively (Saunders et al., 2019).

When it comes to the quantitative data, the reliability is relatively high. Proff Forvalt has entered partnerships with Statistisk sentralbyrå (the statistical institute in Norway) and Brønnøysund Register Centre (the government agency responsible for public registers in Norway), which ensures the reliability of the obtained financial statements. Furthermore, as the data is numerical and obtained through a professional service, bias and errors are highly unlikely. Moreover, there is no ambiguity as to what kind of data is collected, and the data is structured in the same way for each observation, making the data collection thorough and systematic.

This is also the case for the quantitative questionnaires from the interviewees, as they were designed to be short, clear and well-structured. Yet, one cannot rule out the possibility of participant errors. However, as the questionnaires were sent out by e-mail with no deadlines, the interviewees were not under a time pressure and had the ability to check any information that they might have been unsure of. This reduced the possibility of any errors. Moreover, the participants were informed that the information would be anonymous and that they could skip questions they preferred not to answer. We believe that this lessened the chances of obtaining biased information. Therefore, we conclude that the questionnaires also had high reliability.

When it comes to the qualitative data in the form of reports, news articles and publishers' websites, the reliability is also good. We focused on collecting the data from recognized, professional sources like Kunnskapsverket (Norwegian Knowledge Centre for Cultural Industries) or official industry organizations, such as the Norwegian Publishers Association. Many of the news articles were found on Bok365, a website concentrating specifically on the Norwegian book industry. Therefore, the collected data is unlikely to include errors or bias and has good reliability.

As for the interviews, the picture is more complex. The performance of the participants might have been affected by how well rested they were, whether they were busy on the day of the interview etc. Factors such as hurry might have led to participant error. However, the interviewees did not seem time-pressured which should positively impact their performance.

Moreover, as researchers, we made sure to prepare sufficiently before conducting the interviews. This included learning about each interviewed publisher from their website and news articles, and understanding their financial situation using the data from Proff Forvalt. We also made sure to be alert and focused during the phone calls. This reduced the possibility of researcher errors.

Next, one cannot exclude participant bias, as there is always a possibility that the information was falsified in order to make the company look a certain way. However, it is not very likely, as financial statements are publicly available, and the situation in the industry is generally known, so there is little incentive to provide incorrect information. Moreover, the interviewees were given the possibility to skip questions they preferred not to answer. Overall, we

experienced that the interviewees genuinely wanted to help and provide useful information. This further reduces the possibility of participant bias.

As for researcher bias, we tried to be aware of the possibility of interpreting the answers subjectively and prevent that from happening. Moreover, recording and transcribing the interviews allowed us to go back to the original statements of the interviewees, instead of relying on our memory and subjective impressions.

Importantly, preparing an interview guide helped us construct clear and non-leading questions, as well as conduct the interviews in a structured way. This allowed for a rather systematic data collection process, while the possibility to ask follow-up questions cleared out misunderstandings and misinterpretations. All in all, the interviews can be said to have good reliability.

3.5.2 Validity

Validity is an aspect which questions if the data material is relevant for answering the research problem. In other words, one achieves high validity if the data material actually measures the aspects that the researcher is interested in. The two most central forms for validity are *internal* and *external validity*. The former takes a narrow perspective and sets a light on whether the findings of the study actually are valid in the regulated research situation. External validity, on the other hand, answers if the results of the study can be generalized and tailored towards a broader perspective (Grønmo, 2004).

Internal validity

As mentioned, financial statements from Proff Forvalt are used extensively in order to answer the second research question regarding the profitability of the publishing industry. In general, financial statements are meant for reporting purposes, so one can derive information about profitability from them. However, one should have in mind that the data is presented in a compressed way, with aggregated balance posts and income statements not presenting a very detailed structure. Internal reports made by the companies specifically to assess their profitability could be more useful but are naturally not public.

An in-depth analysis shows also that some of the companies are classified to a wrong industry or have missing data. Moreover, some companies are a part of a bigger publishing house and

their numbers are sometimes undervalued. In the analysis, we have tried to make provision for such cases. In other words, one should be cautious when using the data for the purpose of profitability analysis and consider the calculated measures as a proxy. Thus, we consider the internal validity of the data from Proff Forvalt to be moderate.

Secondly, the quantitative questionnaires which were sent to the interviewed publishers, are considered to have a high level of validity. That is due to the fact that the questions were formed specifically in order to answer our research question. Moreover, the questionnaires were filled out by publishers who have worked in their respective companies for several years, which further increases their accuracy.

Next, the information about the industry which was collected from different sources in order to conduct the competition analysis and to examine future changes in the industry, has moderate to high validity. Although the reports and articles used were not made specifically to answer our research questions, it was still possible to derive information about the competitive environment and potential future developments from them. The degree to which it was possible varied between sources, therefore we assess the internal validity to be moderate to high.

The qualitative data consists also of interviews conducted with three publishers. As mentioned, the interview guide was tailored to the research topic and the underlying theoretical framework. This secures that the collected data is relevant for answering the third research question. Moreover, the guide was developed in a way which made room for open, non-suggestive answers. Conducting the interviews over the phone, as opposed to written form, allowed the interviewees to present their answers easily and accurately. On the other hand, some interviewees could offer only limited time, thus there is a chance that the answers are more generalized. In all, we conclude that the internal validity of the interviews is at an acceptable level.

External validity

External validity relates to whether the study's findings can be generalized (Grønmo, 2004). When it comes to the quantitative part of this research, the main question is whether the chosen sample reflects the industry as a whole. The sample from Proff Forvalt consists of 76 companies and can therefore be a good representation of big to middle-sized publishers.

However, the results of the profitability analysis might be less transferable to smaller or locally focused publishers. Thus, the external validity can be seen as moderate.

As for the qualitative data about the industry, its level of competition and its future, the variety of reports and articles used mostly focused on the industry as a whole. Thus, the findings based on this data are applicable to the whole Norwegian publishing industry and present high external validity.

On the other hand, the qualitative data gathered through interviews comes from a much smaller sample. Thus, many of the experiences described by the interviewees are specifically related to the companies they work for. However, the fact that we tried to obtain perspectives from players of different size and profitability gives a broader perspective, allowing to generalize the results to some degree. Moreover, answers which come up repeatedly in the different interviews suggest that the interviewees' experiences are not unusual. Furthermore, the use of questionnaires allows to see the characteristics of the interviewed companies, and thus generalize their answers to similar companies. Therefore, the external validity of the findings based on the interviews can be seen as acceptable.

4. Competition analysis

The objective of this chapter is to examine the competitive environment of the publishing industry in Norway and thus answer the following research question:

What is the level of competition in the Norwegian publishing industry?

In order to make the reader more familiar with the publishing industry, this section starts with a brief introduction to what publishing companies do, and what their role is in the larger process of getting a book to the end customer. Next, the competitive forces and value creation potential of the industry are analyzed, to understand the level of competition between the publishing companies. This analysis builds on the theoretical frameworks of Porter, as well as Lien and Jacobsen. Insights about the competitive environment gained in this chapter lay the foundation for the following analysis of the profitability and its variations.

4.1 Industry description

4.1.1 Stages of publishing process

Publishing companies play a vital role in the process of getting books out in the market. Yet, for an outsider, it can be unclear what exactly is their job. Simplified, the publishing process can be summed up in several stages, namely (1) acquisition, (2) editing, (3) designing, (4) printing, (5) selling and (6) marketing, as presented in Figure 7.



Figure 7: Stages of publishing process, simplified

Firstly, in the acquisition stage, publishing companies decide which books to publish. The process includes acquisition editors, who present their picks, and representatives from departments such as sales and marketing, who provide inputs regarding the book's potential for commercial success (Swainson, n.d.).

When a book is acquired, the editing starts. Firstly, the editor suggests structural and narrative changes. When the text is finalized, it goes through copy editing, a process where all errors are removed, such as spelling or inconsistencies. In the meantime, the cover is being designed. When the design is completed, printing is ordered (Swainson, n.d.).

Meanwhile, the publishing company is also trying to sell the book to the retailers. This requires meetings and presentations and can be a lengthy process, as the retailers are often risk averse. It is usually unclear how many books the retailers are willing to take in before ordering printing, which increases risk for the publisher. Lastly, the marketing team works on the promotion of the book. If the retailers support the marketing efforts, it is easier to achieve the book's success (Blofeld, 2014).

4.1.2 Publishing in a broader perspective

Despite playing a crucial role in the book publication process, publishing companies are not responsible for every stage of getting the book to the end customers. We find it important to present the supply chain from start to finish, as it shows how publishing companies interact with other companies. This understanding is central for the following competitiveness analysis.

Firstly, the publishing company is contacted by an author's agent. If the book catches the publisher's attention and has market potential, the company acquires and publishes the book, as described above. During this process, the first external player comes in place – a printing company. Publishers tend to use the services of printing companies with whom they have worked before, as the process is much easier (Swainson, n.d.). Further on, the books are sent to distribution centers which are responsible for storing books and redistributing them further to the bookstores. Figure 8 shows a simplified version of the entire process.



Figure 8: Process of getting a book from the author to the end customer, simplified

Notably, there is a clear distinction between how the biggest publishers in Norway interact with the other players in this process, in comparison to the middle-sized players. In the following, these interactions are examined closer.

Vertical integration

In order to explain the difference, the term of vertical cooperation comes in use. According to Hjelmeng and Sjørgard (2014), vertical cooperation is cooperation between companies at different stages of the vertical chain. If the players decide to cooperate fully, they might choose to form a joint venture (Hjelmeng and Sjørgard, 2014).

The four biggest publishing companies in Norway are strong examples of cooperation in vertical chains, as they are owned by publishing groups which also own distribution centers, bookstores and book clubs. These publishing groups are Gyldendal ASA, Cappelen Damm Holding AS, H. Ascheoug & Co. AS and Vigmostad & Bjørke AS (Norwegian Publishers Association, 2019).

Notably, there is little vertical integration in the printing phase. It is not common for publishing groups to own their own printing companies. Rather, all publishing companies choose to outsource printing to low cost countries where the book is printed and then sent back (Lund, 2009).

After printing, books are sent to distribution centers. In Norway there are two main centers – Forlagssentralen owned together by Gyldendal ASA and H. Ascheoug & Co. AS, as well as Sentraldistribusjon owned by Cappelen Damm Holding AS (Norwegian Publishers Association, 2019). Naturally, such distribution centers are not used by the main players on their own. Many middle-sized players use the services of either of one of those distribution centers (Ibenholt, 2017).

Lastly, the books are distributed to the bookstores. Again, the big players benefit from the vertical integration, as they own their bookstores. Cappelen Damm Holding AS is an owner of the Tanum bookstore chain. Gyldendal ASA in turn, owns ARK. Their competitor Vigmostad & Bjørke AS owns Akademika, whereas H. Ascheoug & Co. AS owns Norli and a more local bookstore chain, Libris. In comparison, the middle-sized publishing companies, in most cases do not own their own stores (Norwegian Publishers Association, 2019).

Horizontal integration

Moreover, the four big players also display horizontal integration, i.e. they own several publishing companies. Gyldendal ASA, in addition to having a full ownership of its own publishing company Gyldendal Norsk Forlag, also owns 100% of Kunnskapsforlaget as well as 50% of Lydbokforlaget. Secondly, Cappelen Damm Holding AS owns Cappelen Damm, and the majority of Larsforlaget. The group H. Ascheoug & Co. AS owns four publishers, as well as 50% of already mentioned Lydbokforlaget. Lastly, Vigmostad & Bjørke AS is an owner of Vigmostad & Bjørke and a music publishing company (Norwegian Publishers Association, 2019). On the other hand, horizontal integration is less common among middle-sized players (Colbjørnsen, 2015).

4.2 Industry analysis

The following industry analysis will look at the competitive forces which are at work in the Norwegian publishing industry, using Porter's five forces framework. This allows to understand the value capture potential of the industry. Next, the value creation potential will be analyzed, using the profitability tree developed by Lien and Jacobsen. All in all, the industry analysis will thus examine the level of competitiveness between Norwegian publishers, answering the first research question.

4.2.1 Analysis of competitive forces

Threat of new entrants

New entrants have the potential to capture value which belongs to the existing players, and thus pose a threat to their profitability. Entrants can either be completely new publishing companies, or existing companies that diversify into the publishing industry. As mentioned in Chapter 2, the latter can be a substantial threat. Nonetheless, there are several entry barriers which can lessen the threat and they will be examined in the following.

Firstly, let us look at *economies of scale*. Thompson (referred in Slaatta and Rønning, 2012) points out that big publishers have better bargaining power, effective marketing and reduced risk due to their size. However, he notes that smaller publishers gain advantage from *economies of favors*, i.e. the fact that their size allows for tighter networks, better credibility

and reputation, as well as more relationship-based transactions (Thompson, referred in Slaatta and Rønning, 2012). Thus, one can argue that *economies of scale* do not pose a strong barrier for entry, as being small comes with its own advantages.

One can argue that *product differentiation* is not a strong barrier for entry, as any publisher can choose to publish books within any genre and thus attract customers who are interested in it. Similarly, *capital requirements* are low, as publishing is a labor-intensive business where key activities include reviewing manuscripts, editing, keeping contact with authors during the publishing process etc. (Ibenholt, 2017). *Switching costs* for the buyers are also rather irrelevant, as buyers such as bookstores typically obtain books from different publishers to secure a broad selection of books. Thus, buying books from a new publisher does not lead to *switching costs*.

However, if a bookstore is not interested in selling specific books *access to distribution channels* might pose a barrier to entry. Notably, the Book Agreement states that there should be no discrimination based on ownership, thus giving all publishers the same opportunities to sell their books to bookshops (Ibenholt, 2017). Therefore, *access to distribution channels* is in theory not a substantial entry barrier for newcomers.

On the other hand, *cost disadvantages independent of scale* might exist, for example if existing publishers have secured rights to publish books by popular authors. Lastly, there is few formal barriers to start a publishing company, so *government policy* hardly limits entry to the industry. All in all, one can conclude that the entry barriers are low and thus the threat of new entrants is considerable.

A notable example of a new entrant in the recent years is Strawberry Publishing, which has acquired several middle-sized publishers (Eckblad, 2019). Moreover, the company has secured several key people in the industry to work for them, meaning that they left the big established players (Enge, 2019). As authors often follow with their editors, it means that Strawberry Publishing has acquired best-selling authors (Enge, 2019). Although it is a unique example, it clearly illustrates that new entrants, especially those entering through acquisitions, pose a substantial threat to the industry.

Threat of substitute products or services

In order to analyze the threat of substitutes, one needs to define them first. Thus, one has to analyze what alternatives to books exist, i.e. what other products or services perform the same *function*. If good substitutes with relatively low prices exist, this will negatively affect the profitability of the industry.

The function of books (whether it is paper books, e-books or audiobooks) can be defined in many different ways. Yet, *learning* and *entertainment* appear to be the two main purposes to pick up a book. Therefore, one can argue that substitutes include a broad range of product and services that have the same two functions. It can be reading materials like newspapers, magazines, blogs and fanfiction or music and video content from players like Netflix, YouTube and Spotify. Moreover, TV, videogames, board games, concerts and cinemas can also be seen as substitutes to books.

According to the Norwegian Media Barometer, there has been a steady decline in daily newspaper and magazine consumption from 1991 to 2018. The use of TV and radio on everyday basis in this period is also decreasing. Everyday consumption of series, film and video was only 10% in 1991 and has increased steadily to as much as 37% in 2018. This number includes DVD and downloaded files, as well as streaming, yet SSB points out that in the last years streaming has increased, while the other forms have decreased (Statistisk sentralbyrå, 2019b).

Daily use of audio media has also increased, from 43% to 51% in the same period and is experiencing a somewhat similar trend to the video-based content. There has namely been a decline in the use of CDs and an increase in use of mobile phones due to the availability of streaming services. When it comes to digital games, 35% played them daily in 2018. Moreover, visits to cinemas have also steadily increased, as the number of people who have been to a cinema in the past 12 months was 52% in 1992 and 76% in 2018 (Statistisk sentralbyrå, 2019b).

Based on this data, streaming services for video-based content and music, video games and cinemas stand out as the strongest substitutes of books in the Norwegian market, as they are on the rise. Moreover, one can argue that the price/performance ratio of these substitutes is lower, i.e. more desirable. For example, Netflix offers a basic subscription for 89 NOK per

month, which allows for *unlimited* access to a movie and series library, while *one* printed book in a book shop is rarely under 100 NOK. Therefore, the threat from substitutes like Netflix can be seen as substantial. In other words, the development in streaming services might lead to lower sales of books in bookshops, which in turn can make the booksellers order less from publishers, driving the profitability of the industry down.

