



***Mondadori,
How to survive in the
E-book era***

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ABSTRACT

Title: Mondadori, how to survive in the e-book era.

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Mondadori is the Italian market leader in the publishing industry, with a history of more than 100 years of experience in the field. The company headquartered in Milan, is the biggest book and magazine publisher in Italy and the third largest in the consumer magazine category in France. The book category currently accounts for almost 25% of the annual revenues and since the year 2010, the company started focusing also on the digital contents for books.

The case study offers an overview of the market from both a global and a local perspective, with the focus on the Italian situation, where the main topics addressed are the competitive landscape, the digital growth and the digital piracy. This industry analysis is needed to show the environment where the company is working and to make understand possible threats and opportunities, like for example the new regulations on e-books arising through the new Italian government. The following chapters deal with an overview of the company, with a specific analysis on the strategic choices in the e-book market in the past, present and future.

The purpose of the case is to provide the reader sufficient information to evaluate the three strategic alternatives offered and therefore he or she should be able to formulate a complete reasoning behind each of the three options. The first one is focused on reducing the price on e-book as a way to engage further the readers and the reader should be able to understand if such an option could be profitable for Mondadori or not; after that the suggestion is to think about an innovative way to exploit social media to reach out to new readers and to forecast future trends, especially in terms of authors. The last option presented, deals with the new trend of subscription models and the question is whether such a model, which worked successfully for the music and film industries, can be valuable for publishing companies.

Key words: E-book, Publishing industry, Innovation.

RESUMO

Título: Mondadori, como sobreviver na era e-book.

Autor: Riccardo Schena

A Mondadori é líder do mercado italiano na indústria editorial, com uma história de mais de 100 anos de experiência no ramo. A empresa, com sede em Milão, é a maior editora de livros e revistas em Itália e a terceira maior no segmento de revistas para o grande público em França. A categoria de livros é atualmente responsável por quase 25% das receitas anuais da empresa e desde o ano 2010, a Mondadori começou a concentrar-se também em conteúdos digitais para livros.

O estudo de caso permite uma visão geral do mercado tanto do ponto de vista global como local, com um foco na situação italiana, onde os principais temas abordados são o cenário competitivo, o crescimento digital e a pirataria digital. Esta análise da indústria é necessária para mostrar o ambiente em que a empresa está envolvida e para entender possíveis ameaças e oportunidades, como por exemplo a nova regulamentação sobre e-books que surge através do novo governo italiano. Os capítulos seguintes contêm uma visão geral da empresa, com uma análise específica das escolhas estratégicas no mercado de e-books no passado, presente e futuro.

O objectivo do caso é fornecer ao leitor informações suficientes para avaliar as três alternativas estratégicas apresentadas e, portanto, ele ou ela devem ser capazes de formular um raciocínio completo aquando a justificação de cada uma das três opções. A primeira é focada em reduzir o preço dos e-books como forma de envolver ainda mais os leitores e o leitor deve ser capaz de entender se tal opção poderá ser rentável para a Mondadori ou não; posteriormente, a sugestão é que o leitor pense numa forma inovadora de explorar as redes sociais de forma a chegar a novos leitores e prever tendências futuras, especialmente em termos de autores. A última opção apresentada trata da nova tendência de modelos de subscrição e a questão é se tal modelo, que foi bem sucedido nas indústrias de cinema e música, pode representar uma mais valia para editoras.

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“A reader lives a thousand lives before he dies. The man who never reads lives only one.”

George R.R. Martin

Even though only my name appears on the cover of this dissertation, it would have not been possible to complete it without the help and the careful support of the kind people around me, unfortunately it is possible to give particular mention here to only some of them.

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MONDADORI: HOW TO SURVIVE THE E-BOOK ERA

1) INTRODUCTION

It is the fourth consecutive year that the Italian book market is showing substantial decrease in sales: even flat forecasts for 2018 would be a positive signal, but that line is continuing in its vertical decline; publishing companies are being shot down and printers stop working in more and more cities of the country that used to be synonym of culture, but that now is drifting away from those golden ages. This situation is not in line with the world trend, though, which is showing more and more signs of recovery from the economic crisis that crippled the consumption of culture as if it was a luxury item unnecessary in troubled times.

The Italian cultural level is below the European average and this is mainly due to inefficient school policies, cutting down instruction funds in order to be better allocated in more important sectors at the moment; moreover the state and the media incentive to book purchase and consumption is quickly disappearing and more profitable options are being chosen to keep the people entertained, TV series would be a good example of it.

The digital revolution is putting at risk the status quo of companies that are working with a product unchanged for centuries: the paper book. Mondadori, being the market leader with years of entrepreneurial and managerial experience, simply cannot lay back and avoid attacking the new situation arising.

The CEO is sitting on a chair as uncomfortable as the iron throne¹, while he's reading the report carefully prepared by its internal experts that are offering five different strategies to succeed in the upcoming environment. The only thing to do now is to analyse them and to decide which and how many to start implementing.

The job is tough and risky, but it has to be done now.

¹ The Iron Throne is the seat of kings in the popular book series from George R.R. Martin "*A Song of Ice and Fire*", then adapted to TV show (HBO) with the name of "*Game of Thrones*". It is known to be a "*monstrous uncomfortable chair*" [a] both because it is described as cold and hard, with many jagged edges and because it is used as a metaphor to refer to the king's decision-maker role.

2) THE COMPETITIVE ENVIRONMENT

2.1) Global Statistics and Trends

2.1.1) Industry definition

Mondadori should be considered as part of the publishing industry, which is a subsector of the broader media industry: “*companies in this industry produce, process, or distribute information and entertainment content for books and newspapers, motion pictures and music recordings, and radio and TV programming, as well as for the Internet and software*”. [b]

As for the publishing industry, this research is going to be focused on books, composed of a physical and digital categories: the physical book industry claims its origins with the invention of the movable type mechanical printing technology, credited to the German printer Johannes Gutenberg, in 1450. In modern times companies engage in printing fiction and nonfiction trade books, as well as educational and professional titles, in print and digital formats on apparel and textile products, paper and plastic; they may also provide support services such as typesetting, platemaking, and bookbinding. Moreover, the production includes atlases, dictionaries, encyclopedias, textbooks, guidebooks, musical scores, maps, fiction and non-fiction. [c] [d]

Digital innovation changed the competitive landscape through electronic books (or e-books): digital objects with textual and/or other contents, arising from integrating the concept of books, with features provided in the electronic environment of a computer or a specifically designed device (e-reader).

A brief supply chain analysis is here offered, in order to give the reader a better understanding of the dynamics inside the industry. The main players analyzed are the key components of the supply chain: publisher, printer, distributor and bookstores / retailers.

The publisher oversees the whole production and selling process of a book and, because of that, its business includes different costs: editors reviewing each book, sales force, distribution centers, corporate staff and marketing expenses; together with seeking for new authors and new ideas, constantly aiming at the next best seller. Publishers follow the profitability of each book and need to adjust the ones underperforming.

As soon as the publisher’s contents and layout are ready, it refers to the next player in the chain, who can be insourced or outsourced, the publishing company: the printer. Trade-book

printing represents a surprisingly small portion of the sales of these companies that can rely more on catalogues, retail inserts, business forms, advertising coupons, instruction manuals, annual reports and marketing brochures.

The distribution companies, which in the case of big publishers usually work in parallel with the integrated distribution network, represent the next step in the supply chain: wholesalers buy in bulk from publishers and then ship smaller quantities to independent booksellers and sometimes to chain stores.

The last player in the chain is the one in direct contact with consumers: bookstores. The various changes happened in the industries made these small and comfortable shops changing business model from the traditional retail activity to something akin to an intellectual social outing. [e]

2.1.2) Market analysis

Book publishing as a truly global industry begun in 1998, when the German group Bertelsmann acquired the largest trade publisher in the world: Random House, headquartered in New York and moved the central command for all its book publishing to the United States. Many observers agreed that this event marked a shift for the business of books. [f]

In 2014, the United States of America are the largest book market in the world by far, yet followed by China, Germany, Japan, France and the United Kingdom. The global commercial publishing industry generated about \$119bn in 2013 annual revenue², showing a moderated growth on the global scale and the projections are forecasted to continue with this trend until 2018.

Books purchasing preferences are shifting away from the traditional channel of bookshops, preferring an online service instead: this fact increased buyer power, as consumers can compare between retailers on price and stock, while switching costs in terms of loyalty and lock-in to the bookstores are decreasing. Amazon.com Inc. is consolidating its position of market leader for online sales in many countries, and most bookshop chains have websites allowing reaching the products away from the store.

Brand loyalty tends to be mostly towards authors, rather than publishers, although some prestigious imprints exist in areas such as academic publishing and literary classics.

² The physical category accounted for 92.8% of the overall value, while the remaining 7,2% is referred to the digital contents.

2.1.3) Leading companies

The industry is highly concentrated because of the decreasing production costs of the great companies, exploiting economies of scale throughout all the supply chain, and due to the clear advantage in bidding for new manuscripts or authors from the biggest players.

The concentration of the industry is represented by the fact that the 10 largest publishing groups account for over half of the revenues of the 50 largest publishing groups. At a first glance, the top global publishing companies seem to reflect a surprising stability and continuity, from 2009 to 2013.