Bargaining power of suppliers

In order to deliver the final product, publishing companies need to cooperate with suppliers. As presented in Figure 8, the two main suppliers are printing companies, as well as distribution centers. In the following we will discuss the bargaining power of these two players using Porter's framework.

To begin with, let us take a closer look at printing companies. At first, one might come to a conclusion that printing companies have high bargaining power, mainly due to the fact that publishers are fully dependent on having the books printed. However, it is important to assess the criteria determining the power of suppliers. The first aspect is related to the fact that a printing company produces a standardized product. Thus, one can argue that printing quality is similar between suppliers. It is for instance a standard in the printing industry to offer FSC-certified paper, which is an environmentally friendly alternative (FSC, n.d.). This points to lower bargaining power of the printing companies.

The second aspect is related to the fact that there are many players in the market, especially outside of the country. Due to wide selection of printing companies, as well as lower costs outside of Norway, Norwegian publishers often choose international alternatives. Most of the Norwegian books are printed in Baltic countries, other Scandinavian countries, as well as in central Europe (Vollan, 2015). In total, the above-mentioned arguments speak for the fact that the printing companies do not have high bargaining power.

The second supplier group consists of distribution centers. As mentioned in the introductory part of Chapter 4, there are two main distribution centers related to the logistics of books in Norway – Forlagssentralen and Sentraldistribusjon. The logistics systems build on effective IT-systems, allowing efficient storage and further distribution of the books to the bookstores (Norwegian Publishers Association, 2019).

Due to the limited number of suppliers of such systems, the publishers have low incentives of changing the supplier. The small and middle-sized players are fully dependent on the solutions offered by either of those two players, which in turn implies very high bargaining power of the logistics supplier. That is the case for majority of the publishing companies. The biggest players go a step further in order to minimize their dependency and choose to operate in logistics centers owned by them.

Bargaining power of buyers

The topic of bargaining power of buyers is not in any way a straightforward matter. In order to introduce it, it is first necessary to define roles and present the players in the market.

The buyer in this case is most often a bookstore – either being a part of a chain or operating independently. Ibenholt (2017) states that there are as much as 600 bookstores in Norway and the majority of them is a part of a chain. The chains in turn are in most cases owned by the big publishing groups in Norway. Notably, the great majority of bookstores are a part of the Norwegian Booksellers Association (Ibenholt, 2017).

On the other side of the transactions are publishing companies. Many are members of the Norwegian Publishers Association. In fact, 80% of the total revenue in the publishing industry comes from the members (Norwegian Publishers Association, 2015).

Since both the Norwegian Booksellers Association and the Norwegian Publishers Association join the majority of players in their respective industries, it is reasonable to state that they provide a good indication for the situation in the market. Hence, the analysis of the bargaining power of buyers will be conducted on this basis.

Over many years, the buyers have had a strong position in the market. This applies especially to the biggest bookstore chains. The book prices, although negotiated confidentially between the publishers and bookstores, have always included the so-called “bookstore discount”. This discount is considerably bigger for chains. For instance, Norli Libris required as much as 74% discount from the publisher to put the book on the bookstore shelves (Gjærde, 2012). This example, although a few years old, clearly illustrates the high bargaining power of buyers. As Porter states, the buyer is more powerful when the purchased volume is big. In this case, a bookstore chain stands in a very privileged position as they open up the entire market to the

publisher. In contrast, independent bookstores suffer from lower discounts (Gjærde, 2012), which illustrates their lower bargaining power. However, the Norwegian Publishers Associations tries to strengthen the publishers' position, for instance by organizing meetings between small publishers and bookstore chains twice a year (Brevik, 2019).

There are also arguments supporting lower bargaining power of buyers. Each book, for instance, is not a standard product but rather a differentiated one. This speaks up for a lower bargaining power of the buyer as he might wish to have this very product on the shelves. The more popular the book is the more important it is for the quality of the service offered by the bookstore. That argument again speaks up for lower bargaining power of the buyer. However, in reality those aspects have less backup, resulting in high bargaining power of buyers.

It is also important to note that the Book Agreement only regulates the price towards the end consumer, while the discount sizes between publishers and bookstores are not regulated (Gjærde, 2012). Therefore, the law does not help small bookstores to obtain higher bargaining power. Hence, only the big bookstore chains have high bargaining power when buying books from publishers.

Rivalry among existing firms

Rivalry among existing firms is a complex issue depending on several factors. Firstly, the number of players is important. Although there are many publishers in Norway, there is also a clear dominance of the four biggest publishers, imposing more discipline in the industry.

Industry growth is another aspect influencing the internal rivalry. As established earlier, the substitutes pose a substantial threat as their consumption is increasing while they also have a better price/quality ratio when compared with books. Therefore, one can argue that the growth in the publishing industry is rather slow. In fact, according to the annual industry report provided by the Norwegian Publishers Association (2019) the total book market fell by 6.3% from 2017 to 2018. This results in a higher competition between publishers, as results are driven by stealing market shares from the other players, as opposed to expanding due to the general industry growth. The lack of switching costs, described earlier, also leads to increased rivalry.

On the other hand, as customers are not indifferent between different books, but rather have strong preferences for specific authors or genres, one can argue that the industry is characterized by a high level of differentiation. This speaks for a reduction in the competition.

Another aspect to consider is exit barriers, which can keep companies competing. As mentioned, publishing industry is mostly labor-intensive, which means that specialized assets do not pose a high exit barrier. Moreover, there are not any government-imposed restrictions related to exiting the industry. For small players, strategic interrelationships are also unlikely to exist, and thus there is no strategic importance in them operating. The latter is opposite for the big publishing companies which are the core of their vertical value chains. Whether any emotional barriers exist, such as loyalty to the employees, is more individual and thus harder to assess. In all, however, the exit barriers are somewhat low, which can reduce the rivalry.

All in all, one can see that there are forces driving the competition among existing players both up and down. However, even with the decline in the industry, the existence of a few dominating players, differentiation and low exit barriers point toward moderate to low rivalry.

4.2.2 Analysis of value creation

Having looked at the competition in the Norwegian publishing industry, it is now time to analyze its value creation. This section closely examines value creation per unit and the number of units.

Value creation per unit

Maximum price customers are willing to pay

Value creation per unit is influenced by two factors, the first of which is the maximum price customers are willing to pay. As described in Chapter 2, this price can increase due to a worsening of substitutes, an improvement in complimentary products or as a result of income growth (Lien and Jacobsen, 2015).

The steadily increasing consumption of several substitutes among Norwegians has already been discussed. This situation can imply a change in customer preferences or an improvement in the price/quality ratio of substitutes, which in turn decreases the maximum price customers are willing to pay for books, driving the value creation down. When it comes to complementarity, books appear as products that stand well on their own. It is therefore difficult

to identify any *close* complimentary products. As for potential *distant* complimentary products, they are unlikely to influence the maximum price customers are willing to pay.

Another important aspect which can affect the price which customers are willing to pay is the development related to digitalization. The availability of e-books, which do not require printing and distribution, can change the customers' expectations of price. Moreover, with subscriptions taking over the pay-per-product model in music and movies, the customers may soon regard paying for each book an unnecessary expense. Such development has the potential to reduce the maximum price customers are willing to pay for books.

Lastly, it is important to look at the income growth. For the whole country, the median of household income after tax has been increasing in the recent years, based on statistics from Statistisk sentralbyrå (n.d.). Such a general improvement in household income can potentially lead to a willingness to pay more for books, driving the value creation up.

Minimum price suppliers are willing to sell for

The next aspect is related to the minimum price suppliers are willing to sell their product or service for. As presented in Chapter 4.1.2, the two most important suppliers in this case are printing companies as well as distribution centers. In the following their ability to set prices for the offered service is discussed.

According to Lien et al. (2016), the price suppliers are willing to sell their product or service for is adjusted if suppliers face other opportunities outside of the market of our interest. The printing companies are a perfect example here, since they are not only offering book printing, but also a variety of other services – printing banners, product labels, flyers or physical catalogues. Thus, they can easily focus on the other services.

The latter example, catalogues, has been newly declared by Harvard Business Review to make a comeback after years of digital product marketing. HBR has cooperated with a premium watch brand in order to assess if catalogues increase sales. Results from an A/B testing proved that high-quality printed catalogues are able to both raise sales and vividness of a product. This particular example sets a way for other retailers (Zhang, 2020). In our case it implies that printing companies may find a lucrative opportunity in focusing on the emerging field of physical marketing. How lucrative it will become remains unclear, but if the potential is big

enough, it may lead to higher printing prices towards book publishers. On the other hand, given the high degree of competition between printing companies, new opportunities may also simply lessen this competition, without influencing the prices of the printing services offered to publishers.

The other suppliers are logistics centers. Those in turn, stand in a less favorable position in comparison to the printing companies. As already mentioned, there are only two logistics centers which focus solely on the book distribution – Sentraldistribusjon and Forlagsentralen. Such centers operate with sophisticated IT-systems as well as have a storage and logistics system specifically designed for books. Hence, it is difficult to think of other use of such centers. That means that this group of suppliers does not have opportunities outside of the book distribution services. Hence, in accordance with Lien et al. (2016), the suppliers' minimum price of the offered service is unlikely to change in this case.

All in all, a clear picture of the development in value creation per unit is difficult to obtain. While the rise in the substitutes and digitalization can reduce the *maximum price customers are willing to pay* for books, the steady income growth acts in the opposite direction. When it comes to the *minimum price suppliers are willing to sell for*, the printing companies may be facing new lucrative opportunities outside of the publishing market, driving their minimum price up. The same is not the case for the distribution centers who solely rely on publishing companies as their only customers.

Number of units

Value creation can also be affected by the number of books sold in the market. As Lien et al. (2016) point out, it could both be an effect of a changed number of customers in the market or number of units each customer acquires.

It is difficult to determine the development in the number of customers. On one hand, the substitutes are on the rise, which can threaten the number of people buying books, yet on the other hand there is a stable population growth (Statistisk sentralbyrå, 2020) which can contribute to a growth in the customer numbers. Thus, the changes in number of customers are unclear.

The potentially less ambiguous aspect when it comes to value creation is the number of units each customer acquires. The latest reading survey published by the Norwegian Bookstore Association (2018) state that Norwegians bought on average 10.2 books in 2017, excluding textbooks. The number has increased from 9.4 in 2016. One can look deeper into the topic, by analyzing forces affecting the size of the market, namely digitalization, globalization and deregulation.

Firstly, digitalization gives customers a broader range of formats. According to the Norwegian Bookstore Association (2018), almost 16% of Norwegians read at least one e-book in 2018. The survey shows that this number has been steadily increasing throughout the years, ranging at 14.5% in 2016. When it comes to books in foreign languages, the number remained constant. However, when comparing to the traditional formats – the survey shows that between 2015 and 2017 the share of digital formats increased, leading to a lower share of physical books. Moreover, Norwegians borrowed 1.3 less books from libraries in 2017 (Norwegian Bookstore Association, 2018). The choice of digital books could be dictated by unlimited availability of titles, which can now be supplied in a blink of an eye. Thus, we observe that digitalization changes customer preferences – from traditional books towards e-books and audiobooks. The shift to more digital formats in itself does not necessarily affect the number of units, but as there is an increase in the number of books bought, one can argue that digital formats draw new customers to the market.

Looking at globalization, the situation no longer looks so bright for the Norwegian publishers. Globalization works in two directions – it gives more possibilities to scale up the offer, but it also brings into the market several rivals, which were previously kept outside. The latter is the case here. Due to globalization, international players like Amazon can now serve some of the needs of Norwegian customers. With their extended offer – including subscription services, e-readers or their own publishing company – Amazon threatens the national players in many ways. However, looking at the aspect of value creation, it is important to notice that such a comprehensive offer might attract new customers to the market. Also, the availability of books is greater. One can just mention specialized books, which most likely would have never been translated into Norwegian. Therefore, all in all, one can argue that globalization contributes towards greater value creation in the Norwegian market.

When it comes to deregulation, there are no specific changes related to this aspect and thus it will not be discussed.

All in all, the number of units is growing, contributing to a higher value creation in the market. For one, according to the survey from the Norwegian Bookstore Association (2018), Norwegians buy more books on average. Moreover, the availability of digital formats and a wider offer thanks to globalization likely draw new customers to the market.

4.3 Conclusion of competition analysis

This chapter examined the competitive environment of the publishing industry in Norway in order to answer the first research question, namely:

What is the level of competition in the Norwegian publishing industry?

The analysis of competitive forces based on Porter's framework revealed few barriers of entry, leading to a considerable threat of new entrants. Notably, the existence of big publishers has the potential to discourage new players from entering, but as new entrants can benefit from *economies of favor*, the discouragement might not be as strong. Therefore, a moderate to high threat of new entrants exists and it can drive the profitability of the industry down.

Furthermore, several substitutes are on the rise, posing a substantial threat to the publishing industry. The analysis showed that the threat from streaming services like Netflix and Spotify, video games and cinemas is the strongest. When it comes to the bargaining power of suppliers, it can be generally denoted as moderate, with printing companies having rather low bargaining power, mostly due to them providing a standardized product, and distribution centers having higher bargaining power, as the publishers do not have many alternative providers of this service to choose from.

The bargaining power of buyers is twofold. On one hand, small and independent bookstores have a weak position opposite publishers. On the other hand, the big bookstore chains have high bargaining power, as they stand for high sales volumes and bring the books to customers all over the country. Their clear dominance presses the profitability of the publishers down.

The aspect of rivalry between existing firms is complex. The lack of growth and switching costs are aspects that speak for increases in said competition. Yet, the existence of four big players who impose some degree of discipline, as well as low exit barriers, act in the opposite direction. Thus, the internal rivalry can be viewed as moderate.

All in all, the five forces point towards a rather high level of competition in the Norwegian publishing industry. With the threat of new entrants, and substitutes gaining strength, one can argue that the industry will move towards higher competition in the future.

Notably, the value creation development is unclear. Although the number of units is increasing, notably due to globalization and digitalization, the value creation per unit can be driven up by steady income growth, and down by the substitutes, new formats and payment models, as well as new opportunities for printing companies. Therefore, it is difficult to assess how value creation will affect the competitiveness in the industry.

5. Profitability analysis

This chapter aims at examining the current profitability of the Norwegian publishing companies, specifically of the established publishers operating at the nation-wide level. Therefore, it takes the point of departure in the sample of 76 publishers and their financial data from 2016-2018 obtained through Proff Forvalt. As such, this chapter will answer the second research question, namely:

What is the profitability of the Norwegian publishing industry?

In order to provide a first impression of the profitability situation in the industry, this section starts with a graphical depiction of the size and operating profit of the companies included in the sample. Next, a common size analysis is conducted in order to see how the different cost items vary across companies, before analyzing financial ratios, namely operating margin and return on assets, in more detail. Lastly, a multiple regression is conducted in order to examine potential explanatory variables for profitability.

5.1 Income statement

5.1.1 Overview over the industry

In order to gain an understanding of the profitability situation in the industry, this section provides a closer look at the sample. As described in Chapter 3, this study aims at examining the established players aiming at the national markets, as opposed to publishers who have just started out or publishers focusing on local publications. Therefore, the sample only includes companies with a revenue higher than 1 MNOK.

Figure 9 shows size, measured in average revenue in 2016-2018, in relation to profitability, measured in average operating profit (EBIT) in 2016-2018. Notably, the figure includes 72 observations. The four biggest players were excluded, as their size would affect the readability of the graph. Instead, their average revenue and profitability are presented in Table 5.

Figure 9 clearly shows a concentration along the horizontal axis, especially in the lower size range. Most of the publishers in the sample have a revenue under 20 MNOK. In general, the

operating profit is very unlikely to reach 5 MNOK, and the vast majority of the observations is concentrated around the break-even point, whether slightly above or below it. This is in line with the conclusions in Chapter 4, which showed a high degree of competition in the industry.

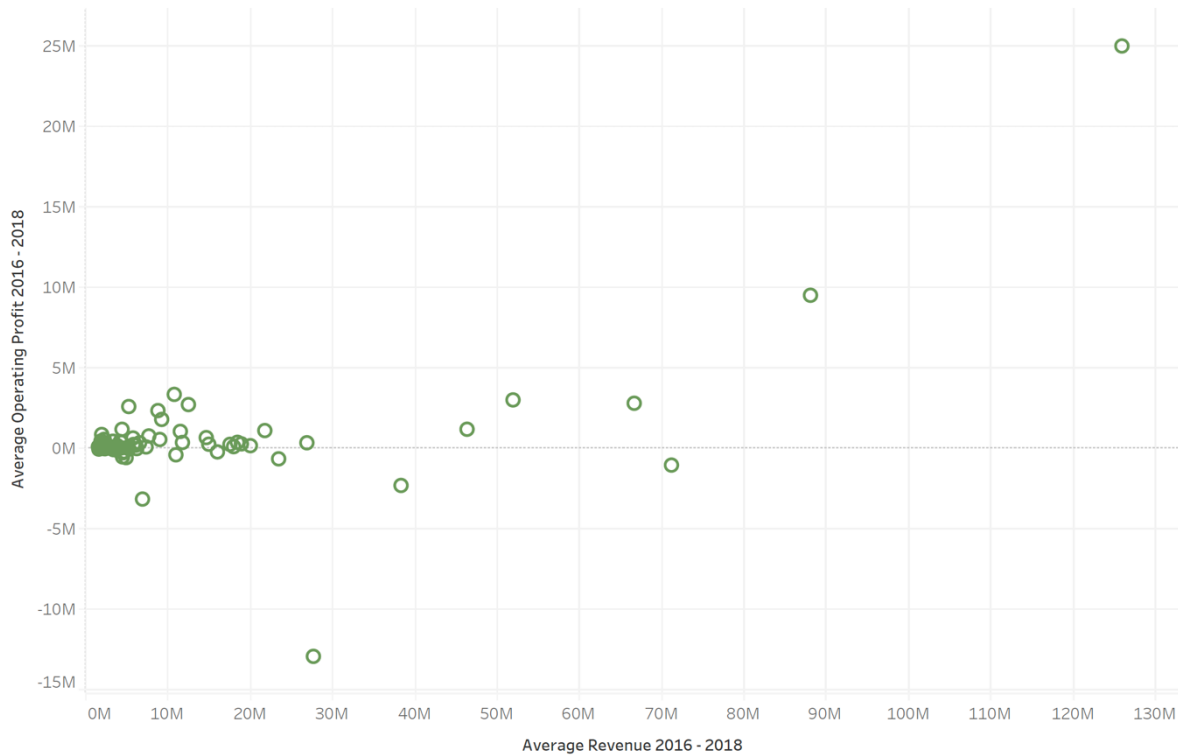


Figure 9: Overview over size and profitability of the players in the sample, excluding the four biggest publishers

| Publisher | Average revenue 2016-2018 | Average operating profit 2016-2018 |
|-------------------------------|---------------------------|------------------------------------|
| Cappelen Damm AS | 1 427 MNOK | 16 MNOK |
| Gyldendal Norsk Forlag AS | 719 MNOK | 80 MNOK |
| H Aschehoug & Co W Nygaard AS | 572 MNOK | - 8 MNOK |
| Vigmostad & Bjørke AS | 477 MNOK | 33 MNOK |

Table 5: Size and profitability of the four biggest Norwegian publishing companies

5.1.2 Common size analysis

In order to understand the cost structure of the studied companies, we conduct a common size analysis. Common size analysis allows to see costs as percentage of revenue, as opposed to

absolute numbers. This is valuable as the sampled companies vary in size substantially, so analyzing relative differences gives better insight. The analysis is based on averaged numbers from the income statements between 2016-2018. Financial results were excluded, as they are not the core of the business.

Table 6 shows the results of the common size analysis. For each cost item, the minimum, average, median and maximum percentage among the companies was found. Thus, there is no additivity when looking at the values vertically, as would be the case if the analysis was conducted for one company only.

Notably, there were several instances of missing data in the income statements obtained through Proff Forvalt and those were excluded from the analysis. However, the fact that this occurred can provide an important indication as to the quality of the data, which one should have in mind when interpreting the results of the analysis.

| | Minimum | Average | Median | Maximum |
|--------------------------|----------------|----------------|---------------|----------------|
| Sum of revenue | 100 % | 100 % | 100 % | 100 % |
| COGS | 11 % | 44 % | 43 % | 84 % |
| Salaries | 4 % | 27 % | 27 % | 62 % |
| Depreciation | 0 % | 1 % | 0 % | 21 % |
| Other operating expenses | 4 % | 25 % | 24 % | 58 % |
| Sum of operating profit | - 47 % | 4 % | 2% | 49% |

Table 6: Common size analysis

The revenue is mainly obtained through sale of books. Additional revenue can come from support schemes such as state aid, selling book rights to foreign publishers, or subscriptions for those publishers who run book clubs.

Cost of goods sold (COGS) include printing and distribution expenses. If other services, e.g. design or proofreading are outsourced, they can also be included here. Table 6 shows that COGS is an important part of the total operating costs, averaging at 44% of the revenue. There are substantial differences between publishers, with the minimum equaling to only 11% and the maximum being as much as 84%. One can find several explanations as to why this occurs.

Producing large volumes, outsourcing the production to low-cost countries and having in-house designers could contribute to lowering COGS. The latter example would however increase the salaries.

The situation is similar when it comes to salaries, though on average they eat up a smaller part of the revenue, namely 27%. Yet, one observes big differences again, with as little as 4% and as much as 62%. Low values can indicate companies which employ only a few editors and outsource all other services. It can also happen that salaries are low relative to revenues when already published books sell well over a long period of time, unrelated to the current work of the editors, making the revenue high relative to salaries. This can be the case with textbooks or bestselling novels. On the other hand, high values can indicate more in-house employees or low sales. When it comes to high number of employees it is also important to remember that salaries often drive other costs, e.g. PCs, travel and recruitment costs (Bjørnenak, 2019).

Depreciation of fixed assets is close to zero in most cases. In fact, the maximum observation of 21% is extreme, as the second and third highest observations equal to only 9% and 4%, respectively. This is in line with the fact that the publishing industry is strongly labor-intensive, as the main tasks involve editing, proofreading, design, sales and marketing. As Publisher A (2020) confirmed, it is unusual for publishing companies not to outsource printing, storage and distribution, which are more capital-intensive. The companies with higher depreciation values likely own, rather than rent or lease, their offices and employees' equipment. Extremely high values might suggest that a company also stand for their own storage and distribution, though this is rather untypical.

When it comes to other operating expenses, they eat up 25% of the revenue on average. However, the percentage ranges from 4% to 58%. Such values make this cost item as important as salaries when it comes to its effect on the operating profit. Other operating expenses can for instance include rent and maintenance of the offices. However, it is important to keep in mind that companies may differ in the way they classify cost items.

All in all, operating profit varies hugely, ranging from -47% to 49%. The average is 4%, but it is somewhat influenced by the extreme observations, as the median shows 2%. This indicates that most companies obtain an operating profit a bit above the break-even point, as could be seen from Figure 9. The analysis shows that COGS has the biggest effect on the bottom-line,

followed by salaries and other operating expenses, while depreciation is not very relevant. Thus, strong positive results are obtained by companies who manage to keep these three cost items low relative to revenues.

5.1.3 Revenue

Lorenz curve presented in Figure 10 shows the distribution of the accumulated revenue in the sample. The x-axis presents the 76 companies, whereas the y-axis shows the share of accumulated revenue. The light green diagonal shows a hypothetical case in which each of the companies notes the same accumulated revenue in the period of 2016-2018. The dark green line presents the share of accumulated profit in the sample.

The companies with the lowest revenue are placed on the left side of the graph, whereas the ones with the highest revenue are found on the right side. One notices that around 40 companies make up less than 5% of the accumulated revenue in the sample. Hence the majority of the players are small to middle-sized players. Looking further, 72 companies make up only 20% of the accumulated revenue. Hence there are the four biggest players who make up 80% of the accumulated revenue.

Summed up, the sizable area between the diagonal line and the Lorenz curve clearly shows that there are considerable revenue differences in this sample, mainly due to the existence of the big players.

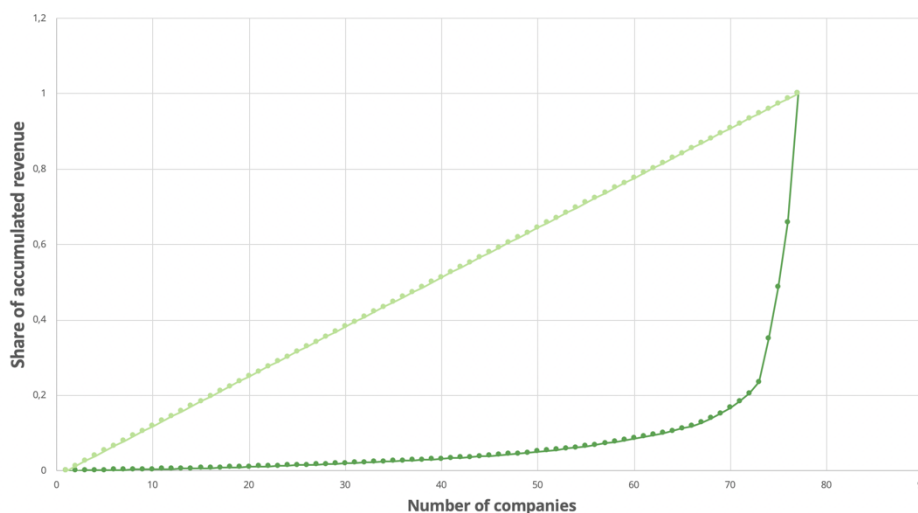


Figure 10: Lorenz curve showing accumulated revenue for the sample

5.1.4 Operating profit

Furthermore, it is of interest to assess the relative profitability of the companies in the sample. For that reason, we have created a Stobachoff curve, as presented in Figure 11. The accumulated revenue is pictured on the x-axis, whereas the accumulated operating profit on the y-axis. Note that the operating margin, which shows the level of profitability is a function of operating profit divided by the revenue.

The light green diagonal presents then a hypothetical case in which all the companies in the sample note the same profitability level. The dark green line shows the deviation from this case. Players in the sample are arranged by ascending operating margin. Hence, on the left side of the graph we note the most profitable players, and the curve is steep. Note that the curve is growing up to the point where the accumulated revenue equals 80%. The following 20% of the accumulated revenue is then negative, indicating that 20% of the companies in the sample have negative operating profit. Again, the sizable area between the diagonal and the Stobachoff curve indicate substantial differences in relative profitability between players.

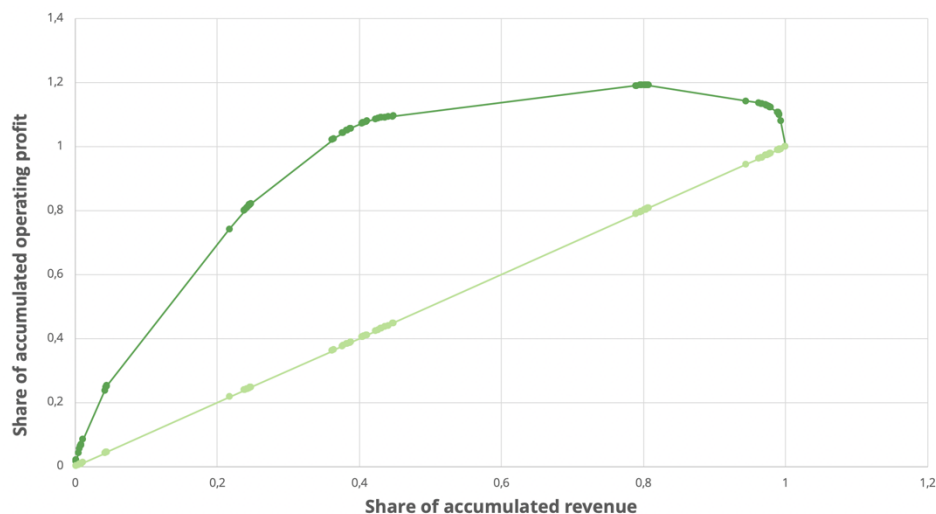


Figure 11: Stobachoff curve showing accumulated operating profit for the sample

5.2 Financial ratios

There are many financial ratios that can be used in order to assess the performance and condition of companies. Standard profitability ratios include operating margin, return on assets (ROA), return on capital employed (ROCE) and more. Due to the fact that only aggregated

financial data about the publishing industry is available through Proff Forvalt, it is not possible to calculate and analyze ROCE. Thus, in the following, we will look at the first two.

5.2.1 Operating margin

Operating margin is a useful measure, as it allows to see how much a company earns per krone of revenue after all operating expenses are subtracted.

$$\text{Operating margin} = \frac{\text{Operating profit}}{\text{Revenue}}$$

When comparing across the industry, possible downsides include the fact that companies may use different methods for calculating depreciation, and that some might classify financial or special items as operating items. The former should however not be a substantial issue, as the industry is labor-intensive, and the common size analysis showed low depreciation costs. The latter should be kept in mind when reviewing the results.

Figure 12 shows operating margin in each year in the 2016-2018 period. As extreme observations would affect the readability of the graph, only 1st and 3rd quartiles were included, while the maximum and minimum values are included in Table 7. For the same reason, both the median and average were included.

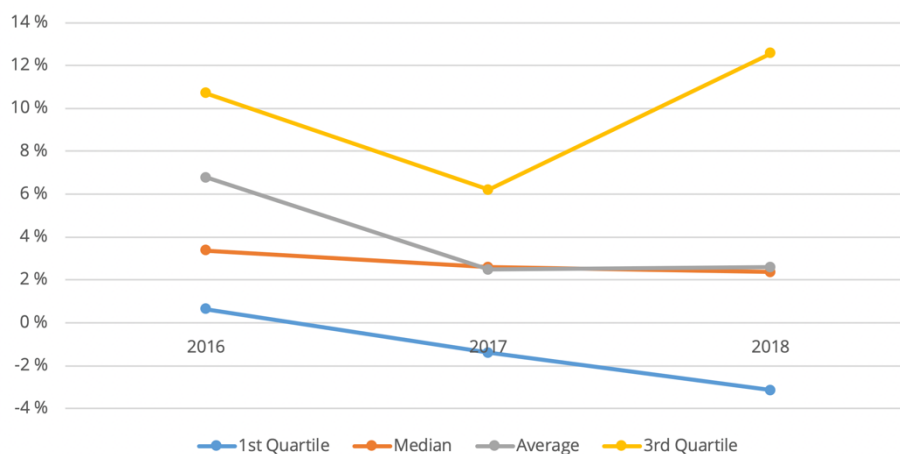


Figure 12: Operating margin in 2016-2018

| | 2016 | 2017 | 2018 |
|--------------|-------------|-------------|-------------|
| Minimum | - 14.6 % | - 60.6 % | - 127.3 % |
| 1st Quartile | 0.6 % | - 1.4 % | - 3.1 % |
| Median | 3.4 % | 2.6 % | 2.4 % |
| Average | 6.8 % | 2.5 % | 2.6 % |
| 3rd Quartile | 10.7 % | 6.2 % | 12.6 % |
| Maximum | 49.2 % | 51.6 % | 57.1 % |

Table 7: Operating margin in 2016-2018

Studying the results reveals a median of around 2-3%, with a downward trend. Moreover, the value of the 1st quartile is also decreasing. Such low margins point to the tough situation in the industry, proving the results of the competitive environment analysis conducted in Chapter 4.

The 3rd quartile fluctuates, not showing a clear trend, but it can be up to 10 percentage points higher than the median. The quartiles, as well as the extreme maximum and minimum values show strong profitability variations between players. There are players such as Spektrum Forlag AS which obtained a margin as low as -127% and whose bad situation has repeatedly been reported by Bok365, a website focusing on the Norwegian book industry (Rogne, 2018; Neraal, 2018). Write-downs of the inventory and goodwill contributed strongly to the negative results (Neraal, 2018) and the company was liquidated in 2019 (Neraal, 2019). On the other hand, there are also players with operating margins as high as 57%, namely Abstrakt Forlag AS which focuses on academic publications. Possible reasons for such strong profitability variations will be analyzed in detail in Chapter 6.

5.2.2 Return on assets

There are several financial ratios one can use in order to assess the return on capital, for instance return on capital employed (ROCE), return on total assets (ROTA), return on equity (ROE) and return on assets (ROA). As it is impossible to calculate ROCE from the available data, the existing alternatives are ROTA, ROE and ROA. They are calculated as follows:

$$ROTA = \frac{EBIT}{Total\ Assets} \qquad ROE = \frac{Net\ income}{Equity} \qquad ROA = \frac{Net\ income}{Total\ Assets}$$

According to Bragelien (2019), ROTA gives little insight, as the numerator and denominator are not coherent. More precisely, EBIT is generated by the company's operations, whereas total assets include both operational and financial posts.