	2009	2013
Top 10	€ 27.553	€ 28.492
Top 11-20	€ 20.469	€ 11.334
Top 21-50	€ 10.146	€ 12.789
Top 50	€ 48.168	€ 52.615

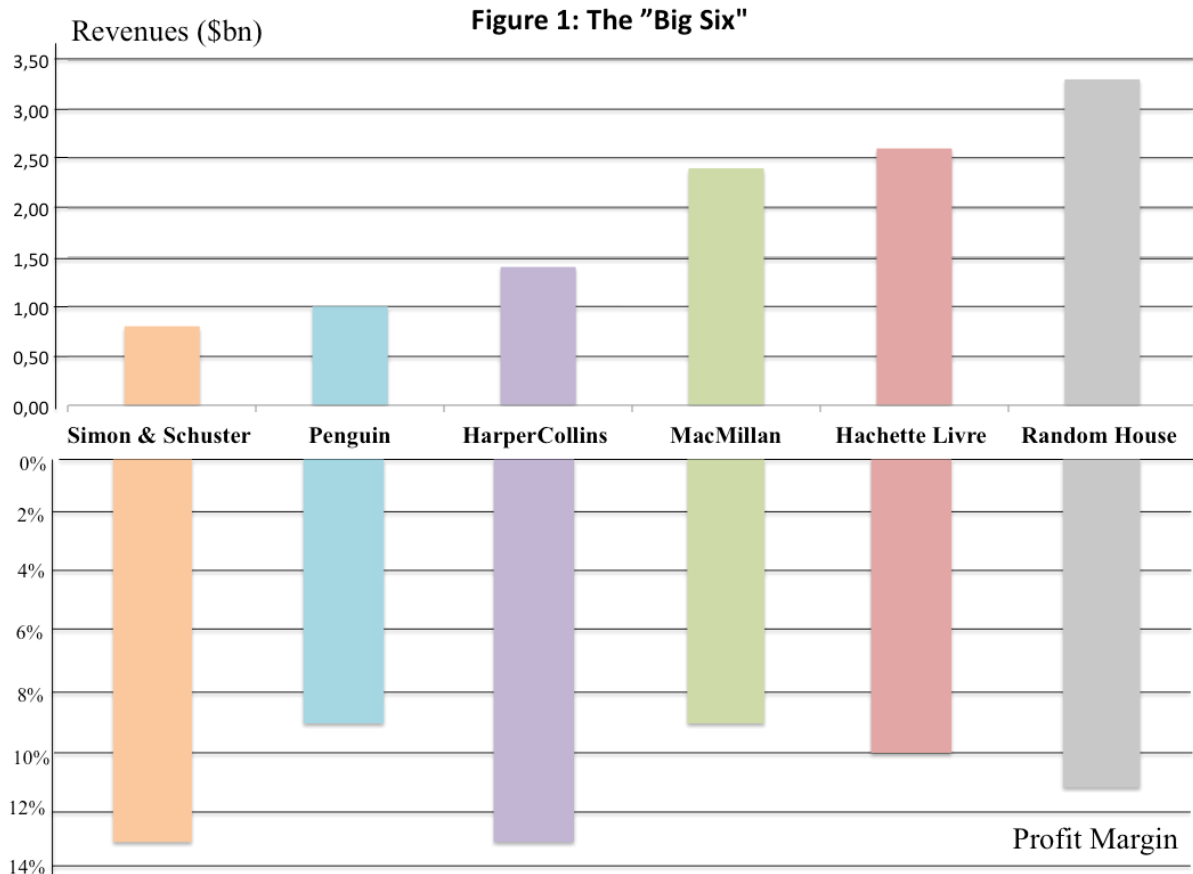
Table 1: Evolution of revenues within the Top 50 listed publishing companies (in M€).

Source: Bloomberg: The Bookseller; Publishers Weekly

As a consequence, most books are published by a small number of very large book groups that enlarge their grasp to wholesalers, retailers, school districts, colleges, libraries, businesses and book clubs. Approximately 60% of English-language books were produced through the "*Big Six*"³ publishing houses: Penguin, Random House, Hachette Livre, HarperCollins, Simon & Schuster and MacMillan. [g]

Besides that, thousands of smaller book publishers manage to survive and co-exist, mainly due to their specialization in specific areas: the focus must be on a specific subject or market. Moreover, thousands of authors have created their own publishing companies, and self-published their own works.

³ In 2013 Penguin and Random House merged together, forming a new colossus of the industry and changing the "*Big Six*" into "*Big Five*".



2.1.4) Digital Growth

For the last two centuries the book industry has been considered a special category of the cultural media industries, because of its power in exchanging and trading ideas; therefore it was easily speculated that the digitalization of contents, would have had a limited impact on books when compared to the music or film industries, where the innovative disruption was significant on all the players involved.

A direct comparison between the book and the other cultural media industries, would be misleading due to the different nature of the product, of the services around it and also of the consumers' requirements in terms of effort and time consumption. An additional comparison inside the book market between the digital and physical market is uncertain as well, mainly due to the lack of consistency in the rules for the analysis. E-book bestselling rankings are usually not the same as the printed ones; therefore they allow a different understanding of the digital market as a new category, not just as an additional format complementary of the printed editions.

Even with this complexities around the analysis, it is safe to say that the digital innovation in the publishing industry is going to evolve differently than how it evolved in the music and film industries, even if similarities will arise: the e-book is not likely to substitute the physical product in the immediate future and this lead to the “*coexistence scenario*”, where digital and physical contents will share the space in the market.

“Digital will continue to grow for a while at least, and continue to exist, because it is becoming part of the world we inhabit at a level below our notice, no more remarkable than roads or supermarkets. E-books are here to stay because digital is, and quite shortly we’ll stop having this debate about paper vs. e-books because it will no longer make a lot of sense.” [h]

In most countries e-books are gaining market share, but yet the local variations are still significant, especially when taking into consideration a culturally fragmented environment like the European Union: Germany has started to evolve similarly to the English language markets, with a lag of roughly three years; Spain had also a fairly impulsive start, while in France and in Italy, the momentum seems to be still limited.

Nevertheless, the expansion of distribution platforms and channels that happened during the last years has brought the internationalization of publishing, books and reading to an entirely new dimension, pushing to the global market. Players like Amazon, Apple and Google embraced the industry’s evolution into global publishing by entering in each part of the value chain as a publisher, distributor, market place for third parties, reading platform and reading community.

“The Internet is disrupting every media industry [...] and Amazon is not happening to book selling, the future is happening to book selling.” [i]

2.1.5) Digital Piracy

Digital piracy can be defined as the illegal copying of digital goods, software and digital documents (audio and video), without explicit permission from and compensation to the

copyright holder.⁴ The World Intellectual Property Organisation (WIPO) has developed several treaties in protection of copyrights: The Copyright Treaty, The Performers and Producers of Phonograms Treaty and The Databases Treaty.

As it already happened in the music and the motion picture industries, piracy is becoming a major threat in the publishing industry as well, since readers can choose to download contents from illegal sources for free. Publishers should understand better the impact of book piracy, in order to have a clear perspective on how to approach the issue; one of the key elements to study is the reason behind the illegal download, when a reader could have had purchased the same content legally.

Between the many reasons, the ones that seem to explain better the motives of someone downloading illegally are: simply the love of pirating and doing something against the rules; creating collections of movies, music and books that may never be used; while sometimes people can't afford to pay. If the first two categories may never be convinced to change their illegal behavior without a stronger legal frame, there is a consumer segment who is engaged in pirating because legit, paid options are not available. In the modern western society, the “*on-demand model*” is the need in the media industry and the lack of a paid option can turn willing customers towards piracy. According to Brian O'Leary, “*Piracy really is the consequence of not meeting consumer demand.*”

What should book publishers do, if they want to avoid some of the piracy issues that have plagued the music, movie, and television industries?

Complete censorship should be avoided, in order to protect the freedom of authors and online users and so far, the only solution offered by the industry associations is a campaign of information and responsibility towards consumers, who need to understand the value and the importance of contributing to the survival of the industry. Addressing the needs of the market, while creating a legal system that repays the copyright holder at the same time, is one of the main reasons why, in other similar industries, the “*subscription model*” gained much appreciation from the public and is still one of the best measures against digital piracy.

"I think the average consumer cares about getting the content that they want, when they want it, in the format that they want, without a lot of overhead, at a reasonable price," says Brian

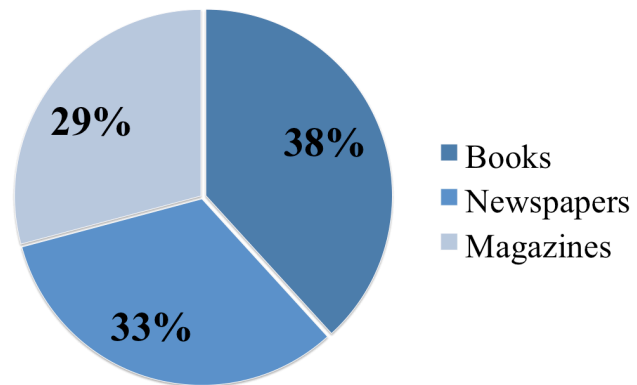
⁴ Gopal, Sanders, Bahattacharjee, Agrawal, & Wagner, 2004

O'Leary. "I think that publishers who realize that and organize their work and their publishing strategies to address those needs are going to succeed."