In contrast, ROE which shows how much income a company makes from the invested equity, does not present such incoherence. However, return in equity has other downsides. As Kinserdal (2020) states, the company's balance sheet consists of assets and liabilities measured using several methods – only to mention historical cost or fair value. That itself implies that the size of equity, which is a residual post, is defined by the way one measures assets and liabilities. Therefore, the size of equity found in the balance is quite arbitrary, making ROE meaningless.

When compared to ROTA and ROE, ROA gives a more meaningful picture. While it is still true that several methods can be used in the balance sheet, the value of total assets is not a residual. Moreover, ROA does not present the incoherence between the numerator and denominator that characterizes ROTA. Therefore, it will be used for further analysis.

However, one should still keep in mind that ROA is not without limitations. To understand a company's performance, it is beneficial to look only at the operations instead of considering both operating and non-operating results (Koller, Goedhart, Wessels, 2015). This suggest that ratios like ROIC or ROCE would be more useful. However, as mentioned the collected data does not allow for calculating ROIC or ROCE, which is why we settled on examining ROA in this chapter.

The results presented in Figure 13 reveal a decreasing median, which went from 4.4% down to 1.7% in as little as three years. Again, this illustrates that the situation becomes tougher and

tougher for the publishing companies. The 1st quartile presents a similar decreasing trend, falling by 3 percentage points in the mentioned time period. The 3rd quartile shows more fluctuation.

In addition, Table 8 shows the maximum and minimum values. Again, one can observe strong variations between players. Extremely low minimum values, such as -213% come from big losses incurred by the company. On the other side of the scale, the highest ROA equals to 64% . This result is obtained by Filiokus Media, a publisher specializing in books for memory keeping, such as baby journals.

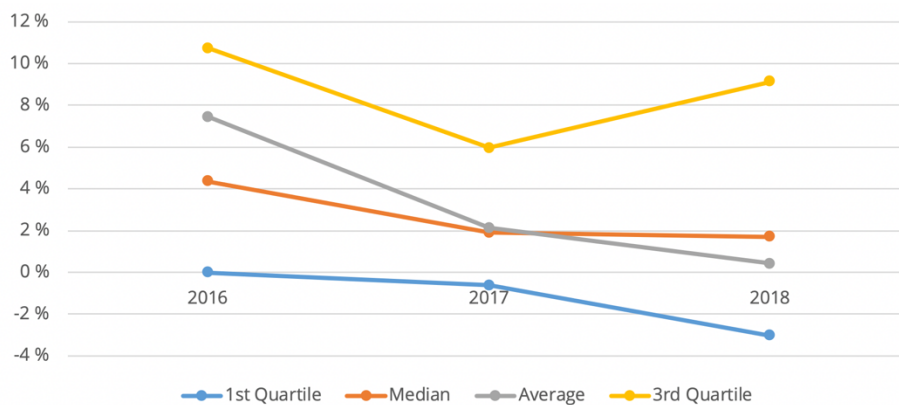


Figure 13: Return on Assets in 2016-2018

| | 2016 | 2017 | 2018 |
|--------------|-------------|-------------|-------------|
| Minimum | - 18.1 % | - 76.3 % | - 213.2 % |
| 1st Quartile | 0.0 % | - 0.6 % | - 3.0 % |
| Median | 4.4 % | 1.9 % | 1.7 % |
| Average | 7.4 % | 2.1 % | 0.4 % |
| 3rd Quartile | 10.7 % | 6.0 % | 9.1 % |
| Maximum | 64.3 % | 37.8 % | 59.1 % |

Table 8: Return on Assets in 2016-2018

5.3 Multiple regression

So far, we have examined the profitability of the publishing industry based on the data sample in a descriptive manner. However, the sample also provides an opportunity to explore potential relationships between profitability and specific characteristics of the firms. Therefore, a multiple regression is conducted in the following part. It examines whether size, experience, complexity in the book offer and inventory size display a linear relationship with profitability.

The dependent variable, namely profitability, is measured using average operating margin between 2016-2018. The choice of independent variables is based on the cost driver framework and the competition analysis conducted in Chapter 4, as well as the availability of relevant data. It is explained in more detail below, before multicollinearity is examined and results are presented. Notably, Chapter 6 will look further into those and other factors which can explain profitability variations.

5.3.1 Independent variables

Size (measured in average revenue)

In the cost driver framework presented in Chapter 2, economies of scale are identified as an important cost driver. Moreover, the competition analysis revealed the existence of economies of scale in the Norwegian publishing industry, especially among the four biggest players, although they were defined more broadly than what Porter (1985) considers as economies of scale. As economies of scale are related to the size of the companies, we find it suitable to examine whether a relationship between profitability and size exists.

Size can be measured by revenue. We chose to use average revenue between 2016-2018, in order to match the profitability measure. However, due to the substantial variations between players, using absolute numbers would not be advantageous. Therefore, we chose to group the companies into clusters, i.e. classify them into separate groups based on similarity in average revenue. Using Microsoft Azure Machine Learning Tool with K-means clustering, we allowed the software to choose the most optimal number of clusters itself.

As a result, the companies were clustered into five groups. The majority of the records, namely 66 companies, were classified into one cluster, hereafter referred to as companies with *small*

revenue. Further on, 6 companies were classified into another cluster, which can be described as *medium* companies. The leading four companies show bigger differences, both between themselves and in relation to the remaining observations. Hence, the tool classified those into three separate groups. Being a clear leader on the market, Cappelen Damm was classified as the only record in its cluster. It was followed by Gyldendal, which also represented a separate cluster. Lastly, Aschehoug & Co and Vigmostad & Bjørke were grouped together. Those three clusters were named *extreme*, *huge* and *big*, respectively.

Experience (measured in years of operation)

Another independent variable which was selected for the regression was experience. According to the cost driver framework, experience can be important as learning often contributes towards greater efficiency, thus reducing costs. As foundation date was included in the data from Proff Forvalt, we decided to use it to calculate years of operations. We believe that the latter reflects experience to some degree and can therefore be used as an independent variable.

To clarify, the foundation date signifies when a company was founded, in contrast to registration date which shows when a company was registered in Brønnøysund Register Centre (Proff Forvalt, 2020). We use the former as it is more likely to reflect experience correctly. The latter could be misleading, because changes in company structure would result in a new registration date, while the actual experience would date further back.

Complexity (measured by genre range)

According to the cost driver theory, complexity refers to how wide a line of products is. With higher product complexity, it is more likely that costs related to coordination will emerge. In case of publishing companies, one can look at the range of genres offered to customers in order to assess the complexity. Coordination costs related to publishing many genres can be related to the complexity of managing more varied book projects, and of marketing and selling to more diverse customer groups. Moreover, one can argue that it is harder to build a solid reputation when publishing many different genres, than when specializing in one.

As data on the range of genres was not readily available from Proff Forvalt, we decided to go through the websites of the sampled publishers and categorize the selection of their books as

either *wide* or *narrow*. The classification was based on the “About us” sections on the websites, where the companies described which types of books they publish.

Publishing companies which covered a wide range of different genres were naturally classified as *wide*. On the other hand, publishers with one type of literature or several closely related genres were classified as *narrow*. With such specialized publishers, we found it fruitless to distinguish between specific genres, such as *children books*, *art* or *crime*, as there were few observations of each. Only publishers of academic literature represented a bigger group, so that we decided to separate them from the general *narrow* category. Thus, we ended up with three categories, *wide*, *narrow* and *academic*.

Note that there were no publishers with both a narrow selection of genres and academic publications. However, there was a handful of observations, notably the four biggest players, which published both academic literature and a wide range of other genres. These publishers were still categorized as *wide*.

We decided against creating a *mixed* category for them, as the number of such observations was small. Moreover, the variable’s objective is to reflect the complexity of managing varied book projects. Thus, the role of the *wide* category is to indicate publishers facing a higher degree of complexity than publishers with *narrow* and *academic* selections. As the collected data does not allow to analyze the degree of such complexity, the goal is not to differentiate between the companies within *wide*. Similarly, *narrow* and *academic* selections only indicate levels of complexity that are distinctly different from each other and from *wide*.

As it cannot be said that publishers of wide selections manage a less complex set of projects than publishers of wide selections and academic literature, it could be misleading to add a *mixed* category. The latter could be interpreted as distinctly different from *wide*, which does not have to be the case.

Inventory size (measured in % of total assets)

Lastly, the available data allowed us also to look at the size of inventory. Here, we chose to measure it as percentage of total assets. This measure was chosen due to the fact that large inventory of books can indicate the company’s inability to market and sell the published books, or to assess the market potential of acquired books. Moreover, it can increase storage costs.

Therefore, we found it worthwhile to examine if there was any relationship between this measure and profitability.

5.3.2 Correlation

Multicollinearity between independent variables can be a problem when conducting multiple regressions. In order to examine potential correlations between the numerical variables in our model, we created a correlation matrix presented in Table 9. This kind of analysis is important, as collinear variables affect the interpretability of the model's coefficients.

| | Years of operation | Inventory size |
|--------------------|--------------------|----------------|
| Years of operation | 1.000 | -0.2105 |
| Inventory size | | 1.000 |

Table 9: Correlation matrix of the numerical independent variables

Note that average revenue clusters and genre range are not included in the correlation matrix, as they are non-numerical variables. Measuring correlation using Pearson coefficient is only meaningful for continuous variables.

The correlation matrix reveals a negative correlation of 0.21 between years of operation and inventory size. This implies that for every additional year of operation, we observe a fall in the inventory size by 0.21. Although not very close to 0, the correlation is not strong either, so the interpretability should not be affected heavily.

5.3.3 Results

Based on the above argumentation, the final multiple regression model is as follows:

$$\begin{aligned} \text{Average operating margin} = & \beta_0 + \beta_1 \text{Big} + \beta_2 \text{Extreme} + \beta_3 \text{Huge} + \beta_4 \text{Medium} + \\ & \beta_5 \text{Narrow} + \beta_6 \text{Academic} + \beta_7 (\text{Years of operation}) + \\ & \beta_8 (\text{Inventory size}) + \varepsilon \end{aligned}$$

The results of the multiple regression are presented in Table 10 below. The adjusted R-squared equals around 15%, meaning that only 15% of the variation in average operating margin can be explained by the model's independent variables. In other words, the majority of the

variation in profitability remains unexplained. Moreover, only two variables show statistical significance, namely the narrow and academic genre ranges. Wide range of genres, average revenue clusters, years of operation and inventory size have high P values, indicating no statistical significance. These findings might be somewhat surprising and are discussed in more detail below.

| Multiple regression | | | | |
|----------------------------|--------------------------|--|--|--|
| Dependent variable | Average operating margin | | | |
| Multiple R-squared | 0.2454 | | | |
| Adjusted R-squared | 0.1481 | | | |

| | Coefficient | Std. Error | T value | P value |
|--------------------|--------------------|-------------------|----------------|----------------|
| Intercept | 0.00473 | 0.04564 | 0.104 | 0.91778 |
| Big | 0.06085 | 0.10139 | 0.600 | 0.55061 |
| Extreme | 0.04786 | 0.13195 | 0.363 | 0.71806 |
| Huge | 0.13469 | 0.13332 | 1.010 | 0.31629 |
| Medium | 0.04991 | 0.07118 | 0.701 | 0.48586 |
| Narrow | 0.07448 | 0.03682 | 2.023 | 0.04738 * |
| Academic | 0.18689 | 0.04982 | 3.751 | 0.00039 *** |
| Years of operation | -0.00047 | 0.00068 | -0.695 | 0.48937 |
| Inventory Size | -0.08837 | 0.08690 | -1.017 | 0.31317 |

*Significance codes: '***' 0.001 '**' 0.01 '*' 0.05*

Table 10: Multiple regression results

Size (measured in average revenue)

When it comes to size, none of the dummy variables representing the revenue clusters showed any significance. This can be caused by the big differences in revenue between companies, which in turn led to classifying the majority of observations into one cluster. Having a big cluster which 66 observations meant that this cluster covered a large variety of operating margins, and thus there could be no linear relationship between these *small* companies and

operating margin. However, it is worth mentioning that using the average revenue figures directly, both as-is and as a logarithm, also showed no significance. Similarly, using total assets in order to account for size, was not significant either.

A potential explanation is that size alone does not grant profitability, but rather that the latter depends on other factors or on a combination of factors. It is often the case that costs cannot be attributed to one cost driver only, because the cost drivers are usually complexly interrelated, rather than separable (Bjørnenak, 2000). Therefore, the insignificance of the clusters of average revenue does not necessarily mean that economies of scale are immaterial for profitability in publishing. It is fully possible that they are of consequence, but in relation with other factors.

Moreover, the lack of significance can indicate the existence of diseconomies of scale mentioned in Chapter 2 or the presence of economies of favor mentioned in Chapter 4. The latter would benefit the smaller publishers and may to some degree outweigh the economies of scale of the big players, resulting in no linearity between size and operating margin. Lastly, it might also be the case that the clusters, which are meant to function as a proxy for *economies of scale*, are in fact inadequate in reflecting it.

Experience (measured in years of operation)

Similarly, years of operation do not display any significance. Again, this can indicate that experience does not secure successful book sales or increased efficiency, which could in turn result in a high operating margin. However, one should also have in mind that years of operation might be a somewhat inadequate measure of experience, for instance when a publisher has high turnover and is unable to keep the knowledge inside the company.

Complexity (measured by genre range)

Complexity in genres is the only significant variable. Here, academic publishers show a strongly significant positive linear relationship with operating margin. Publishers with narrow genre ranges also display a positive correlation with profitability, but the P value is just under 5%, revealing a weaker significance. Publishers with wide offers are included in the reference group, but the intercept does not show any significance.

The findings related to academic publishers, which show that the operating margin is almost 19% higher for academic publishers, are not surprising. One can argue that publishing textbooks and other academic literature is a profitable business for several reasons. For one, it can be easier to predict the sales volumes, which reduces the risk of overproducing. Moreover, as textbooks are usually part of the curriculum for several years, a major share of the revenue is likely to come from old publications. Thus, the results are not dependent on the success of new publications but can be sustained over time through previous books.

The significance of publishers with narrow offers can be the result of the fact that it is likely easier to build reputation and customer loyalty when specializing in specific types of literature. However, the higher P value suggest that the linear relationship with operating margin is not as strong as for academic publishers. It might also be the result of the fact that companies classified as narrow were each focusing on different genres, some of which are likely more popular than other. Therefore, although the results show that operating margin increases by over 7 percentage points for publishing companies with narrow selections, one should by no means conclude that establishing such a company automatically leads to success.

As the publishers with wide offers represented the biggest group, it is not surprising that there was not any significance. This can be a result of the fact that, because of its size, the group had a large variety of operating margins. Moreover, one can argue that it is more challenging to build a good reputation and secure success when publishing a wide range of genres. It is more likely that the customers will not have any strong preference among those publishers, which in turn suggest that other factors will influence potential success.

Inventory size (measured in % of total assets)

Although inventory size has the lowest P value out of all the insignificant variables, it is still too high to prove a linear relationship with operating margin. Again, this shows that the size of the inventory is not an explanatory factor for profitability.

Limitations

This regression shows the insignificance of average revenue, years of operation and inventory size in explaining profitability. However, it is important to keep in mind that this relates to a linear relationship. In other words, it is possible that a relationship between these variables and operating margin exists but is non-linear.

Moreover, one should keep in mind the limitations related to the data source when interpreting these results. It is namely possible that few significant relationships were found because the financial data is not normalized. To illustrate, if any of the reported results include extraordinary items, it will have an effect on the operating margins, making them inaccurate. The fact that the analysis spans over a relatively short period of time means that this effect will not be balanced out, if present. Thus, there might be relationships which were not revealed due to the nature of the data source.

Conclusion

In the light of the above sections, the results may be less surprising than they appeared at first. All in all, the findings show that profitability in the Norwegian publishing industry cannot be explained easily, but rather is a complex topic for most publishers. Complexity in genres gives some indication, but one should keep in mind that the model was able to explain only 15% of the variation in profitability. In other words, it is not unlikely that success in this industry is a result of many interrelated factors. Chapter 6 will look further into the topic and examine the information obtained through interviews conducted with a variety of publishers.

5.4 Conclusion of profitability analysis

This chapter looked at different profitability measures in order to answer the second research question, namely:

What is the profitability of the Norwegian publishing industry?

The common size analysis revealed that the average operating margin was 4%, while the median equaled 2%. Still, considerable differences between players were easily noticeable. Cost of goods sold, as well as salaries and other operating expenses had the biggest impact on the bottom-line. In contrast, depreciation had little impact as the industry is labor-intensive. Furthermore, the Lorenz and Stobachoff curves confirmed big differences in the size (revenue) and relative profitability (operating margin) of the players. These analyses were conducted on averaged numbers from the 2016-2018 period, as opposed to the following analysis of the operating margin and ROA.