2.2) The Italian Market

2.2.1) Market analysis

In 2013, the Italian publishing market had total revenues of \$10.8bn, but it displayed contraction for the fourth successive year, with a double-digit percentage decline in revenues, likely to be followed by same negative trends until 2018. The book's category was the most lucrative, followed by newspapers and then magazines.



Source: Marketiline

Figure 2: The Italian Publishing Market

Due to a strong language barrier and an appreciation of local authors, the Italian book market confirms itself as strongly related to its national production and language: the international publications in their original language are just 15% of the offer presented to the public, while the translated editions of foreign books have reached 23% in 2012, with 19 of them becoming top sellers (100.000 copies sold). [j]

A survey conducted between a vast number of Italian publishers revealed that the main drivers pushing the decline of the industry are: the lack of efficient policies in schools to educate new generation to read (44,5%), the low cultural level of the population (36,6%), inadequate public policies of incentivisation to book purchases (35,3%) and a low cultural promotion by the media (23,4%). [k]

2.2.3) Competition

In 2012 the number of active Italian publishers, producing at least 10 books per year, are 2.225 and inside this broad variety, the 41% of the market is controlled by small-medium sized enterprises and the other 59% is owned by the top 5 players, listed and briefly described here, except for Mondadori, which is better analyzed in the following chapter.

RCS

RCS MediaGroup, based in Milan and formerly known as “*Rizzoli-Corriere della Sera*”, is a multimedia publishing group engaged in operating daily newspapers, magazines, books, radio broadcasting, and digital and satellite TV (television) businesses. It is the national leader in the daily newspapers, producing the first and third best sellers: “*Corriere della Sera*” and “*La Gazzetta dello Sport*” [l]

Feltrinelli

Feltrinelli was founded in 1954 in Milan by Giangiacomo Feltrinelli, after the previous initiative of creating a library “*Biblioteca G. Feltrinelli*” in 1949. The company was created through the acquisition of the existing publishing company “*Colip*” (Cooperativa del Libro Popolare) that provided specialistic know-how and an initial market share; today the company controls 5,5% of the Italian market. [m]

Having its focus mainly on books, the company is one of the first in Italy to move through the digitalization and the online sales: in 2005 the digital market is approached through the creation of the specialist website “www.lafeltrinelli.it”. [n]

Giunti Editore

Giunti Editore, founded in 1956 in Florence, is one of the oldest publishing companies in Italy, currently holding 5,8% of the market, even though in the kids sector the share raises to 17,5%. Trying to anticipate the digital era in the industry, Giunti Editore decided to acquire a 20% share of Simplicissimus Book Farm the company leader in the e-book distribution in Italy. [o]

Gruppo editoriale Mauri Spagnol (GeMS)

GeMS is a publishing group created in 2005, but started as Bompiani editor in 1929, when its founder Valentino Bompiani decided to create its own business after working for Arnoldo Mondadori. The group is currently controlled by Messaggerie Italiane and its market share is 10,6% in Italy, thanks to the ownership or control of 11 editors around the country. [p]

Regarding the e-book market, GeMS group is still considering it as a secondary business for authors and readers, with only 700 e-books available offered through its website “www.illibraio.it”. [q]

2.2.4) Digital Growth

E-books are estimated to have had a 4% market share in 2013 (against 2% in 2012), with 60.589 commercial e-book titles available and with 44% of new titles released in digital format; the average pricing is €10,44, meaning that they are discounted at 43% from printed editions, based on the cover price.

The Italian market follows values and trends of the other European countries, far away from the English-speaking countries: in the USA the overall offer of e-book is 950.000 unique titles, almost 10 times more than all the European countries together.

If, from one side the product innovation is reducing physical costs and improving efficiency and effectiveness, from the other side such a disruption created a context of fear and uncertainty between all players that were stable in the industrial competition.

2.2.5) Digital Piracy

Piracy in Italy continues to hurt both Italian and international authors, as the illegal phenomenon is moving faster than the measures to fight it: already in 2011 almost 15.000 illegal Italian titles were tracked by the authorities, while recent studies revealed how 70% of the best-selling books are always available in their pirate e-book version. Italian publishing companies are not ready to face this kind of competition yet. [r]

In 2012, the Congressional International Anti-Piracy Caucusin called the attention in various countries, about copyright piracy problems and Italy was one of them. For Italy this was the first official red flag, caused by lack of enforcement and insufficient protections for copyright and intellectual property rights, causing great harm to all the players in the industry: there has not been a sufficient legislative framework for addressing the problem, or clear leadership in developing one⁵.

2.2.5) Technological Gap

A relevant issue of the Italian market in digital economies is the technological gap, affecting the choices of those industries that should push on the development of digital contents, in order to follow international trends and in order to not be considered retrograde. The book industry is not an exception to this case.

⁵ The Congressional International Anti-Piracy Caucus, 2012

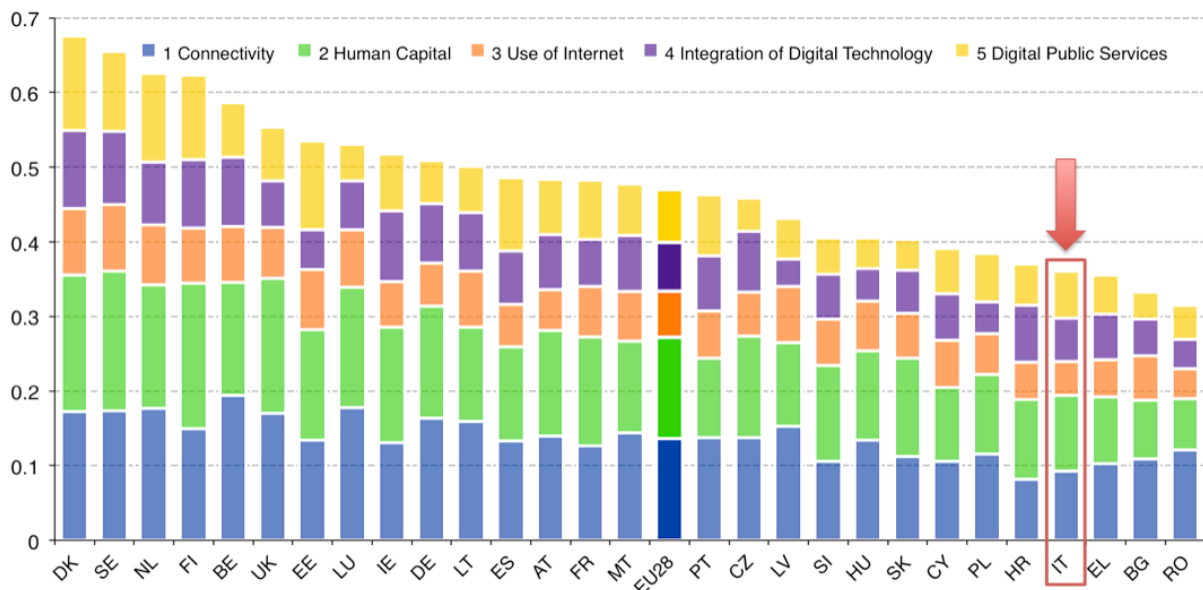


Figure 3: Digital Economy and Society Index 2015. (1)

The best tool to understand the context of Italian companies is the Digital Economy and Society Index (DESI): a composite index that summarizes relevant indicators on Europe’s digital performance and tracks the evolution of EU member states in digital competitiveness. Italy ranks 25th, out of the 28 EU Member States, and it falls into the cluster of low-performance countries, despite the progress made in its businesses’ Integration of Digital Technologies during the last year. Italian businesses are still largely non-digital and could benefit from an implementation of e-commerce in all the supply chain.

Moreover, the country is still behind on Connectivity⁶ and there is the need for progress on the demand side, where low levels of digital skills⁷ and trust (42% of Internet users makes use of online banking and 35% shops online) seem to be holding back the development of its digital economy. The only category where Italy scores close to the EU average is in the Digital Public Services. [t]

⁶ Where fast Internet was only available to 21% of households in December 2013 (the worst coverage in the EU) and only 2,2% of broadband subscriptions are for speeds above 30 Mbps.

⁷ Italy has one of the lowest percentages of regular Internet users in the EU (59%), and 31% of the Italian population has never used the Internet.