The detailed analysis of the operating margin showed a median around 2-3% with a downward trend. In other words, only in the three-year period there was a development towards lower margins. Moreover, extreme differences between players could also be observed. A somewhat similar picture emerged from the analysis of ROA. The median decreased from 4.4% to 1.7% in the three studied years and average showed the same downward trend. Again, strong variations in ROA were noticeable among the companies.

All in all, the profitability picture which emerges in this chapter is in line with the findings of the competitive analysis, namely that the situation in the publishing market is getting tougher. Moreover, the industry is characterized by strong variations in profitability. Potential reasons for such a situation are the focus of the next chapter.

Moreover, the profitability analysis also examined correlations between profitability, measured by average operating margin in 2016-2018, and several variables. The results show that publishers of academic literature and publishers with narrower genre ranges have a statistically significant positive relationship with operating margin. On the other hand, size, years of operation and inventory size did not show any linear relationship with profitability, indicating that obtaining good results in this industry cannot be explained by those factors.

6. Analysis of profitability variations

The findings from the competition and probability analyses point towards high competition and strong profitability variations in the Norwegian publishing industry. This chapter examines the situation further, looking into factors which can lead to those differences. Thus, it aims at answering the following research question:

What are the potential sources of profitability variations between players?

In order to answer this question, in-depth interviews with several publishers were conducted. This allowed to gain first-hand insight into the experiences and reflections of the players themselves, and thus identify the most important cost drivers.

In the following, each of the interviewees is shortly described. Next, the selection of the central cost drivers is presented, followed by an explanation for excluding several cost drivers from further analysis. Then, each of the central cost drivers is analyzed in detail. Lastly, additional insights gained from the interviews, which fall outside of the scope of the cost driver framework, are presented before the conclusion.

6.1 Sample for analysis of profitability variations

The factors behind profitability variations among publishers were explored based on three in-depth interviews. As mentioned, the original goal to interview five publishing companies was not achieved due to the Covid-19 outbreak, which led both to declines and unresponsiveness of potential interviewees, as well as cancellations of already scheduled interviews.

Nevertheless, we believe that the three interviews conducted before the outbreak give important insights and cover central aspects of the operations of publishing companies in Norway. Although interviews with a bigger variety of publishers might have resulted in more diverse insights, the collected information is still valuable and allows to pinpoint crucial factors leading to profitability variations between publishers, which is the goal of this analysis. This section presents the interviewed players and their characteristics.

| | Size | Profitability | Scope |
|--------------------|--------------------------------------|---|------------------------|
| | <i>Average revenue 2016-2018</i> | <i>Average operating margin 2016-2018</i> | <i>Range of genres</i> |
| Publisher A | Around 4 MNOK | 0.65 % | Many genres |
| Publisher B | Around 5 MNOK | – 5.39 % | Specialized |
| Publisher C | Around 25 MNOK | 1.17 % | Many genres |

Table 11: Interviewed publishers and their characteristics

Table 11 lists the interviewed publishers. The companies can be seen as middle-size to small players. Publisher C differs in size from the other two, obtaining over 20 MNOK in average revenue between 2016-2018. The two remaining players are of relatively similar size, namely around 4-5 MNOK.

Moreover, the interviewees differ in terms of profitability, as well as literary scope. Profitability is measured by average operating margin between 2016-2018, with Publisher A and C achieving positive operating margin of around 1% and Publisher B obtaining negative results, namely –5%. When it comes to scope, Publisher A and C offer a wide range of genres, whereas Publisher B focuses on a narrow selection.

| | Year | Number of publications | Full-time equivalents (FTE) | Full-time equivalents (FTE) of editors |
|--------------------|-------------|-----------------------------------|--|---|
| Publisher A | 2016 | 25 | 2.3 | 2 |
| | 2017 | 25 | 2.4 | 2 |
| | 2018 | 30 | 3 | 3 |
| Publisher B | 2016 | 15 | 2.85 | 2 |
| | 2017 | 18 | 2.85 | 2 |
| | 2018 | 11 | 2.85 | 2 |
| Publisher C | 2016 | 46 | 10 | 4 |
| | 2017 | 40 | 10 | 4 |
| | 2018 | 42 | 9 | 3 |

Table 12: Operational characteristics of the interviewed publishers

Furthermore, data regarding operational characteristics, such as number of new publications, total number of full-time equivalents (FTEs) and number of FTEs of editors, was collected and is presented in Table 12. Even though they are similar in size, Publishers A and C vary when it comes to the number of publications, publishing an average of twenty-six and fourteen new titles between 2016-2018, respectively. Coincidentally, the number of fulltime workers and editors is equal. Naturally, due to a greater size of the company, the number of publications is higher for Publisher C and oscillates around forty. Number of fulltime workers equals ten, and four of those are editors.

All of the interviewed players are independent publishing companies, not associated with any larger publishing house.

6.2 Choice of cost drivers

The cost driver framework presented in Chapter 2 lists as many as thirteen cost drivers. Depending on the industry in question, different factors will stand out as more important than others. In other words, it is unlikely that each of the cost drivers identified by Porter (1985), Riley (referred in Blindheim, 2010) and Shank and Govindarajan (1993) should be of consequence when analyzing the cost structure of a company.

Consequently, not all of the thirteen cost drivers were found to be material in the context of publishing. Therefore, several cost drivers were excluded from further analysis. The cost drivers which were found to be important are presented in Figure 14. The selection was based on the findings from the previous chapters, as well as the insights gained through interviews. Each of the factors presented in Figure 14 is analyzed in detail in a separate section of this chapter.

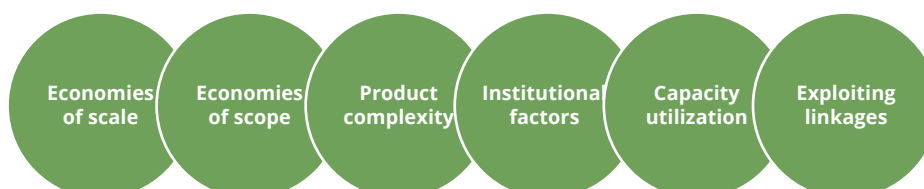


Figure 14: Cost drivers central for further analysis

6.2.1 Cost drivers included in the analysis

Several of the cost drivers in Figure 14 were chosen because the answers given by the interviewees indicated that they had considerable impact on the profitability of the companies. These include *product complexity*, *institutional factors*, *capacity utilization* and *exploiting linkages*. The importance of *product complexity* was further underlined by the results of the regression in Chapter 5.

However, the following analysis also includes *economies of scale* and *scope* whose impact on profitability is not clear, but which still provide important insights related to the third research question. Notably, *economies of scale* represented by clusters of average revenue were found to be insignificant in Chapter 5. Still, we believe that a closer look on the impact of *scale* on the transactions with different suppliers and customers enhances the analysis, as the regression did not allow to look at each of these relations separately.

Along the same lines, even though no clear conclusions can be drawn with regards to the *economies of scope*, we believe that an analysis of the integration of the different parts of the value chain can still be valuable for understanding what can and cannot be a potential source of profitability variations.

6.2.2 Cost drivers excluded from the analysis

On the other hand, *technology*, *experience*, *workforce involvement*, *location*, *total quality management (TQM)*, *process design* and *product design* were found to be immaterial for answering the third research question. Some were excluded already in the process of designing the interview guide, because of their irrelevance. For instance, *process design* which refers to the plant layout is meaningless in the context publishing, even though it could be important in other industries, such as the printing industry. Similar logic applies to *location*, *TQM* and *product design*.

Others, including *technology*, *experience* and *workforce involvement* were ruled out through the insights gained when conducting the interviews. To illustrate, Publisher A (2020) did not see any possibilities for increasing efficiency through technology, as deciding which books to acquire and editing manuscripts cannot be automated, but requires human skill and intuition. Moreover, Publisher C (2020) noted that digitalization of manuscripts, as well as typesetting

and design processes is a norm in the industry. As such, it cannot be a source of cost advantage. Therefore, the lack of automation possibilities and the widespread digitalization make *technology* an irrelevant cost driver.

Somewhat along the same lines, *experience* was found to be immaterial. Based on the interviews, one could observe that time indeed resulted in learning, but according to Publisher B (2020) only the learning that happened at the very beginning was substantial. Later on, the knowledge and skills were preserved, but it can hardly be said that the learning which results from publishing new books leads to lower costs (Publisher B, 2020). Moreover, the exclusion of the cost driver was also supported by its lack of significance in the regression conducted in Chapter 5.

When it comes to *workforce involvement*, all interviewees observed that their employees were motivated to improve operations. Yet, there was a lack of concrete examples, which suggested that this motivation was more of a general impression of the coworkers but did not produce measurable results. Thus, it was not a real source of cost advantage and was excluded from the central cost drivers.

Based on the above argumentation, seven of the original thirteen cost drivers are excluded from further analysis, while the cost drivers shown in Figure 14 are seen as ones that can provide a better understanding of about potential sources of profitability variations in the context of publishing. Therefore, each of them is analyzed in the following sections. Moreover, insights which fall outside of the scope of the cost driver framework are presented towards the end.

6.3 Economies of scale

Based on the conducted interviews, the publishing industry does not display clear *economies of scale*, i.e. direct cost advantages obtained when producing a larger volume (Porter, 1985). There are in fact other benefits related to large scale, which will be covered in section 6.9 on other findings, but the interviewees' experiences do not show clear cost advantages from *scale* either in relation to suppliers or customers. The following sections examine each of these interactions in more detail.

6.3.1 Suppliers

The competition analysis conducted in Chapter 4 examined the bargaining power of the publishers in relation to different supplier groups. The interviews support the findings from that analysis, while at the same time supplying more details. In the following, insights related to the different groups of suppliers are studied.

Printing companies

When it comes to printing companies, previous findings suggested that they do not have high bargaining power as they provide a standardized product. Publisher A (2020) recounts her experiences as a small player:

There is high competition among printing companies in Eastern Europe. On a weekly basis, we get contacted by several printing companies who want to offer us their services.

In other words, publishers appear to stand in a good position in relation to printing companies. Moreover, it seems that scale does not have much influence, as the competition among printing companies forces them to seek out customers. Although larger volumes might give lower prices (Publisher B, 2020), the printing companies are clearly not in a position to demand high prices even from small customers, as they will lose them to their competitors. Therefore, one can conclude that economies of scale have little to say for costs related to printing.

Distributors

In relation to distribution, there are only two players offering this service, which gives them a relatively high bargaining power as publishers are fully dependent on the solutions offered by them. Publisher A (2020) highlights that it would be impossible for them to store and distribute their books themselves, due to the considerable need for storage space and complex logistics.

Furthermore, Publisher A (2020) shares that they get a standardized price list from the distribution center they use, but she adds that it might vary with volume. In other words, they cannot negotiate the price. However, as we were unable to interview the biggest publishers, it remains unclear whether this varies with size. Therefore, whether economies of scale are present in terms of distribution remains uncertain.

6.3.2 Customers

When it comes to the customers (bookstores), the main cost is related to the bookstore discounts, i.e. the price cut required by the bookstore when it purchases books from a publisher. Publisher A (2020) notes that the conditions offered by the various bookstores are fixed, and as a small publisher they do not have any power to negotiate the bookstore discounts.

One can suppose that bigger publishers who also sell larger volumes of books might have more power to negotiate the discount. However, as Publisher C (2020) who represents a bigger company did not go into details regarding this topic, we are unable to come to a clear conclusion of the effects of scale. Therefore, it remains unclear whether economies of scale exist in the relation with bookstores.

6.4 Economies of scope

Economies of scope, which reflect the degree of vertical integration, is another cost driver which provided interesting insights during the interviews. According to Porter (1985), a company might be able to lower its costs by integrating vertically because it skips using the market. The opposite argument states however that integrating activities in-house might create inflexibility and be more expensive than outsourcing (Porter, 1985).

In order to understand the situation in the publishing industry, we asked the interviewees about their degree of vertical integration, its pros and cons and views on how it influences the costs. The answers revealed that they outsourced most of the processes, generally due to the convenience and lower costs, thus displaying no vertical integration. In the following, we look further into the answers and examine their implications for profitability.

Design

All three publishers outsource design. Publisher A (2020) mentions that hiring an in-house designer would not be as cost effective and thereby negative for the company from the profitability perspective. Notably, the designer who works for Publisher A (2020) is based in Eastern Europe. Furthermore, she underlines that it is valuable for them to have a designer

with whom they have cooperated for a long time (Publisher A, 2020). This is similar for Publisher B (2020) who has cooperated with one designer for 12 years.

Such long-term relations suggest that the transactions between the designers and the publishers are simplified, as an understanding for the process and its expected results has likely developed between the involved parties. Thus, “costs of using the market” referred by Porter (1985) are reduced or even absent. Moreover, the positive experiences of both publishers imply that few advantages could be gained from hiring in-house designers.

Although we were unable to interview any publisher with in-house designers, it is hard to envision that this arrangement is very different from using an outside designer with whom one has a longstanding cooperation, in terms of convenience and quality. Therefore, based on these criteria, there seems to be little difference between vertically integrating the designers into the company and outsourcing.

The only downside of hiring designers in-house is the apparently higher cost. However, one could argue that the companies which decide to have in-house designers have so many publications that the cost of using the market, which is minimal for small to middle-size publishers, would increase in their case due to the sheer number of designs required. In such cases, the higher cost could outweigh the inconvenience of having to deal with an outside party, thereby making the vertical integration desirable. Moreover, one can expect that at a certain level of publications, the using an external designer would be more expensive than hiring one in-house.

Thus, one could conclude that outsourcing the design process is advantageous for middle-size to small players, while hiring in-house is better for publishers with many publications for whom dealing with an outside designer would be less convenient or more expensive. This in turn suggest that economies of scope, i.e. vertical integration, does not provide a cost advantage in case of designers.

Printing

The universal practice among not only the interviewed publishers, but across the industry, is to outsource printing (Lund, 2009). Notably, all interviewees outsourced the process to Eastern Europe due to lower costs (Publisher A, B and C, 2020), which confirms the findings from the

competition analysis. Still, as all publishers follow the same practice of outsourcing, rather than vertically integrating printing, the process is of no consequence for explaining profitability variations between publishers.

Distribution

Another process which could potentially be done in-house, but is instead outsourced, is distribution. Publisher A (2020) notes that at the very beginning when they used to have few publications, they stored and sent out books themselves, but underlines that it would be impossible nowadays and would require a warehouse. This explains the widespread practice of outsourcing the task to distribution centers with specialized IT systems and large warehouses suited for book storage.

As mentioned before, three of the four biggest players own the two distribution centers located in Norway. Thus, it can be said that they have vertically integrated distribution into their companies, in contrast to the other Norwegian publishers. The central question is therefore whether they experience any advantages of this integration, broadly defined as skipping the costs of using the market, or disadvantages such as inflexibility and higher costs.

On one hand, the positive experiences of the interviewees suggest that there are no considerable costs related to using the market, suggesting that there are few advantages of integration. However, as the three players sell the service to other players, it can be an important revenue source. In this sense, vertical integration of distribution can represent an advantage from the point of view of the publishing groups.

Bookstores

The smaller publishers experience difficulties in getting access to the large bookstore chains, a topic described in more detail in section 6.9. Based on the insights shared by the small publishers, it is much easier for the big players who own these chains to sell their books there, as both parties aim at bestsellers (Publisher A and B, 2020).

One could suppose that it is easier for the publishing companies who own bookstores to understand of what the latter wants to buy and in what quantities, and thereby secure good sales. Moreover, the negotiation process is likely simplified, and the bookstore discounts might be more favorable than for other publishers. However, not having the opportunity to

interview a vertically integrated publisher, we were unable to confirm these suppositions or find any other cost advantages related to integrating bookstores. Therefore, it remains unclear whether economies of scope, specifically with regards to integrating bookstores, can help explain profitability variations between players.

6.5 Product complexity

Product complexity is yet another cost driver and it refers to how wide a line of products is offered to the customers. As mentioned in Chapter 5, this definition is better suited to manufacturing companies, and in the publishing context we chose to think of it as the range of genres that a publisher offers. Still, during the interviews we observed another important aspect related to this cost driver, namely the complexity of each book project. Therefore, both aspects are discussed in the following.

6.5.1 Genre range

Firstly, we examine the complexity related to the range of genres offered by the publishers. Figure 15 shows the number of genres and the operating margin of the companies represented by the interviewees.