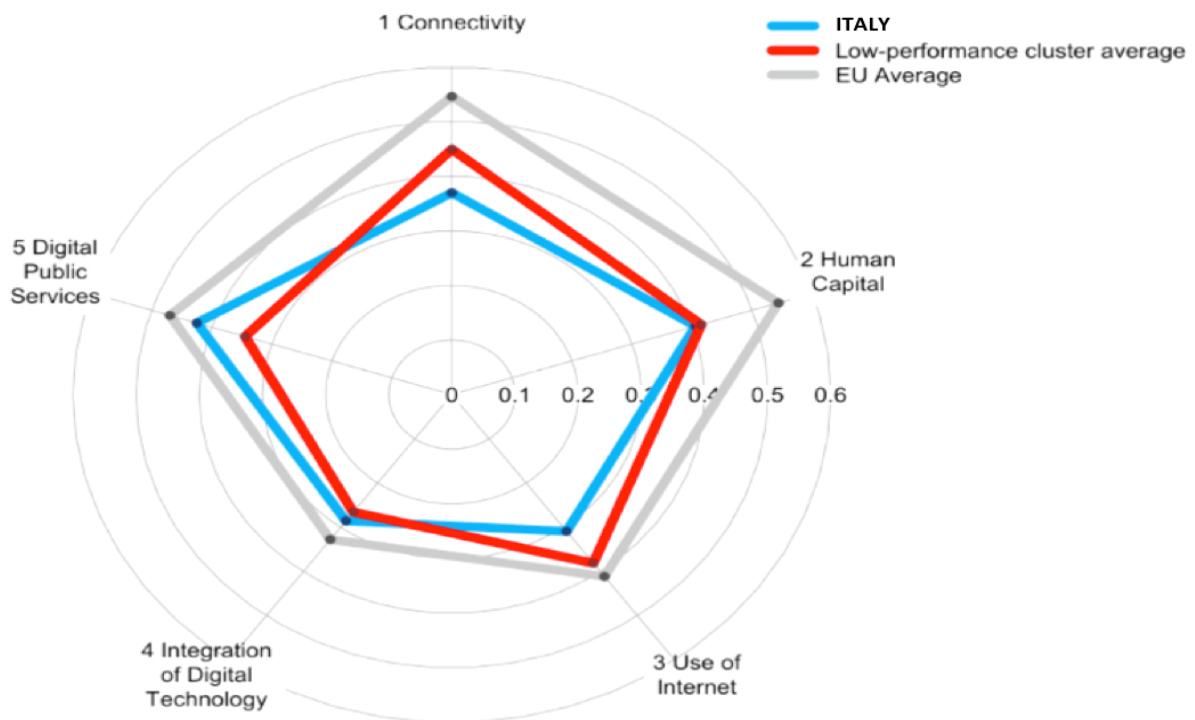


Figure 4: Digital Economy and Society Index 2015.

Publishing companies should take into deep consideration this internal situation before defining any kind of strategy exploring the digital market.

2.2.6) New Regulations

The Italian government approved the amendment of the minister for culture Dario Franceschini, aimed at lowering the VAT on e-books from 22% to 4% (like the printed version), starting from January 1st 2015. This decision, aimed at defending and supporting the Italian culture and the book market, is openly against the current European regulation, which considers the e-book as a service, like a software. Even if the only difference between the two products is the device needed for reading, the European Union doesn't recognize the e-book as a cultural product, whose expansion should be facilitated by the tax system.

This new regulation can create a “win-win” situation, from both an economic and cultural point of view and the hope for Italian publishers is to see results similar to France⁸, where not only the number of e-book buyers doubled, but there was also a significant increase in the young readers population. [u]

⁸ France and Belgium created a similar regulation in 2012.

In order to avoid all sorts of critics, the reaction from the publisher was immediate and the digital book prices started to decline after the Christmas holyday season. Most of the companies decided to announce it through twitter and the price reduction range is between 12% and 40%. [v]

3) THE COMPANY

3.1) Arnoldo Mondadori Editore (Mondadori)

3.1.1) Overview

Arnoldo Mondadori Editore (for reasons of brevity, it will be further referred with its more common name “*Mondadori*”) is one of the top publishing companies in Europe; it is the biggest book and magazine publisher in Italy and the third largest in France’s consumer magazine. Mondadori’s activities also include advertising, digital, radio, retailing and direct marketing. The group, headquartered in Milan, is internationally operating in Europe and in the fiscal year ended in December 2013, revenues were approximately €1,275.8 million. In terms of sales, magazine is the biggest division, contributing for 53% to the 2013 annual revenues (25% in Italy and 28% in France), primarily publishing women’s magazine (including “*Grazia*”, Italy’s first women’s magazine), weekly magazine (including Panorama, the country’s first ever news weekly), and news magazine.

The book division accounted for 26% of the revenues and the Group is the absolute leader in Italy’s book market, operating through publishing houses including: Edizioni Mondadori, Einaudi, Piemme, Sperling & Kupfer and Electa.

The company's mission is “*to encourage the widest possible dissemination of culture and ideas with a product range that spans all genres and reaches all readers*” and within this vision, Mondadori combines a love of culture and editorial quality with the laws of the market and a capacity to identify and anticipate change, while respecting and protecting the values that underlie the publisher’s role in civil society. [w]

3.1.2) History

The company was founded in 1907 in Ostiglia (Mantova, Italy) by Arnaldo Mondadori, who began his publishing career with the magazine “*Luce!*”. Since its origins, Mondadori aimed to be a publishing house for all Italians and even during the World Wars it kept working on magazines for the troops on the front. [x]

After a period of cultural autarky, in 1933 Mondadori started publishing works of international writers and, through an agreement with Walt Disney, it started a children's series based on Disney cartoon characters. In 1971, with Arnaldo Mondadori's death, his son Giorgio (who was chairman in 1968) took over from him. After complex succession situations, the company has been acquired in 1991 by Fininvest (Silvio Berlusconi's family holding company) and Marina Berlusconi is now the chairman.

In 2010 Mondadori decided that it was the right moment to tackle the digital market, with three separate initiatives: in June, a section dedicated to digital books was added in the Group's online bookstore; in October, an agreement was signed with Telecom Italia for the distribution of books on “Biblestore”, Italy's first digital bookstore; finally, in December, Mondadori reached an agreement for the international distribution on Google Books and Google eBooks.

3.1.3) The Presence In Italy

In the fiscal year 2013, the Mondadori Group confirmed its established position as absolute leader in the printed and digital book market in Italy, with a 27% of market share and the largest number of bookstores (550). These numbers are the results of a quality selection of the books published, proved by the presence of 56 titles owned by the group in the Top 100 books sold in 2013. Despite of the strong international expansion started in the last decade, the most important market for Mondadori in terms of sales is still Italy weighting more than 70% of the total value. In addition to the classic book, through the subsidiaries Mondadori Education and Mondadori Electa, the group plays an important role in the Italian market of school textbook, art and illustrated books and also operates in the provision for museums, exhibitions and cultural events. [y]

In 2012 great focus was given to digital products through the agreement signed with the Toronto-based company Kobo Inc., manufacturer of the homonymous e-reader device. Mondadori gained exclusive distribution rights in Italy and the Kobo had great impact in

terms of market response: two million pieces in one year, also thanks to first bundle package (hard and digital copies sold together) was introduced during the Christmas period.

These are clear strategies aimed at reducing the gap with countries like the United States and the United Kingdom, where the new digital trend was followed earlier on; despite that, the Italian digital market is still unprivileged by its consumers.

3.1.4) International Presence

The international expansion begun in 2004, with the international release of the top selling magazine in the Italian market “*Grazia*”: published in 23 different countries. The objective was to export worldwide the style, quality and excellence of Italian fashion, design and cooking; besides the more pragmatic objective of positively impacting the sales and improving the existing diversification in the company’s business areas.

The expansion movements in France is still the most significant step in the Mondadori Group’s growth, as it created substantial results in the short and long term, so that now the company reached one of the main positions in the European publishing market.

4) MONDADORI’S STRATEGIC ANALYSIS ON E-BOOKS

Mondadori’s book division accounts for about 25% of its annual revenues, while the magazine division is almost double the size and offers similar opportunities in terms of digital contents.

Despite that, there are factors driving the choice of preferring e-books over digital magazines. In the magazines and newspapers market, the print format lost almost 10% against the digital (2014), but in this case, the contents have no need for a specific reading device, as the most common tool of access to digital is directly the web. A comparison is therefore complicated, not only because there are different technologies involved, but also because the business models differ in a fundamental way: while e-books still focus on the number of sales as their main source of revenues, magazines and newspapers are more reliant on advertising and subscriptions.

In addition to that, the e-book market is much newer and more contemporary to discuss: while the first e-book reached the market in the early 2000s, it became a mainstream product only in 2007 when Sony and Amazon launched their e-readers; online newspapers and magazines, on the other hand, as they were invented in 1987 and they caught the attention of the market almost a decade earlier than e-book, becoming of common use in the late 1990s.

4.1) Past

In its recent past, through a detailed analysis of countries ahead in digital economies like the United States, Mondadori believed to have understood how the e-book market would have developed in Italy and it was therefore decided that, the acquisition of market share in digital contents should have been the driver for all of the Group's businesses.

The strategy for developing digital contents was launched in 2010 through an agreement with Vodafone Italia, market leader in the telecommunication industry, to launch the first digital newsstand for tablet devices: an aggregator for digital contents that provided access to Italy's best magazines and, with "*Bol.it*", to more than 110.000 e-books. [z]

The digital development continued in July 2011 when Mondadori announced an agreement with Amazon, which made available on the Kindle stores more than 2.000 e-books published by the Mondadori Group. In September 2011, Mondadori's digital titles were also made available on the iBookstore for the Apple iPad, iPhone and iPod touch. [aa]

In July 2012 another milestone was reached when Mondadori Group and Kobo Inc., a leading company globally in digital reading, signed an agreement to bring the Kobo e-Reading platform to the Italian consumers. Kobo's eReader devices, the most known are Touch, Mini and Glo, offered competitive prices and features and were supported by an open network that allowed users to synchronize purchased e-books across different devices (desktop, laptop, tablet, Android smartphones, iPhone and iPad). [ab] [ac]

On April 2013 Mondadori established a new area, known as "*Digital Innovation*", dealing with digital activities in the single divisions of the company; the main role was to structure innovation processes and to identify new opportunities for business development. The long-term goal was to create integration between the paper page and the digital one, while the

short-term target was to have digital contents to contribute for 13% to margins in 2016 compared with 5% of 2014. [ad]

4.2) Current Strategies

The forecasts through 2016 show a market still in the recovery phase, characterized by a strong volatility and a reduction on sales, with less new entrants and an increasing number of small and medium sized players closing their businesses [r]; this contest involves companies striving for profitability and this involves critical strategic decisions to make, in general the tendency in the industry is to improve efficiency and reduce expenses in all the main activities.

The mid-term strategy for Mondadori started in 2014 and approaching the year 2016, known as operation “*Cambio di Passo*”, is to reduce costs by €70 million in fiscal year 2014 and by €100 million by the end of 2015. The aim is to free up resources from the areas of logistic and industrial production, to be better allocated to core activities and investments needed for development, in addition to a simplification of the organizational structure that saw a strong reorganization at the top management level.

The customer loyalty is rarely towards the publishers, while is much stronger to the authors; getting to know your customer in order to improve its experience inside the shop is already a strength for Mondadori, but it reveals to be more complicated to replicate online where the atmosphere of comfort and involvement is completely different, therefore in 2014 a first step to implement the network of bookstores in the online world was made through the acquisition of the brand and assets of social reading service “Anobii”, a global community built by readers for readers allowing you to find, shelve, review and share books with more than 1 million users worldwide, of which 300.000 in Italy. [ae]

4.3) Future Strategies

This section is gathering together four strategic options for the future of Mondadori. There are strategies tackling the digital market more directly than others and there is not the need to implement all of them. The goal here is to evaluate the outcomes of each option and to create a ranking from the best strategy to be implemented as soon as possible, to the least attractive one.

4.3.1) Sales and digital share expansion through price reduction

The average e-book price in the Italian market, regardless of the selling channel used, is €10,44: 42% less than the average physical book price, that is €18. This first strategy offered, explores the possibility of restructuring the e-book pricing, with the objective of showing that companies can increase profits by reducing the e-book prices.

The first and most interesting trend, that should be carefully approached by Mondadori, is a direct consequence of the new amendment of the minister for culture Dario Franceschini that lowers the VAT on e-books from 22% to 4%, starting from January 1st 2015; this adjustment is needed by the new European regulation, which forces buyers to pay the tax of their country rather than that of the vendor. [af]

This is a great opportunity for sales expansion in the e-book market, but offering discounts on existing products is not going to be enough. One of the main concerns for an effective pricing strategy should be to understand the market and the customers: even though the impact of price on sales is inversely proportional⁹, there is a limit to this statement.

The goal is double:

1. Lowering prices - The average reader requires lower prices for digital contents, due to the absence of the production costs; moreover a the reduced e-book price aims to make them become a product sensible to “impulse purchase¹⁰”.
2. Keeping the model profitable – The profit margins shouldn’t suffer from this new pricing and customers are going to be skeptical towards prices that are too low, as the perception would be of scarce quality.

Pricing a product as tempting for impulsive buyers shouldn’t trick publishers in discount them all, as it has been studied by “*smashwords.com*¹¹”, which shows how a book sold for

⁹ Meaning that lower priced books, usually, sell more copies than higher priced ones.

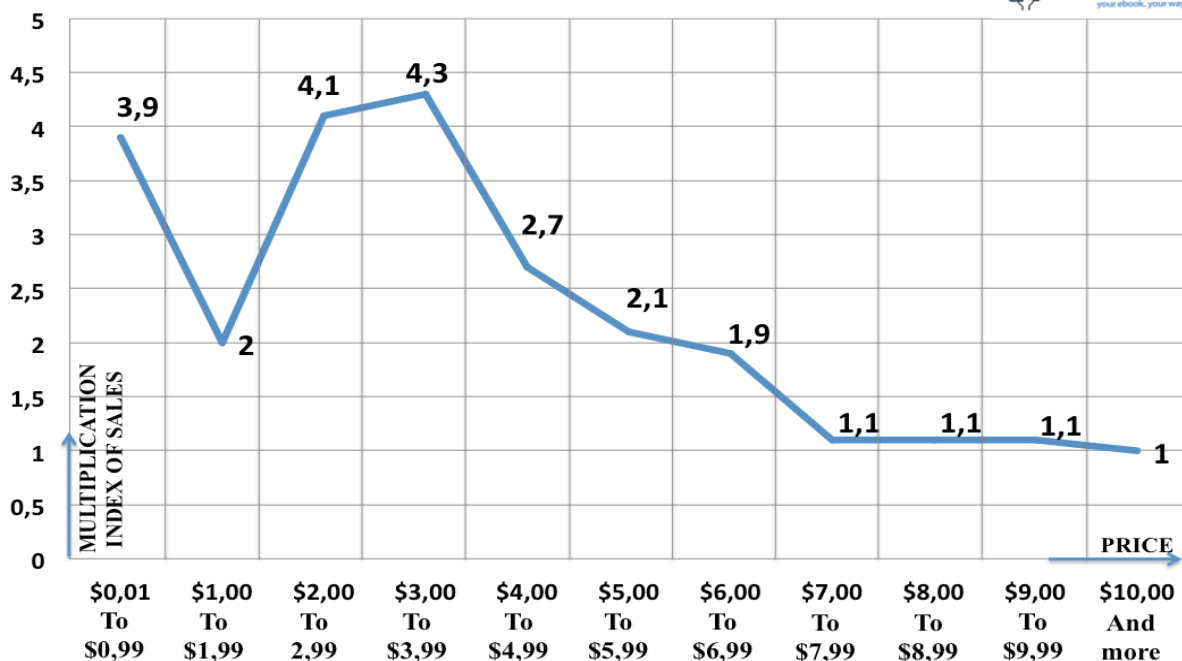
¹⁰ The concept of impulse buying can be defined as “*an unplanned, which is characterized by both relatively rapid decision- making, and a subjective bias for immediate possession*”. [ag]

\$0,99 will have a multiplication index of 3,9 compared with any similar book sold for \$10 or more, but the growing trend is showing that the best price range is between \$2 and \$4 having an impact of almost 4,3.

The surprise here is obviously the underperforming results of the e-books sold at a price range between \$1 and \$1,99. The main explanation to this phenomenon is that consumers might become skeptical in the moment of purchasing a product that is sold at a suspiciously cheap price, while when it is lower than \$1 it might be explained through a promotion here the perception is usually of a low quality or a old and a product not well received by the community.

Figure 5: How Does E-Book Price Impact Unit Sales Volume?

(Data shown as multiple of unit volume at \$10+)



Despite these new discoveries in the field of consumer behavior linked to e-book pricing, the pricing choice for mainstream e-books usually varies from €0,99 to €9,99, depending mostly on the cost structure linked with its publication, together with the distributor adopted and the dimension of the publisher.

¹¹ Smashwords, Inc. is an e-book self-publishing and distribution platform based in Los Gatos (CA), USA. Authors upload their manuscripts as Microsoft Word files, which are converted into multiple e-book formats for various e-reading devices.

Modern Italian publishers are unwilling to lower their prices between the ideal value of \$2-\$4 because their core business is still the printed physical book and they don't want to see their main product crippled and cannibalized by the new digital substitute.

The best way to understand if this strategic choice might be interesting for Mondadori, is a comparison of the cost structures and margins arising from the two options of physical and digital books.

The first cost structure offered is based on a book above average from a known author, with a first print of 10.000 copies and a reasonable selling price of €18. The assumption is that all books are sold, while it is known that during the life of a book the unsold rate is usually between 20% and 30%. The decision of not including the unsold books as a cost is due to the fact that they will not lose their value and they might be actually sold in the future. This calculation is very sensitive to the price, as an increase of few euros in the selling price would already have a great impact on the profit margins; despite this fact, though, it is clear how the price here used is intended to be an average to represent a random book and, in addition to that, it is unsure how an increase in prices could impact the volumes of sales.