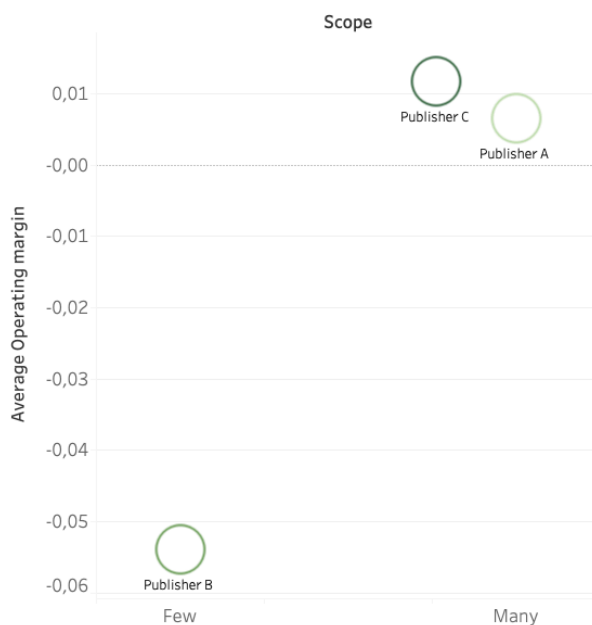


Figure 15: Complexity (number of genres) and operating margin

The previous findings have shown that academic and narrow genres have a statistically significant relationship with operating margin. Note that Publisher B notes a negative operating margin even though it represents a narrow range of genres, which is atypical given the results of the regression.

With regards to complexities that showed significance, our interviewees include only a publisher which represents a narrow genre range, as the interview with an academic publisher was cancelled after the Covid-19 outbreak. Nevertheless, we gained valuable insights from Publisher B who specializes in specific types of non-fiction books.

Specifically, Publisher B (2020) believes that a clearly specialized profile has the potential of increasing the customers loyalty. Moreover, she points out the following aspect related to publishing a narrow selection of books:

I think it is positive [that we are specialized], because it allows us to have a very clear understanding of what we want. [...] When we get inquiries [from authors and agents], it is easy for us to figure out what we want to continue with and what we want to say no to. We spend very little time evaluating incoming ideas. [...] We can operate very efficiently and have few meetings.

In other words, Publisher B (2020) highlights that the acquisition process is quick and easy as the employees have a very clear understanding of what their company stands for. For bigger publishers with a wider range of books, the acquisition process seems to be longer and more complex, being characterized by acquisition meetings where books are chosen based on their potential for success and preferences of the editors and the sales and marketing teams (Swainson, n.d.).

On the other hand, the editing process might not be very different. Asked whether it is complex to work with a wide selection of genres and how it influences efficiency, Publisher A (2020) notes the following:

Efficiency is not affected. We have good routines and set one project team per publication.

She adds that if the publication is related to a genre which needs specific expertise, for instance books on World War II, they hire a consultant (Publisher A, 2020). Having good routines and

good networks allows them to publish books within different genres without affecting the efficiency. Publisher C (2020) seconds this perspective.

In other words, the topic of product complexity proves to be nothing less than complex. Although academic and narrow genre range showed a significant relationship with operating margin, there seems to be few differences in efficiency of editing between publishers with narrow and wide genre selections. However, the insights from interviews point to potential differences in customer loyalty and efficiency of book acquisition.

6.5.2 Complexity of book projects

The second aspect related to the cost driver in question is the complexity of the book projects, i.e. how complicated the book projects are, and thereby how much time and effort are needed in order to publish each book. Publisher A (2020) shared her experiences related to this aspect:

If the projects are more complicated than we had originally anticipated and there is more work with text editing or higher need to use consultants, the costs go up and our efficiency decreases. [...] For instance, if the editor needs more time and publishes six rather than eight books [in a year], it will affect the costs.

In other words, taking on projects that turn out to be more complicated than first anticipated affects the profitability. Thus, the central question is whether the publisher has an ability to appropriately assess the projects before they are acquired. One could argue that specialized publishers might be better suited for the task, as they have knowledge and experience with publishing a certain type of books. In contrast, publishers with wider selections can take on projects they have never had before, which may make it more difficult to assess their complexity and to work on them.

Moreover, the interviews showed that the length of the book is also an important factor, as longer manuscripts naturally require a longer editing process. Publisher C (2020) clearly stated that:

The word count has a lot to say. It is less profitable to publish thicker books.

All in all, it is clear that the complexity of the projects that a publisher takes on, both in terms of length, as well as knowledge and experience required to publish them, influences the profitability.

6.6 Institutional factors

Institutional factors represent another cost driver category. It focuses mostly on the effect of government policies, unions and financial incentives such as tax holidays (Porter, 1985). The interviews with publishers revealed some interesting dynamics when it comes to this topic.

6.6.1 Book Agreement

Publisher A (2020) who has over 25 years of experience in the industry mentioned how changes in policies throughout this period influenced sales:

In the past, it was easier to sell books. The bookstores had a much bigger obligation to take books in [...] and now they can decide for themselves how many new releases they want to receive.

In other words, the duty to take in new releases used to be part of the Book Agreement, but no longer is, making it harder for publishers to get their books onto the bookstore shelves. One can observe that the past regulations, while contributing to a higher number and variety of publications, created an artificially high revenue for the publishers. The Book Agreement in its current form no longer transfers the risk over to the bookstores, which can help explain why many publishers face lower sales or increased storage costs and low profitability.

Another aspect related to institutional factors has to do with the fixed price policy towards the end customer, also included in the Book Agreement. In most cases, this does not affect the publisher in any way, as it only regulates the retail price, while the price the bookstore pays to the publisher is not regulated. Publisher A (2020) put it simply: *the fixed retail price does not affect us either negatively or positively.*

Yet, the interview with Publisher B (2020) highlighted a different aspect. Publisher B differs from Publisher A in that, besides selling their books through bookstores, they also sell them directly through their website or on fairs and conferences, thereby avoiding the use of middlemen. It is an interesting practice in and of itself and we will come back to it towards

the end of the chapter, focusing only on the institutional factors in this section. Namely, the fixed retail price policy allows the publishers who sell their books directly to end consumers to obtain good prices. Publisher B (2020) notes:

Thanks to the Book Agreement, we have the same prices in our [online] bookstore as in the big bookstores, which is very good. Everyone wants to buy books as cheaply as possible, but they can't [as the prices and discounts are regulated]. The Book Agreement gives us a clear framework for direct sales and saves negotiations and discussions with customers. We can simply say that we are not allowed to give higher discounts due to the regulations.

Thus, for publishers who have direct sales, the existing policies allow them to secure good prices. This can be especially important for small publishers who do not have high bargaining power towards big bookstore chains. As can be observed when comparing Publishers A and B, not all publishing companies take advantage of this policy. Therefore, it might be an important source of cost advantage and a factor which contributes to explaining profitability variations between players in the industry.

6.6.2 Procurement schemes

Yet another institutional aspect relates to the procurement schemes for literature administered by the Art Council Norway. The council can be an important source of revenue for publishers, as it purchases new publications to distribute to libraries across Norway (Kulturrådet, 2020). The council evaluates the quality of books and decides whether or not to purchase a given title. There is no limit on the number of Norwegian fiction books purchased, in contrast with Norwegian non-fiction, translated literature and comics (Kulturrådet, 2020). Publisher B (2020) shed more light on this topic:

For a small publishing company like us, the procurement schemes have a lot to say. [...] In their current form, it is very profitable to publish fiction and very demanding to publish non-fiction. Being a non-fiction publisher is a pretty bad business idea, considering how the scheme works.

Thus, one can see that the current government policy favors a specific type of literature, namely Norwegian fiction. Publisher B's negative results are influenced by this policy, as they publish books in one of the categories which get less support from the Art Council (Publisher B, 2020). Therefore, the procurement schemes might be another factor which explains differences in profitability between different publishers.

6.7 Capacity utilization

Another cost driver category is capacity utilization. Here, we were interested in examining to which extent the capacity of the editors is used and learn the publishers' perspective on their workload. As pointed out by Porter (1985), capacity utilization is affected both by supply and demand changes, as well as by seasonal variations. Therefore, the interviewees were asked specifically about their experience of available capacity, as well as variations in capacity utilization with regard to the seasons.

6.7.1 Utilization of editors' capacity

Although the cost driver framework might at times fit manufacturing companies better than other types of companies, the importance of capacity utilization is undeniable in most industries. In the context of publishing, one can specifically look at the number of books that a full-time editor publishes in a year to get an idea of the extent to which the capacity of editors is used. Figure 16 presents just these figures, i.e. publications per FTE of editors for each year between 2016-2018, for the interviewed publishers.



Figure 16: Publications per editor between 2016-2018

One can clearly see that Publisher B has the lowest output per editor. Note that for Publisher A and B editors are the only employees, while Publisher C has 4 editors (3 in 2018) out of 10

(9 in 2018) employees in total. This might allow the editors of Publisher C to focus solely on the acquisition and editing processes, without having to use their time and resources on sales and marketing as well.

Naturally, it is important to underline what was already noted in section 6.5.2, namely that the complexity and length of book projects are important factors influencing these results. In other words, rather than showing that Publisher B does not manage to utilize the editors' capacity well, it might be showing that the editors had more complex projects. Still, these does not change the fact that output per editor might be an important cost driver. To examine this further, we look into seasonal variations in capacity utilization.

6.7.2 Seasonal variations

When it comes to seasonal variations, Publisher B (2020) explains that autumn is the high season in publishing. That is due to the fact that books need to be ready for printing at that time, in order to make it to the bookstore shelves in time for the Christmas shopping. Furthermore, Publisher B (2020) also elaborates on experiencing low seasons:

There are also some periods during the year when the workload is limited. In such situations, the tasks are directed towards creating a list of books to be published in the autumn. We also use this capacity to promote our older books.

In contrast, Publisher A, who publishes around twice as many books as the specialized Publisher B, states that they manage to spread the work on publications over the entire year (Publisher A, 2020). In such way, the variations in capacity utilization are not present.

The lack of constant capacity utilization which is present for Publisher B can be a factor that explains the lower output (number of publications) per editor. Moreover, as Porter (1985) argues, constant capacity utilization level is less costly, compared to fluctuating utilization. Therefore, the seasonal variations experienced by Publisher B might be one of the reasons behind its negative profitability, compared to the positive operating margin of Publisher A who manages to spread the work more evenly throughout the year. In all, these findings indicate that capacity utilization can be an important cost driver in the publishing industry.

6.8 Exploiting linkages

Exploitation of linkages is another cost driver with high relevance for the publishing industry. As already mentioned in the theoretical framework, activities are often interrelated – both internally within the value chain of a company, and externally with suppliers or customers. This means that the cost of one activity is rarely unaffected by other activities, whether internal or external. These costs can naturally be lowered by good coordination (Porter, 1985). In the following we will we will discuss the exploitation of internal and external linkages in publishing.

6.8.1 Exploiting internal linkages

The internal value chain of a publishing company consists mainly of editing, with the book going through a structural edit first and copy editing afterwards. For our interviewees, the design, printing and distributing processes were outsourced, leaving only editing and sales in the hands of the publisher.

It was therefore unsurprising that there were few internal linkages among the interviewed publishers. Publisher A (2020) pointed out that “*coordination has nothing to say*”, as project leaders work on their separate book projects, making any coordination unnecessary. This suggest that exploiting internal linkages has little to say for small to medium-size publishers.

However, one can imagine that for bigger publishing companies which have in-house designers and coordinate their sales and marketing efforts to a much higher degree, internal coordination is more important. This perspective is supported by Publisher C (2020) who has worked in one of the biggest Norwegian publishing companies before and shares that:

The bigger the company, the more important it is to coordinate well [internally]. When you release several books a week, you quickly end up competing with yourself in several places. Then you need to know what your colleagues have planned.

In such cases, one can imagine that the reliance on good external coordination is weaker, as most activities are done in-house.

6.8.2 Exploiting external linkages

With several processes outsourced, one can expect that external linkages will be of consequence for efficiency – and in turn for profitability. In order to examine this aspect, we asked the interviewees about their perception of coordination with external parties. We were particularly interested in spotting the activities which cause bottlenecks.

As mentioned, in order to deliver the final product, publishing companies need to cooperate with several external players – such as authors, designers, proofreaders, printing companies, as well as bookstores. The activities are highly interrelated in that there is little flexibility when it comes to the order in which they are conducted. This suggests that delays on one stage might lead to problems and increased costs in other parts of the process. One of the interviewees highlighted the importance of good organization and planning ahead of time.

Publisher A (2020) stressed the fact that autumn is the high season for book printing, to get books ready before Christmas. For that reason, publishers need to remember to plan ahead and schedule printing well ahead of time, in order to avoid problems in the process (Publisher A, 2020).

A matter of company's size also comes into picture. With a moderate number of publications, one is easily able to plan ahead and book time slots for printing, as pointed out by the interviewee (Publisher A, 2020). However, Publisher C (2020) notes that if there are delays with editing, one can miss the deadline for sending the book for printing, which results in several weeks of delay, as the printing companies tend to be fully booked in high seasons.

Another activity which is very often outsourced by the publishers is proofreading. Publisher A and B (2020) present similar perspective on the matter, as they both choose to rely on proofreading services from an external part which they have cooperated with for a longer period of time. In case of Publisher B, the proofreader is a former employee and it is highlighted that good relations, as well as experience make the work easier in terms of coordination and exploitation of this external linkage.

Based on the above examples, one can conclude that good coordination, as well as good relations, are highly important for the exploitation of external linkages. For publishers who do not manage to achieve this, the profitability might be affected.

6.9 Other findings

As mentioned in Chapter 2, although the cost driver framework can point towards important factors which affect profitability, it has noteworthy limitations. The central one is that it only focuses on costs, while profitability is two-fold, being also influenced by revenue (Shields and Shields, 2005). While we focused on formulating the main part of the interview guide with the cost drivers in mind, we also included some more general questions which could potentially highlight aspects not covered by the framework. The insights obtained from these questions turned out to be largely related to the revenue streams and are presented below.

6.9.1 Access to bookstores

Based on the interviews, the first aspect which influences the revenue of publishers has to do with their relationship with the customers, i.e. bookstores, which in many cases are organized in large chains.

Publisher A (2020) describes the position of small publishing companies very clearly:

We are a small supplier, so we have no negotiating power at all in relation to the bookstores. They set their own conditions. The various bookstores have fixed conditions with regards to how much discount they should get [...] and it never changes in our favor.

Publisher B (2020), who also represents a small-sized company, seconds this. Furthermore, both interviewees highlight that selling books to the bookstore chains is tough as “*the big publishers have stronger and bigger titles*” (Publisher B, 2020) and “*they have acquired bookstore chains and focused on bestsellers sales*” (Publisher A, 2020). In other words, the small players experience difficulties in getting their books onto the shelves of large bookstores.

In contrast, Publisher C (2020) who is characterized by bigger size experiences being heard and taken seriously in contact with bookstores. This suggests that, while there were no clear *economies of scale*, i.e. direct cost advantages related to large volumes, size might still represent a considerable advantage. The bookstores’ focus on bestsellers could explain their interest in bigger publishers, as size indicates that the latter’s publications sell in large quantities.

To put it simply, the strategy of bookstore chains seems to be to buy and promote bigger titles (Publisher A, 2020), for instance books from well-known authors or related to current trends. Consequently, they do not trouble themselves with taking in books from smaller publishers who do not have a history of such bestselling titles (Publisher B, 2020). Instead, they lean towards the bigger publishers whose size indicates larger volumes and bigger titles.

This is reflected in Figure 17, which shows revenue per publication and can give a sense of the quantity of books sold by each of the publishers. Naturally, revenue is also influenced by the price obtained, but the stark contrast between Publisher C and the other two publishers indicates a clear difference in volume sold per publication.