Table 2: Cost structure of the physical book

	TOTAL (€)	PER COPY (€)	% OF TOTAL REVENUES	% OF TOTAL COSTS
Editorial Costs <i>Draft revision, editing, cover, illustrations, printing layout, translation, ecc...</i>	6.000	0,60	3,33%	3,44%
Fixed production Costs <i>Letterpress: Printing equipments</i>	1.000	0,10	0,56%	0,57%
Variable production Costs <i>Typography: Paper printing, rebinding, ecc...</i>	11.000	1,10	6,11%	6,30%
Copyrights <i>7% of the selling price up to 5.000 copies, 9% up to 10.000</i>	14.400	1,44	8,00%	8,25%
Distribution Costs <i>Promotion, distribution, logistics, warehousing and stocking</i>	108.000	10,80	60,00%	61,86%
Marketing	5.400	0,54	3,00%	3,09%
Internal Costs	28.800	2,88	16,00%	16,49%
Total Costs	174.600	17,46	97,00%	
Sales	180.000	18,00	100,00%	
Margins	5.400	0,54	3,00%	

Even without considering the unsold costs, the margins are here incredibly low, at a 3% profit. Surprisingly, the production costs are not affecting the total structure by how much people would expect (not even 7%), while it is clear how the real costs are coming from the

distribution and the internal expenses of keeping alive the company (together accounting for almost $\frac{3}{4}$ of the overall cost). When talking about the distribution costs, the intention is to include those activities that let a book reach the public from the moment when it is printed. In this end side of the supply chain, there are lots of players involved who, due to their close contact with customers, require a substantial payment.

The macro-groups involved are the following:

- Transportation companies, dealing with shipping books to all the location needed that can be directly to the bookstores or to warehousing locations;
- Warehouses and Cross Dock locations, liable for stocking the books while they are re-directed to the stores. This is one of the most expensive passages for publishing companies, because they see their assets frozen until they reach the locations where they are effectively sold;
- Retailers, accounting for the final contact with customers. Whether this last step is outsourced or owned by the publisher, it is still a costly passage for the company.

The e-book format, on the other hand, would offer a different cost structure:

1. Editorial and marketing costs can be considered equal between physical and digital format, since each new e-book requires the same editing and advertisement effort;
2. All the fixed and variable production costs are missing, due to the digital content;
3. Copyrights margins are higher for e-books: the author is receiving 25% of revenues up to 25.000 copies sold, while only when topping that number there would be a bonus of 5%, meaning that for each e-book sold after the first 25.000 the royalty paid reaches 30%;
4. The internal costs are not changing, but the only reduction that sounds logical at this step is linked to the 20% of unsold, which is irrelevant when talking about digital products;
5. The distribution and logistic costs are following the “Amazon Model”, supposing that each e-book is sold through a channel that works similarly Amazon in terms of costs;
6. The average e-book size is 2 Megabyte.

Being Amazon the largest e-book retailer in the Italian and European market, this analysis takes its model as the most common one. With this model, for each e-books sold at the unit

price of €3,99, Amazon offers to the publisher the payment of a 70% payment on each transaction, not including the local VAT and the online delivery costs of €0,12/MB.

Knowing that this new pricing structure would most likely decrease the costs and increase the revenue margins, does it make sense for Mondadori to be the first big player stepping in such a new trend or should it stay with the actual conservative pricing strategy and wait for others to move?

4.3.2) Improving the customer knowledge through social media

Catching the right series of novel, or the right author, can mean a huge amount of sales for the publisher who invested in it, which is what usually distinguishes a good year from a bad one. In the past in Italy, it already happened for Mondadori, who dominated the market in the last few years also thanks to the “*Fifty Shades*” trilogy by Erika Mitchell, whose three books were situated in the “*2014 top 10 bestsellers*” (Positions 1st, 2nd and 9th) and the massive opera of the “*A Song Of Ice And Fire*” by George R. R. Martin that topped the selling rankings both in 2011 and 2012. Unfortunately, these kind of trends are incredibly difficult to foresee and sometimes just waiting for acquiring the rights on the best-sellers from the American or English market is not enough, since the competition can access to the same opportunities: a new tool is needed. The objective is to discover new authors, just before they become mainstream, in order to lock their intellectual property rights with exclusivity contracts at a reasonable price and then gaining the returns on the investment.

Some might argue that, in this particular field of action, Amazon is already the undisputed leader, as it collects reader’s preferences, ratings and comments in order to understand what books are becoming bestsellers. Even if this might be correct, there still might be the possibility to anticipate this process of an additional step and understand which books or authors have the potential to become a bestseller. This should be done before they reach Amazon, meaning before being published. Being able to forecast the American trends can be too complicated for an Italian publisher, but on the national territory it is an achievable goal. Italian readers are attached to their national authors: every year between 60% and 70% of the best selling books in the market are from Italian writers. In this relatively small and closed market, Amazon has a disadvantage against local publishers and Mondadori could be able to create a system to forecast successful authors.

Can Mondadori have already the tools to leverage the crowd and predict which products are more likely to be appreciated by the readers? And if so, would it be interesting for the company to start invest in potential best-seller authors?

4.3.3) The E-book Subscription Business Model

It is not clear how the digital revolution will impact book publishers, what it is clear is that there are similarities arising with the music and video entertainment industries. At one point of the their own digital revolutions, they needed to come up with alternative solutions to face the threat of online piracy that tore their markets apart and both of them adapted their businesses to the “subscription model”, accepting that services like “Spotify” or “Netflix” might be one of the few survival alternatives. Now it could be also the time for the publishing industry to consider the option of a mass-market e-book subscription through an “all-you-can-read” service for the customers.

The two main expected outputs coming from this new model are a degree of market expansion and a degree of product cannibalization: researches have shown that, for strong readers, 1/3 of the market expansion is coming from books that wouldn't be read in their physical format, while the remaining 2/3 are due to sales lost of paper books. [ah]

Despite this degree of cannibalization, there are USA companies exploring this business model, like “Oyster” and “Scribd” that are now being supported by some of the most powerful organizations in book publishing, including two of the “Big Five” (HarperCollins, Simon & Schuster). [ai]

When, in July 2014, also Amazon made the first step in this direction with its “Kindle Unlimited”¹², all the players started suddenly to pay much more attention to this new trend and the feeling in the industry is that the time to move is now.

The companies previously quoted are the three biggest precursors at the moment, but copycats and alternatives from other independents are already approaching the market; each subscription offers unlimited access to a virtual library upon the payment a monthly fee

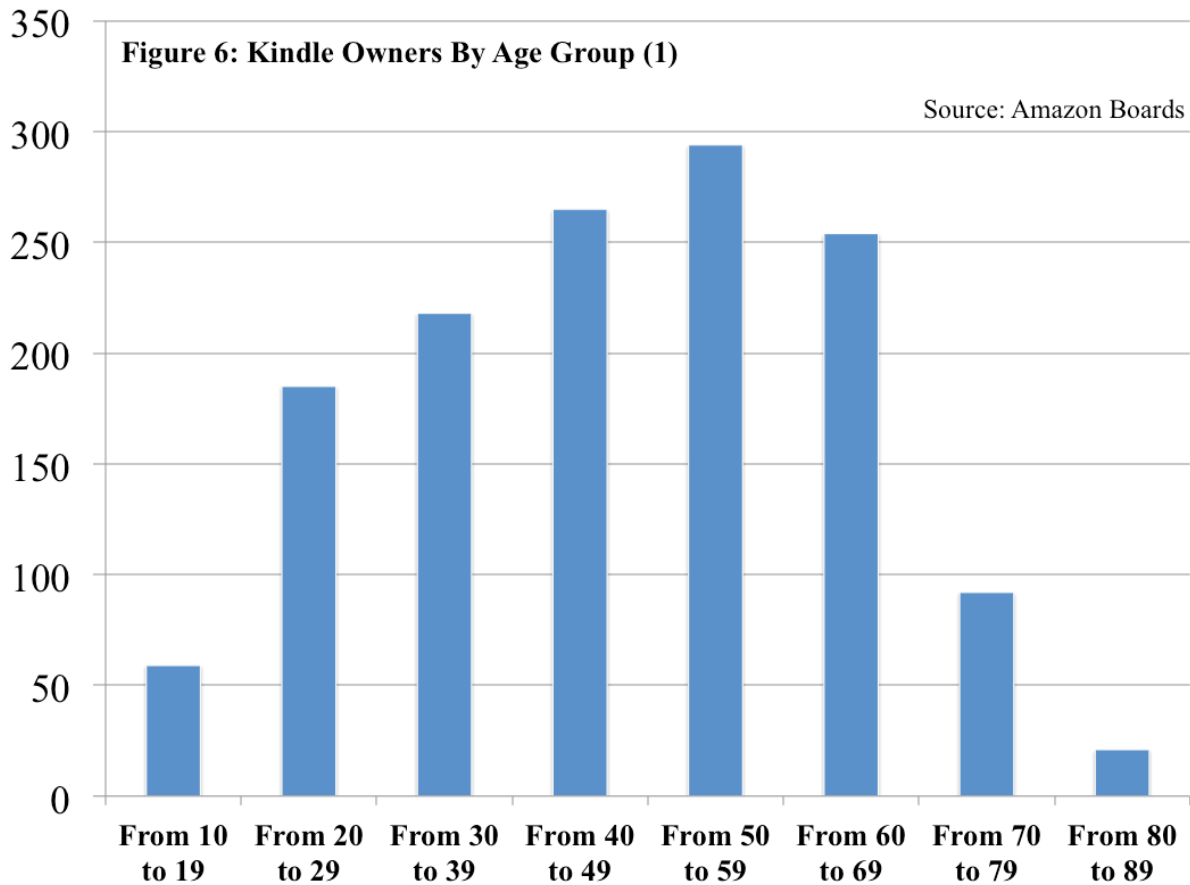
¹² A new service offering more than 600.000 Kindle e-books and thousands of Audible audiobooks for \$9.99 a month.

(usually between \$9 and \$10), with the possibility of downloading the contents for offline reading. The system may look like an online library: the ownership of the books is not sold and as soon as the subscription is not renewed, the flow of contents will stop.

In the analysis required, one of the most relevant factors to take into consideration is the customer segmentation, mainly based on the willingness to pay, the degree of usage and age: the first element can reveal the probability of having a customer paying a monthly fee, due to the high quantity of books consumed. The table provided is an elaboration of the data provided by the Italian statistical institute (ISTAT).

Table 3: Number of Books In One Year				
GENDER and AGE	Fom 1 to 3	From 4 to 11	12 or more	TOTAL
Male	50,1%	37,3%	12,6%	100%
Female	44,2%	41,0%	14,8%	100%
Average	47,2%	39,2%	13,7%	100%
Kids	51,1%	38,3%	10,7%	100%
Students	48,3%	41,1%	10,7%	100%
Adults - A	40,0%	47,3%	12,8%	100%
Adults - B	40,8%	40,2%	18,9%	100%
Elderly	51,9%	33,5%	14,6%	100%
Average	46,4%	40,1%	13,5%	100%

The second factor is the usage of digital readers depending on the age, showing the different attitudes towards technology as a solution for their need. The data is based on Amazon Kindle, being one of the best selling e-reader on the market.



After the understanding of this new option is clear, the question asked is: is this model going to be valuable for a company like Mondadori?

4.4) The Decision

Being in the shoes of Mondadori's CEO it is now the time to evaluate the strategies prepared by your team of experts and the decision on what to do next lays in your hands.

Keep in mind that time and money are scarce resources, so it is unlikely to develop all four strategies at the same time. The preferred way would be to create a ranking of preference, stating when to proceed with which strategy and explain the reasoning behind the decision.

5) LITERATURE REVIEW

5.1) DESI - The Technological Gap

The e-book revolution is pushing a digital transition of a physical object such as the book and because of that it is relevant to understand how different countries can be able to accept the transformation. The best tool to complete this task is called DESI and it is offered by the European Commission, the executive body of the European Union, and it has a score system using the interval (0,1) with higher values representing better performance.

The Digital Economy and Society Index (DESI) is a composite index that summarises relevant indicators on Europe's digital performance and tracks the evolution of EU member states in digital competitiveness.

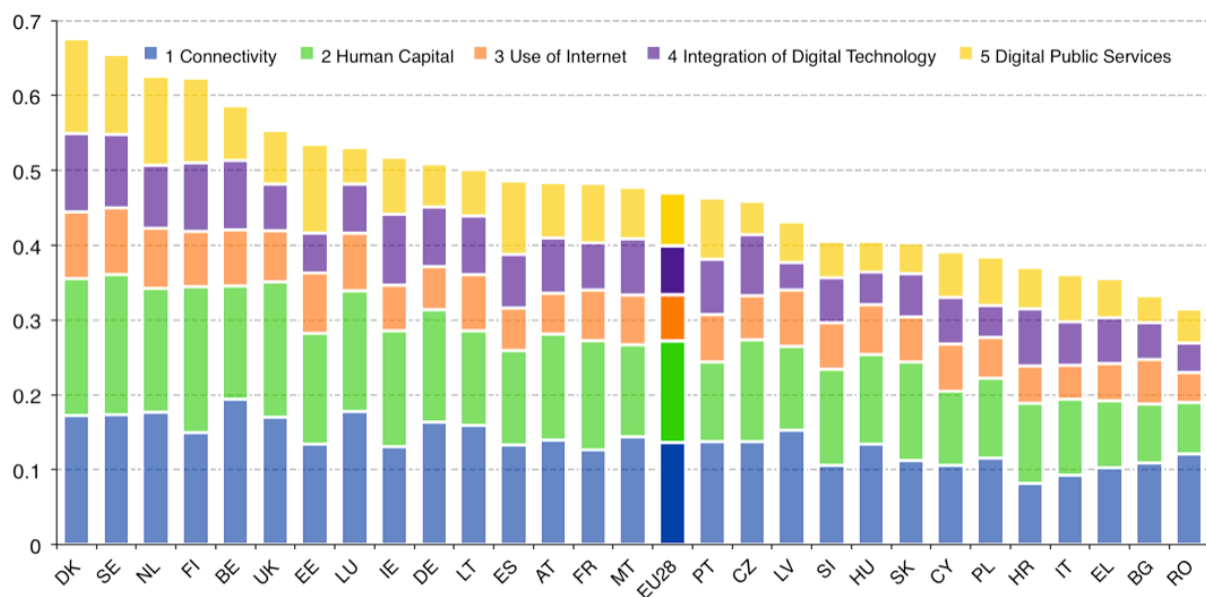


Figure 7: Digital Economy and Society Index 2015. (2)

It includes five main dimensions:

1. Connectivity measures the deployment of broadband infrastructure and its quality.
2. Human Capital measures the skills needed to take advantage of the possibilities offered by a digital society.
3. Use of Internet accounts for the variety of activities performed by citizens already online.

4. Integration of Digital Technology measures the digitisation of businesses and their exploitation of the online sales channel.
5. Digital Public Services measures the digitisation of public services, and focuses in particular on eGovernment and eHealth.

5.2) Impulse Buying

Impulse buying is a sudden, compelling, hedonically complex purchase behaviour in which the speed of the impulse purchase decision precludes any thoughtful, deliberate consideration of alternatives or future implications. [aj]

Impulse buying is defined as an unplanned, which is characterized by both relatively rapid decision- making, and a subjective bias for immediate possession. The purchase is unintended because it is made while shopping, although the individual was not actively looking for that item, had no pre-shopping plans to buy the item, and was not involved with a shopping task, such as searching for a gift. There are a lot of studies on various factors affecting impulse buying and Stern (1962) characterized nine factors affecting impulse buying as follows: Low price, Marginal need for item, Mass distribution, Self service, Mass advertising, Prominent store display, Short product life, Small size or light weight, Ease of storage.

5.3) Amazon Pricing Model

In order to better understand how the online e-book distribution works, it is relevant to focus on the Amazon model: the company headquartered in Seattle is the easiest and clearest example available and, moreover, it is the most used both in Italy and in Europe.

Even though Amazon is providing the distribution network to independent authors and publishing company, for the sake of brevity the following analysis is going to be focused just on the publishing houses, in order to be consistent with the topic of the thesis.

Even though all the information can be found in the contract offered by Amazon¹³, due to its importance in the digital environment I feel the need of explicating it in this paragraph instead of just insert it in the references.

¹³ “*Kindle Direct Publishing Terms of Service*” updated at 1st January 2015.

A publishing company willing to sell its products through Amazon, needs to provide each Digital Book to be distributed at its own expenses, there must be an extreme attention in delivering all electronic files free and clear of viruses, worms and other potentially harmful or disrupting codes; in return Amazon will market and promote the contents provided, following the prices determined by the publisher and applying the VAT of the country where the purchase happened. Amazon is still empowered to choose what content to accept and distribute through the program but the publisher is still in control to decide if it wants to withdraw any digital book from further sale in the Program.

The Amazon model is empowering authors and publishers, as they can benefit from one of the biggest and most trusted online retailers. The cost for the publisher is related to what Amazon calls “*Royalty*”: for each transaction, Amazon pays to the owner of the e-book a percentage of the price paid by the buyer and keeps the complementary percentage as its revenue. Publishers can chose between two royalty options.

With the “*35% royalty option*”, Amazon pays 35% of the e-book’s price back to the publisher, earning the remaining 65%. This option applies to sales of e-books in any territory, it includes all delivery costs and it will immediately stop paying royalties when the same product would be available for free on any other sales channel. The price range is at complete discretion of the publisher, but it has to be at least €0,99 and the royalty calculation follows the formula:

$$35\% \text{ Royalty Rate } \times (\text{List Price} - \text{applicable VAT}) = \text{Royalty}.$$

Example: Assuming to set the e-book list price at €5,99 the “*35% royalty option*” will be applied, meaning that Amazon retains 65% of the transaction, paying 35% as a royalty to the author. If Amazon does not find any free promotion on another sales channel, its distribution cost would be of €3,997 while the revenues for the publisher would be €2,013¹⁴ per unit sold.

¹⁴ [$0.35 \times (\text{€}5.99 - (\text{€}5.99 \times 4\%)) = \text{€}2,013$]

On the other hand, the “70% royalty option” is available only for sales occurred in a limited number of countries¹⁵ and if the purchase is from a customer outside the mentioned countries, the 35% royalty option will be applied.

In order to choose the 70% option, the price range of the e-book must be between €2,99 and €9,99 and, moreover, there must be a continuous adjustment of the prices so that they are at least 20% below the list price in any sales channel for any physical edition of the Digital Book. This option is also including delivery costs, equal to the number of megabytes sold and in Italy the rate is €0,12/MB; therefore, the formula for the publisher’s income is:

$$70\% \text{ Royalty Rate } \times (\text{List Price} - \text{applicable VAT} - \text{Delivery Costs}) = \text{Royalty}$$

This means that the publisher pays just 70% of the VAT and the delivery costs.