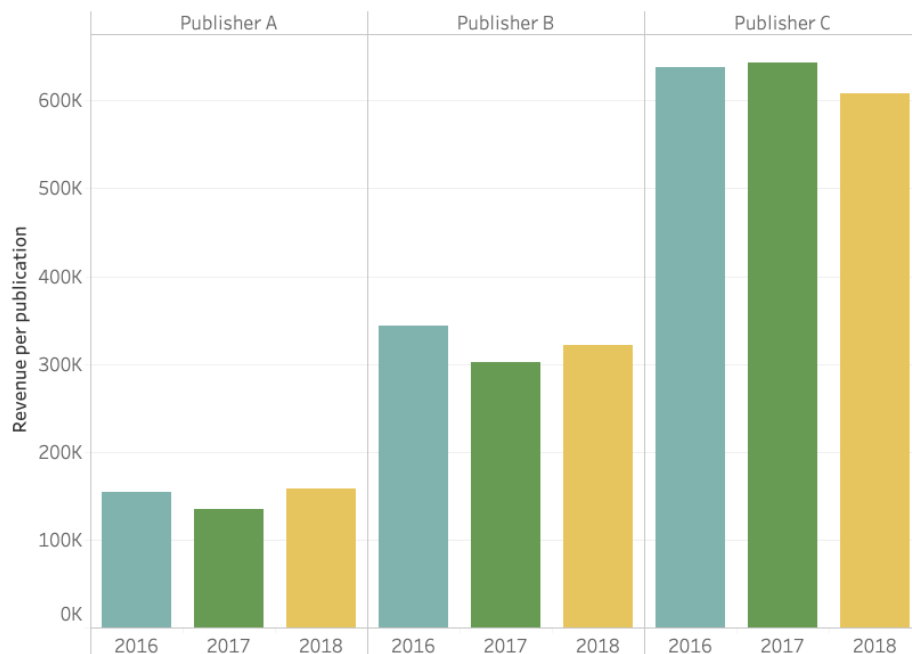


Figure 17: Revenue per publication

Naturally, the bookstores' focus on big titles, recounted by the interviewees, creates a vicious circle. The publishers who already sell large quantities of books continue to get space on the bookstores' shelves, while small publishers have much smaller chances of turning their titles into bestsellers without equally far-reaching access to bookstores across the country.

How the current big players got to their position is another question. Still, the interviews indicate that the advantage of being taken seriously by the bookstores comes with size. In other words, large volumes give the advantage of continuing attention from bookstores, creating

revenue streams. In contrast, bookstores show little interest in buying small publishers' books. Therefore, the attention from bookstores, which appears to result from large volumes, can be considered an important factor in explaining profitability variations between players.

6.9.2 Direct sales

As already mentioned, Publisher B (2020) sells its books not only to bookstores, but also directly to end customers, through its website, on conferences and Christmas markets. This strategy reduces their use of middlemen and allows them to keep more of the revenue. In fact, Publisher B (2020) notes the following:

When selling to bookstores, half the price goes to them. We earn the most when we sell books directly, we do not earn much through bookstores.

This highlights that publishers who engage in direct sales can find an important source of revenue in them. The earnings are higher, as the price does not include the bookstore discount which is required by bookstores when accepting a book onto their shelves. Moreover, end customers cannot receive high discounts on new publications due to the Book Agreement. However, for this to be substantial for the profitability, the publisher needs to put effort into making direct sales a bigger portion of the total revenue. Publisher B (2020) has several strategies to achieve this:

We sell directly through our website and to organizations. We take our books to conferences and fairs and participate in Christmas markets or arrange our own. This also helps to deal with older [unsold] books, which are still important and relevant. [...] This way we are not dependent on bookstore sales only.

Based on the insights from Publisher B, one can observe that reducing the dependence on bookstores and achieving higher direct sales can have an important impact on the profitability as it allows to obtain better prices. Moreover, one could argue that the direct sales channels, especially ones allowing face to face contact, strengthen the reputation and build higher customer loyalty, as the customers are able to get expert information and tailored recommendations. All in all, one can identify direct sales as an important factor which influences profitability.

6.9.3 Commissioned publications

Publisher A and C (2020) both noted that commissioned publications were an important revenue stream, with Publisher C (2020) estimating that they can make up to one third of the total revenue. Commissioned books differ from normal publications in that they are ordered by a company or an organization. Thus, the process is less risky as the number of copies is known in advance and there is a certain buyer.

This kind of publications can also be seen as a form of direct sales, as the middlemen are avoided. Yet, it is distinctive from them in relation to risk and the fact that commissioned publications only have one buyer. Still, they reduce the dependence on bookstore sales and are another noteworthy factor with influence on profitability.

6.9.4 Support schemes

Being a governmental policy, one important support scheme was already mentioned in the section on institutional factors, namely the procurement schemes for literature administered by Arts Council Norway. However, there are also other, private support schemes and grants which have an important impact. Publisher A and B (2020) both mention support schemes from the Fritt Ord Foundation, which supports book production and Norwegian culture in the wider context and other private grants.

One can therefore argue that publishing books which are eligible for both governmental and private support schemes and grants can contribute to higher revenues. As already mentioned, this can have the biggest impact on smaller publishers who cannot rely on the security of bestsellers for their revenue.

6.10 Conclusion of the analysis of profitability variations

The goal of this chapter was to examine different factors that can affect the profitability of publishing companies. Interviews with three different publishers were conducted and analyzed using the cost driver framework in order to answer the third research question, namely:

What are the potential sources of profitability variations between players?

The analysis examined six cost drivers, namely *economies of scale*, *economies of scope*, *complexity*, *institutional factors*, *capacity utilization* and *exploiting linkages*, to provide a more in-depth understanding on profitability in the context of publishing.

The analysis did not find clear cost advantages related to *scale*, both when suppliers and bookstores were considered. More specifically, *scale* is unlikely to considerably influence printing costs, while its impact on costs related to distribution and on bookstore discounts is uncertain, as it could not be examined based on the conducted interviews.

With regards to *scale*, having in-house designers in big companies is comparable with outsourcing the job by smaller companies in terms of costs and convenience. Furthermore, integrating distribution centers does not present advantages except for an additional revenue source. Lastly, there might be advantages of integrating bookstores, such as gaining a better understanding of what they want to buy and in what quantities, but these findings could not be confirmed.

Complexity, defined as the range of genres that a publisher offers, pointed towards the fact that specialized publishers are more likely to conduct acquisition effectively, but there was little evidence to support substantial differences in the editing process. Furthermore, *complexity* related to how complicated and long the book projects are indicated that more complex projects are less profitable.

Institutional factors such as the Book Agreement and procurement schemes revealed potential advantages from direct sales and from publishing books that are favored by governmental policies, respectively. *Capacity utilization* indicated that spreading the workload throughout the year might allow to obtain higher output of publications per editor.

Lastly, due to the fact that the publishing process consists of several activities that need to be done in a specific order, *exploiting linkages* stood out as potentially important. In other words, good coordination and relations both internally for in-house activities and externally for outsourced processes could help avoid delays and bottlenecks, thus positively influencing profitability.

Moreover, insights related to the revenue streams were discussed, including *access to bookstores*, *direct sales*, *commissioned publications* and *support schemes*. Specifically, the findings indicate that bookstores focus on bestseller sales, thus concentrating on buying books from big publishers which have a history of successful titles. This makes it challenging for smaller and middle-sized publishers to sell their books. Furthermore, the interviews uncover that succeeding at having a larger share of *direct sales* allows for higher revenues, *commissioned publications* reduce the risks related to sales and different *support schemes* can provide additional revenue sources independent of sales.

In all, it is important to keep in mind that the different cost drivers often are interconnected and that one should rather look at their interplay, rather than each of them separately, when trying to find sources of profitability variations between publishing companies. In other words, it is unlikely that there is a clear link between one cost driver and profitability. Therefore, the goal of this analysis was not to point to one specific feature that can explain profitability variations, but rather present an overview of the factors that stand out as ones having influence on profitability, even if the strength and range of this influence requires further research.

Moreover, it is important to note that this analysis was conducted on a limited number of interviews and could have benefited from a larger and more differentiated group of participants. Thereby, some of the findings might be the experience of a specific company, rather than a representation of the industry as a whole. Moreover, the collected data allowed only for a strongly qualitative research. Still, we believe that the analysis gives valuable insights and provides the directions in which one can look at in order to analyze factors that influence the profitability of publishers.

7. Profitable business models in the future

Having examined the current competitive environment, the profitability of Norwegian publishers in the recent years and the sources of profitability variations, it is only natural to look into the future and ask how the industry will change in the coming years. We believe that the previous chapters give some indications as to the future development in the industry, but there are several circumstances and trends – both in Norway and abroad – which have not been discussed but can be material in assessing what kind of publishing companies can be profitable in the future. We believe that the best way to approach this topic is by looking at business models of the publishing companies. Therefore, this chapter aims at answering the following research question:

Which business models can be profitable in the future?

In order to answer this question, we go through several business models that we identified as ones having profitability potential in the future, namely publishing companies selling directly to customers (henceforth referred to as direct-sales publishers), merged publishers and specialized publishers. The selection was based on examples from both Norway and abroad, as well as findings from the previous chapters. To examine the business models more closely, Osterwalder and Pigneur's (2010) business model canvas is applied. Lastly, we look at the impact of digitalization and the implications of the Covid-19 pandemic, before we conclude.

7.1 Direct-sales publishers

One of the findings in Chapter 6 revealed the potential of higher profits that lies in direct sales. Furthermore, the interviews showed that small and middle-sized Norwegian publishers face challenges related to sales through bookstores. Namely, the lack of interest from bookstores results in low sales and leads to higher storage costs, as the unsold books remain in the warehouse (Publisher B, 2020). Moreover, the bookstores represent a major cost for the publishers, as they demand high discounts which are nonnegotiable for the publishers with less power (Publisher A, 2020). This is especially the case with big bookstore chains which usually demand between 50-60% discount (Gjærde, 2012).

In this light, it is interesting to look at publishing companies which cut out bookstores completely and instead operate only by selling books directly to customers. This can be illustrated using the example of Altenberg, a Polish publishing company which sells its books only through their website. Notably, Altenberg started out by publishing books by online creators and plans to branch out in the near future (Druś, 2017). In the following, we analyze the business model, before we take a look at its potential in Norway.

The most notable difference between direct-sales and traditional publishers has to do with *value capture*. Publishers who only sell directly need to use money on building a strong presence on the market and attracting customers, as well as investing in an easy-to-use online shop. However, they benefit from the fact that their revenue is not reduced by the bookstore discount but equals the retail price. As mentioned, such discounts can amount to around 50-60% (Gjærde, 2012), so cutting out bookstores represents a substantial saving.

Notably, Altenberg does not apply the usual pricing model used in publishing, i.e. offering the book for a high price first and discounting it later on. Instead, the company offers a discount or free delivery on preorders, thereby rewarding the first customers, and offers the book for full and unchanging price after its release (Druś, 2017). The preorders allow to measure the interest in the book, making it easier not to overinvest in printing too many copies, while the constant price after release does not incentivize customers to wait and buy the book cheaper at a later date. This way, the company can *capture* more *value*.

Notably, Altenberg's owner notes that the savings allow them to pay authors 3-4 times more than traditional publishers (Druś, 2017). This represents obvious benefits for authors and can help publishers like Altenberg acquire well-known authors as *key partners*. Another *key partner* is the distribution company which now has to distribute to individuals instead of bookstores. Relations with printing companies, which are also *key partners*, remain unchanged when compared to traditional publishers. In relation to *key resources*, the need for sales and marketing employees stands out, as *key activities* of direct-sales publishers include building the brand and attracting customers to shop online rather than in bookstores.

The *customer segments* are dependent on whom the company wants to serve. It is therefore a company-specific decision, but on a more general note one could point towards the fact that the customer group should be comfortable with online shopping. This is due to the fact that

direct-selling publishers use their website with online shop as the *channel* to reach customers. Having this direct *customer relationship* also allows to gather and utilize data about the buyers to generate customer insight. Moreover, the publisher can communicate with the customers directly, for instance if they agree to receive newsletters. Such advantages are impossible when the bookstore is responsible for the contact with customers.

Lastly, the *value proposition* of direct-sales publishers is different from the traditional offers. Here, the publisher offers not only the book, but also an easy buying experience and delivery, making it unnecessary for the customer to visit bookstores to find the book they wish to buy.

As we saw through the example of Publisher B, some Norwegian publishing companies make direct sales a part of their operations and experience that it has a positive effect on the profitability. This can indicate that there is potential in the direct-sales business model also in the Norwegian market. Moreover, the reading survey published by Norwegian Bookstore Association (2018) shows that more customers buy books online. Namely, 36.3% of Norwegians bought at least one book online in 2017, which represents an increase from 31% in 2015. This suggests that there is an already ongoing change in the shopping behavior of book buyers, which can be decisive for the success of online direct-sales business models in Norway.

However, for many Norwegian publishers switching to direct sales only will not be a viable option, as it requires strong branding and marketing to succeed with sales. In fact, Altenberg's example illustrates that with this model, it is a substantial advantage to publish books of authors who already have an audience. If such an audience is in addition based online, such as communities that form around online creators and influencers, the advantage is even stronger.

It is needless to say that not all publishers in Norway publish authors with such audiences. In other words, they could experience lack of sales if they were to switch to direct sales only and fail to build up an audience through marketing. Yet, with the cost advantages of such models, as well as the turn towards online book shopping among customers, it will be interesting to observe whether the direct-sales model will become more prominent in the Norwegian market in the future.

7.2 Merged publishers

A noticeable, though not wide-ranging, development that can be observed in the Norwegian publishing industry has to do with merger. The example of Strawberry Publishing, mentioned in the competition analysis in Chapter 4, illustrates it well. The company can be considered as a market invader, as its aggressive entrance to the market placed it in the top 25 publishing companies by market share in 2018 (Norwegian Publishers Association, 2019).

The core idea behind Strawberry Publishing is to acquire middle-sized existing players, as well as to establish new publishing companies (Neraal, 2020). Besides benefiting greatly from the competence of the acquired publishers (Neraal, 2020), the company has also hired employees who left well-established companies like Gyldendal to work for them (Enge, 2019). Strawberry Publishing is however not the only case of middle-sized players being merged into one company. Another, though less aggressive, example is Solum Bokvennen Forlag which combined five former publishing companies together (Solum Bokvennen, n.d.). In the following, we examine the business model of such merged publishers in relation to traditional publishers, before we take a closer look at their profitability potential in the future.

Starting with value delivery, the first element that stands out in terms of merged publishers is *key resources*. By acquiring or merging publishers, the companies can have experienced employees working together and learn from each other. Naturally, there are cases where such a move will result in conflicts, but if executed properly it can also become a *key resource*. For Strawberry Publishing, another important *key resource* is hiring employees from big players such as Gyldendal (Enge, 2019). The acquired competence brings also an important network giving access to a combined group of *key partners*, thereby strengthening the position of the company in relation to the formerly individual publishers. The *key activities* remain the same as before, focusing on editing and production, as well as sales.

This business model does not stand out in terms of *channels*, *customer relationships*, *customer segments*, as well as *value proposition* in a way that the direct-sales model did, unless the company decides to change the way they do business. For instance, Strawberry Publishing sells its books both in the major bookstore chains and on their website and offers books in many different genres to cater the needs of a wider audience – which is fairly standard for individual publishers. Therefore, also the *cost structure* and *revenue streams* are similar to the

traditional model, where the revenues are affected by the bookstore discount and costs consist of editing, production and distribution.

When it comes to current profitability, Strawberry Publishing has had negative results in the past years. This might be explained by the fact that it is still in the growth stage of its lifecycle, which is more cost intensive, as the company has not matured and stabilized yet. This suggests that even though their business model is not profitable yet, it has a potential to become so in the future, especially given their success in gaining market share at early stages. When it comes to Solum Bokvennen, its operating margin is positive and shows an increasing trend between 2016-2018.

Even though no economies of scale, defined by Porter (1985) as direct cost advantages obtained when producing a larger volume, could be identified in Chapter 6, both examples indicate that there are other advantages of merging publishers together. They can include stronger position due to increased market share, competence-building and learning between the formerly individual publishers, and lower costs from centralized administration. This can have a positive influence on the profitability.

On the other hand, there are also disadvantages of such mergers. When asked about becoming a part of a bigger publishing house, Publisher A (2020) highlighted the disadvantage of being subject to others' decision-making systems. She emphasized their wish to stay independent, but at the same time could see that better financial predictability could be an important reason to consider this solution (Publisher A, 2020).

All in all, we believe that merged publishers are an important group to consider when examining business models that have the potential to be profitable in the future, as they provide advantages such as stronger market and financial position, as well as competence-building. Whether more publishers will merge in the future remains to be seen and will depend on the individual publishers' perception of these advantages and the degree to which they wish to remain independent.

7.3 Specialized publishers

Lastly, one cannot consider which business models can be profitable in the future without mentioning specialized publishers. As the findings in Chapter 5 showed, specialized publishers had a significantly higher operating margin compared to publishers with broader selections of books. Moreover, the interviews examined in Chapter 6 suggested higher customer loyalty and efficiency of book acquisition among specialized publishers. In the following, we take a closer look at this business model and consider its potential in the future.

Independent of the genre in which the publisher specializes, the *value proposition* will usually focus on the publisher's expertise and the fact that the offered books therefore have high quality. To illustrate, Abstrakt Forlag, one of the publishers included in the sample in Chapter 5 which specializes in academic literature, states on its website that quality and insight into the various academic fields they work with is the core of the company.

Therefore, *key resources* will include editors with expertise, while *key partners* can be authors who specialize in the given field, but apart from that will not differ very much from traditional publishers. *Key activities* will still center around editing and producing the book. Moreover, while the *customer segments* will be narrower than for publishers with wide selections, the *channels* and *customer relationships* will not be different.

Thus, the *cost structure* will still be based on the editing and production cost, and *revenue streams* will come from sales through bookstores or through direct sales. For instance, academic publishers are likely to utilize the bookstore chain Akademika, which has outlets located close to major Norwegian universities. A special case are publishers which specialize in commissioned publications only. As mentioned, they face lower risk as they do not need to predict the demand of their publications, but rather produce what the customers order and deliver directly to them.

As long as specialized publishers are covering an existing demand for books within their area of expertise, there is little to suggest that such business models should not be profitable in the future. One can suppose that the profitability potential can attract new players, thereby potentially increasing the competition, but the expertise required to start such a company and

build its reputation can be a barrier for potential newcomers. All in all, it will be interesting to follow the profitability development of specialized publishers in the future.

7.4 Impact of digitalization

When considering business models that can be profitable in the future, one also has to consider the impact of digitalization and its potential to be disruptive. In the publishing industry, digitalization manifests itself in new formats like e-books and audiobooks, but also in the possibility of online sales. In a broader perspective, digitalization can also change how authors publish books and how customers consume them. In the following, we examine these aspects and their implications for publishing companies in more detail.

Firstly, let us consider the implications of new digital formats. Ibenholt (2017) argues that e-books can be a challenge for publishers, as they give room for illegal use of books, such as unauthorized copying and sharing. This argument can also be extended to audiobooks, as they also exist as digital files. Ibenholt (2017) argues that because the book industry is divided into smaller national markets and the readers prefer the traditional paper format, there has been few incentives to develop good payment mechanisms and reduce the risk of piracy. Although the digital formats make up a small percentage of sales (Ibenholt, 2017), in the light of piracy, their future rise could affect the revenues of publishers and be a threat to their profitability. However, their existence does not change the role of publishers or the way they do business otherwise.

On the other hand, the possibility of online sales can change the business models of publishers to a higher degree. As we have covered the topic in the above section on direct-sales publishers, we will not go into detail here. However, it is worth mentioning that online sales open for international competition from players like Amazon. Although the main consequences of this development apply to bookstores, publishers can be affected, too. If Norwegian bookstores face lower sales as a result of international competition, they will likely buy less books from Norwegian publishers. However, the increase of competition might not be as strong, since it depends on the readers' preferences regarding the language. Norwegian customers may have a preference for books in their own language, while Amazon offers most

books in English. All in all, one can see that online sales bring both opportunities and threats for publishers.

The implications of digitalization examined so far are important, but not disruptive for the publishers. However, there are other effects of digitalization which might make the current business models of publishing companies unfit for the future, and thus threaten their position. The first one has to do with the way in which readers consume books.

As digitalization has not come a long way in the book industry yet (Ibenholt, 2017), it is worth taking a look at other industries. In the music industry, the rise of streaming platforms like Spotify has influenced the customers' relationship with records, changing their preferences from ownership to access (Luck, 2016). The existence of streaming platforms for audiobooks such as Storytel and Fabel, as well as subscription services for e-books and audiobooks like Ebok.no Pluss might have a similar potential. Today, publishers rely on selling books, but if ownership of books was to become less important to readers, the sales-oriented business models of publishing companies could become ill-suited to cover the needs of consumers.

Another aspect of such a development is curation. In the music industry, streaming services like Spotify influence what users listen to through the playlists they create and promote (Constine, 2017). Thus, they have the power to influence an artist's success. If streaming platforms were to become an important form of book consumption, they would also be in the position to influence which books get readers' attention. Although bookstores have a similar power today, the use of algorithms to provide users with personalized recommendations might multiply the effect and deprive publishers of more of their power.

Whether such a development is probable is another question. On one hand, most readers prefer physical books to their digital alternatives (Ibenholt, 2017; Handley, 2019) and switching from reading to listening to books can be considered an invasive change, as it implies a different way of consuming the book. Yet, with Storytel and Fabel experiencing an unprecedented growth during the Covid-19 pandemic (Bok365, 2020), new habits might form among readers.

Another potentially disruptive aspect of digitalization is the fact that it makes self-publishing easier. For instance, self-service platforms like BoldBooks which provide a network and tools for authors to self-publish their books have been launched in Norway (Ibenholt, 2017). As

self-publishing allows authors to retain more of the revenues to themselves and to have more control over the choices made in the publishing process, more and more authors choose to self-publish their books (Ibenholt, 2017). Colbjørnsen (2015) points out that this can lead to disintermediation, a phenomenon which refers to the disappearance of middlemen in a value chain (Chircu & Kauffman; Martin & Tian, referred in Colbjørnsen, 2015). In other words, publishing companies could become unnecessary, as a result of self-publishing solutions. This is yet another example of how technologies can have a disruptive effect on the publishing industry, making their business models obsolete.

It is worth mentioning that publishers view self-publishing as a complimentary offer, rather than a threat (Ibenholt, 2017). This attitude might mean that they overlook the risks related to the disruptive potential of technology and a future where their current business models will no longer be functional. Therefore, to secure that they can operate in a profitable manner in the future, they should consider the impact of digitalization. Both big and small publishers are in a position to do so, though they can draw on different advantages. Big players can exploit their resources and existing infrastructure, while small publishers have bigger flexibility and adaptability (Colbjørnsen, 2015) when facing the digital opportunities and threats.

All in all, we see that the effects of digitalization can be diverse. Digital formats can threaten the profitability of publishers, but do not change their role as such. Online shopping can provide opportunities for direct-sales, but might also have a negative effect on sales due to increased competition among bookstores. However, digitalization can also bring more disruptive changes. For one, the way in which readers consume books can change. If ownership of books becomes less important for customers, the sales-oriented business models of publishing companies could become ill-suited to the market situation and publishers could lose their position. Moreover, with the rise of self-publishing, another threat lies in the fact that authors might deem publishers unnecessary in their book publishing processes. All in all, disruptive technological changes could mean that the business models which publishing companies currently operate with will not be profitable in the future.

7.5 Implications of the Covid-19 pandemic

It is impossible to analyze the future development of any industry today, without looking at the consequences of the ongoing pandemic. Although the outcome of the situation is uncertain, we will take a short look at the implications that are visible already today.

The newest figures from the Norwegian Publishers Association (2020) show that, compared to April last year, sales of physical books decreased by 35%, while sales of digital books increased by 31%. Moreover, some publishing companies are postponing book releases or cancelling planned projects (Enge, 2020). This is the result of the fact that bookstores are not willing to take risks and therefore prefer to sell what they already have in stock rather than buy new books from publishing companies (Enge, 2020).

As bookstores are the most important sales channel for Norwegian publishers, this situation is affecting their revenues (Grünfeld et al., 2020). However, according to the report prepared for Arts Council Norway, other channels such as direct sales and sales to libraries are not directly affected by the pandemic (Grünfeld et al., 2020).

For small and middle-sized publishers with low cash reserves which rely on paper book sales through bookstores this situation can in the worst case mean bankruptcy, if the governmental support schemes are not enough to carry them through the crisis. However, the publishers that have focused on direct sales or digital offers can experience the opposite and grow during the pandemic. For instance, Gyldendal notes increased demand for digital textbooks for higher education (Rogne, 2020).

Moreover, according to Gyldendal, several genres are experiencing a growth in sales, namely childrens books and non-fiction books within hobby and needlework (Rogne, 2020). On the other hand, crime sales at Gyldendal were lower than expected (Rogne, 2020). Although this experience is specific for Gyldendal, it can suggest that some publishers will suffer more than others, depending on the genres they publish.

All in all, the extent of the effects of the pandemic remains uncertain, but the consequences visible today suggest that there will be both winners and losers. The effect on individual publishers depends on their reliance on bookstores, digital offer and the selection of genres.

7.6 Conclusion

The goal of this chapter was to examine how the publishing industry can change in the coming years. To address this topic, we took the business model perspective and used Osterwalder and Pigneur's (2010) canvas to answer the fourth and last research question, namely:

Which business models can be profitable in the future?

The analysis looked at direct-sales, merged and specialized publishers, all of which have the potential to become or remain profitable business models in the light of our analysis. The most innovative one is the direct-sales model which captures more value by cutting out bookstores and thus avoiding high bookstore discounts. Furthermore, merged publishers can draw advantages such as stronger market and financial position, as well as competence-building, which also can have positive implications for profitability. Lastly, specialized publishers have a good point of departure for being profitable in the future, as their operating margin is significantly higher than that of publishers with broader selections of books.

Naturally, the future development is uncertain, and the above-mentioned models face different challenges. To illustrate, the direct-sales publishers are dependent on building a strong presence in the market, merged publishers need to overcome potential conflicts and inefficiencies related to combining formerly individual companies, while the profitability of specialized publishers can be threatened by new entrants.

Moreover, digitalization and technological changes add another layer of uncertainty. New digital formats and online shopping can affect the profitability of publishers, but a far more disruptive effect can come from change in the way customer consume books, as well as the rise of self-publishing. In the light of disruptive technologies, the current business models of publisher might become ill-suited to serve the customers or even obsolete.

Furthermore, it is clear that the industry will be impacted by the ongoing Covid-19 pandemic. The impact can be both positive and negative, depending on factors such as the publishers' reliance on bookstores, their digital offer and their selection of genres.

8. Conclusion

8.1 Final conclusion

The purpose of this thesis was to examine the profitability of the Norwegian publishing industry, as well as to analyze sources of profitability variations between players. The profitability of the industry was studied based on financial statements from a sample of 76 Norwegian publishing companies, while the factors behind profitability variations were explored based on in-depth interviews conducted with three publishers.

The objectives of the thesis were encapsulated in the main research question, namely:

What can explain the profitability of the Norwegian publishing industry, and the variations between players?

We broke this research question down into four points.

1. What is the level of competition in the Norwegian publishing industry?

Firstly, to understand the competitive environment, we examined the competitive forces and the value creation potential of the industry. We found that the Norwegian publishing industry is characterized by a high level of competition. Lower price/quality ratio of substitutes, high bargaining power of bookstore chains and low barriers for new entrants were among the reasons behind the high rivalry.

As for the forces affecting value creation, one can point out that globalization and digitalization can increase the number of units, while value creation per unit can be driven up by steady income growth and down by the substitutes and digital formats which affect the price expectations of customers. However, the question of which of these forces has the strongest influence on the value creation remains unresolved.

2. What is the profitability of the industry?

The profitability analysis showed that the industry had an average operating margin of 4% and a median of 2% in the studied period of 2016-2018, while the average and median return on assets were both 3%. The development in both ratios between 2016-2018 indicates a

downward trend. Furthermore, the analysis revealed considerable variations between players, both in terms of operating margin and return on assets.

A common-size analysis was conducted to gain a better understanding of the cost items influencing profitability. It showed that cost of goods sold had the biggest impact on the bottom-line, followed by salaries and other operating expenses, while depreciation was of little importance as the industry is labor-intensive. This illustrates that for many publishers, focusing on reductions in COGS can be an important step towards obtaining better results.

In addition, by conducting a multiple regression we found that publishers of academic literature and publishers with narrow genre ranges had a statistically significant positive linear relationship with operating margin.

3. What are the potential sources of profitability variations between players?

Interviews conducted with publishers indicated several factors that could explain profitability variations between players. We found that publishers with wider selection of genres were likely to be less efficient in decisions regarding book acquisitions. Moreover, the length and complexity of book projects, high capacity utilization without seasonal variations, as well as internal and external coordination and relations were identified as important cost drivers. Furthermore, governmental procurement schemes were important for profitability, especially for smaller publishers.

Additional findings showed that one of the main challenges that smaller and middle-sized publishers face is access to bookstores, as bookstore chains tend to buy and promote books from big publishers who have a history of successful titles. Therefore, other revenue sources such as direct sales, commissioned publications and support schemes could play an important role in securing profitable operations.

4. Which business models can be profitable in the future?

Lastly, we considered the future profitability of the industry, taking the business model perspective. Based on the previous findings and examples from the industry in Norway and abroad, we argued that publishers who focus on direct sales, as well as merged and specialized publishers have potential to be profitable in the future.

Moreover, we examined the impact of digitalization. While digitalization creates opportunities like online sales and opens for threats such as piracy, the main risk lies in overlooking the fact that it can cause disruptive changes to the industry.

For one, the development of audiobook streaming platforms might change how readers consume books. If streaming was to become the preferred way to consume a book, the current sales-oriented business models of publishing companies would be ill-suited to cover the needs of consumers and streaming companies would gain power. Moreover, the rise of self-publishing can lead to the disappearance of publishers from the value chain.

While the probability and extent of such disruptive changes is arguable, they illustrate that overlooking the impact of digitalization can be dangerous for publishers. All in all, the Norwegian publishing industry is certainly characterized by complex dynamics, and digitalization adds yet another layer of uncertainty to it.

8.2 Suggestions for further studies

Working on this thesis proved to us that the Norwegian publishing industry is both interesting and complex. While writing, we found several areas that could be studied further.

In particular, we believe that the big players' perspective is a topic which requires better insight and understanding. We had the opportunity to talk to three small and middle-sized publishers but were unfortunately unable to conduct interviews with the biggest players. Therefore, we believe that it would be valuable to see studies which obtain in-depth perspectives from the biggest publishers on the market.

Moreover, our research had a descriptive and an explorative purpose, i.e. it aimed at describing the profitability levels of the industry and giving indications of what could explain variations between players. However, further and more detailed research could be conducted to find causal relationships between profitability measures and different variables.

Furthermore, comparative studies with publishing industries in other countries could also be an interesting alternative for further research. Lastly, the impact of digitalization on the profitability of the industry and on the business models of publishing companies is a broad

and relevant topic which could constitute a separate study. More specifically, investigating potential disruptive changes and how publishers could adapt to them could be a useful contribution of managerial importance.

We believe that this study can function as a background for further research on the topics related to the profitability of the Norwegian publishing industry and hope to see more studies related to this field in the future.

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Appendix A

Quantitative questionnaire

Company name: _____

How many years has this company been operating? _____

How many full-time equivalents did you have in recent years?

2016: _____

2017: _____

2018: _____

How many of these were editors?

2016: _____

2017: _____

2018: _____

How many publications did you have in recent years?

2016: _____

2017: _____

2018: _____

How many different genres do you work with? (Specialized or wide selection?)

Appendix B

Interview Guide

About the interviewee

- What role do you have in the company?
- How long have you worked in this company? And in the publishing industry?

Introductory questions

- What is the company's core business, compared to other publishing companies?
- How do you experience the profitability of the company in general? (Good, moderate, unprofitable etc.?)

Product range

- *With reference to number of genres.* Why have you decided to publish a narrow selection of genres/many genres?
- How does the complexity (number of genres) affect the work efficiency in your company?

Learning

- *With reference to number of years in operation.* How do you experience the learning and competence-building in the company during the years of operation?
- To what extent do the employees contribute to continuous improvement of processes?
- Do you have employees who previously worked for other publishers? If so, to what extent do you experience that they contribute to learning and competence-building in your company?
- To what extent do you observe other publishers and learn from them?

Capacity

- To what extent do the employees experience available capacity? What is the reason for any available capacity?
- Are there any cyclical or seasonal variations in capacity utilization?
- How well are the internal activities in the company coordinated? To what extent do you experience bottlenecks and where?

Size and scope

- To what extent do you experience that the size of the company affects the bargaining power and relationships with suppliers (e.g. with printing companies or distribution centers)? And with customers (booksellers)?
- Which processes do you outsource? (Printing, proofreading, design, distribution etc.)? Why? How does it affect the costs and quality?
- How good is your coordination with external players?
- Are you a part of a larger publishing house? (Horizontal integration)
 - If so, what are the advantages / disadvantages of being a part of a larger publishing house?
 - If not, what are the advantages / disadvantages of **not** being a part of a larger publishing house?
- Are you vertically integrated? (I.e. is your company a part of an organization which also owns bookstores, distribution centers, printing companies or other parts of the value chain)?
 - If so, what are the advantages / disadvantages of being vertically integrated?
 - If not, what are the advantages / disadvantages of **not** being vertically integrated?

Profitability

- What do you think contributes to the profitability of your company the most?
- What drives your costs up? Down?
- What drives your revenues up? Down?
- Do you have any sources of income other than selling books?

Ending

- Is there anything you would like to add?
- Can we contact you if we need more information?