5.4) The Long Tail

Trends, data and researches claim that the emerging digital entertainment economy is looking different from today’s mass market: it appears that niches could be preferred to mainstream hits like catchy songs and blockbuster movies.

The old needs were driven by the scarcity of products in the market, as no shelf space could have hosted all the CDs, DVDs, and video games produced; digital contents changed this and it seems that the need for modern consumers is more sophisticated and away from the mainstream because “*in an era without the constraints of physical shelf space and other bottlenecks of distribution, narrowly targeted goods and services can be as economically attractive as mainstream fare*”. [ak]

In this environment the demand tends to follow the new supply, as “the Tail” is measured both in available products and in people gravitating around them and following the theory, the true shape of demand is revealed when consumers are facing infinite choices. The Long Tail starts with a million niches, but it isn’t meaningful until those niches are populated with people who want them.

¹⁵ Including most of European countries, Brazil, India, Japan, Mexico and Canada.

6) CASE ANALYSIS AND TEACHING NOTES

1) Introduction

This section serves as a guide plan for the instructor. It includes a brief synopsis of the case, a suggestion of queries and a detailed analysis to be used as a guideline for possible answers that relate relevant theory and the case analysis.

2) Case Synopsis

Mondadori is a publishing company active since 1907 and it is the current Italian market leader in the book in the Italian market, which accounts for 70% of its revenue stream.

The company is in need to decide about the digital innovation developing in the industry and should formulate a strategy to be pursued in the future. After a couple of years keeping a low profile in the digital market, should it focus on maintaining its leadership in the physical sector, waiting for small and more flexible competitors to move first in the digital area? Or should it be the player leading the change and embracing the risks and opportunities linked to that?

3) Suggested Question

The following question is intended to be studied and answered by the students.

The core question here asked is to evaluate the strategies presented and, assuming that they should not be all implemented at once, to give a judgment on the order of their implementation and if there is any to be completely avoided.

4) Teaching Objectives

This case has been developed according to the following objectives:

- Understanding and analyzing the evolution of the strategy that Mondadori has been pursuing regarding the digital market.
- Understanding and interpreting external and internal factors that influence the company's decisions, in terms of resources allocation and category selection.

- Analyzing and interpreting the main issues and figures on the specific theme, that is the e-book: with greater focus on the legal, economical and entrepreneurial environment.
- Developing and presenting a solution to Mondadori's dilemma, analyzing the pros and cons of three alternatives, taking into deep consideration the past, present and future of the company.

5) Use of the Case

This case study is aimed to illustrate the strategy that the publishing Italian leader company has been pursuing in the digital market. At a certain point, the head of the company needs to decide how, when and if implement the three options presented to him.

The case can be taught in strategy courses (Strategy and Strategic Management), as well as innovation courses (Innovation Management and Technology Strategy), for both undergraduate and master students.

6) Analysis and Discussion

This section of the research is focused on presenting three strategic alternatives, for Mondadori to explore in the future; it is going to be the most speculative part of the paper, where the company chooses whether to embrace or mitigate those future trends and industry drivers that have been studied in previous chapters are going to be analyzed and then evaluated in order to propose a valuable suggestion for the company.

The strategic options are here ranked in their priority order.

1) Sales and digital share expansion through price reduction

In the first scenario, the revenue/cost structure of a physical book with an average acceptance and from a good author is compared with the potential results of a e-book from the same author. In the case of the physical product, the results are showing profits of €5.400, in a perfect scenario where all the copies are sold, without considering any margin aimed at covering unforeseen and unexpected events. Although this might be perceived as a very unlikely scenario, due to the aleatory nature of the product and the market it seems more

reasonable to compare the digital scenario with the best physical scenario, knowing that there are some margins of mistake impacting only positively.

In order to be consistent and coherent, the comparison was then created with the e-book from that same author who would have sold 10.000 copies. Now the strategy offered is to sell the digital book at a more appealing price than €10, which is now the average offer by all major Italian publishers. This price reduction would be in line with the readers' expectations generated by the new fiscal regulation, which lowered the VAT on e-book to 4%.

Following the data listed in the case, telling us that an e-book priced at \$3,99 can sell 4,3 times more than the same printed book, the cost comparison is here offered. The increase in sales is not only valid because of the consumer behavior dynamics previously discussed (where a price reduction is increasing the number of books purchased by current readers), but it's safe to assume that a decrease in costs of books is going to create new readers, who are currently avoiding unnecessary expenses. Moreover, the digital format might be able to catch new fans and create a whole younger generation of readers who feel confident in managing contents on their tablets and e-readers.

The new scenario considers an increase of units sold up to 43.000, at the price of €3,99; the data provided in the text are sufficient to create the new e-book's cost structure and here is a reminder of them:

1. All the fixed and variable production costs are missing;
2. The internal costs are not changing and the only reduction that sounds logical at this step is linked to the 20% of unsold, which is irrelevant when talking about digital products;
3. Copyrights margins are higher for e-books: 25% of revenues up to 25.000 copies sold and 30% if topping that number;
4. Editorial and marketing costs can be considered as equal between physical and digital format;
5. The average e-book size is 2 Megabyte;
6. The distribution and logistic costs can be restructured following the "Amazon Model".

UNIT	Revenues	Cost	Cost %
Royalty Rate	€ 2,79	€ 1,20	30,00%
Delivery Cost		€ 0,17	4,21%
VAT		€ 0,11	2,80%
TOTAL	€ 2,79	€ 1,48	37,01%

Table 4: The Amazon model, Detailed

Being Amazon the largest e-book retailer in the Italian and European market, this analysis takes its model as the most common one. The Amazon model, for e-books sold at the unit price of €3,99, offers the payment to the publisher of a 70% payment on each transaction, not including the local VAT and the online delivery costs of €0,12/MB.

If Amazon pays the publisher 63% of each transaction, the remaining 37% can be considered as the cost that Mondadori would be sustaining to use the Amazon service.

Table 5: Cost structure of the e-book

	TOTAL (€)	PER UNIT (€)	% OF TOTAL REVENUES	% OF TOTAL COSTS
Editorial Costs <i>Draft revision, editing, cover, illustrations, printing layout, translation, ecc...</i>	6.000	0,14	3,50%	4,26%
Fixed production Costs <i>Letterpress: Printing equipments</i>	-	-	-	-
Variable production Costs <i>Typography: Paper printing, rebinding, ecc...</i>	-	-	-	-
Copyrights <i>25% of the selling price up to 25.000 in sales, 30% above</i>	42.893	1,00	25,00%	30,46%
Distribution Costs	63.499	1,48	37,01%	45,09%
Payment to Amazon	51.471	1,20	30,00%	36,55%
Delivery Cost	7.224	0,17	4,21%	5,13%
VAT	4.804	0,11	2,80%	3,41%
Marketing	5.400	0,13	3,15%	3,83%
Internal Costs (Excluding the unsold)	23.040	0,54	13,43%	16,36%
Total Costs	140.831	3,28	82,08%	
Sales	171.570	3,99	100%	
Margins	30.739	0,71	17,92%	

The profits (€30.739) are almost six times higher than the initial scenario (€5.400) and it is immediate to notice the reduction of the distribution impact on the total costs and total revenues, while the only cost having an increase are related to copyrights.

One of the main downturns in this scenario is related to the cannibalization¹⁶ risk, here defined as the number of books that could have been bought in paperback format in the absence of the e-book format. The industry is still undecided on this topic, but looking at past examples in other markets one thing might look clear:

“If you don’t cannibalize your own business, count on a competitor to do it for you.”

Ken Goldstein

While cannibalization is just perceived by companies as negative, truly innovative firms are sometimes willing to sacrifice or cannibalize their prior investments in more profitable markets as a type of growth strategy and in order to overcome the product obsolescence.

One of the best examples offered by digital technology innovation, is the Kodak's analog business: Kodak’s core business (analog photography) was much more profitable than the new digital innovation and the company decided to maximize the profits from its traditional business, instead of promoting a product that would have cannibalized it. The reason behind the choice is due to the difficulty in justifying a large investment in a less profitable disruptive business at the expense of further investment in a more profitable traditional business that continues to require additional resources. Having said that, Kodak dominated its market and the feeling is that they could manage the impact of digital technology on their hugely profitable analog business. [al]

This brief example was meant to show how not only the risk of cannibalization is not big enough yet to become a relevant factor in the decision, but also that promoting the innovative option can sometimes avoid the collapse under competitors who are innovating.

In conclusion, taking into consideration the growth of e-book gaining market share every year, the price reduction expected by the readers due to the new regulation on the VAT, the positive impact on profits of this new model and the cannibalization risk, this the best strategy for Mondadori to invest.

¹⁶ *“Cannibalization is a phenomenon that results when a firm develops a new product or service that steals business or market share from one or more of its existing products and services” - www.referenceforbusiness.com*

2) Improving the customer knowledge through social media

Modern times are witnessing the establishment of the social media era: with the world population reaching 7,2 billion people in January 2015, the market penetration of social media is already 30% thanks to its 2,1 billion users. [am] The publishing industry should capture new opportunities and tools offered by the emerging technology, rather than fearing or avoiding them. A good use of social media for publishers to build awareness, engagement, interest and even loyalty, is to introduce readers into the book creation process (the concept, the development of the content, spreading the word), instead of simply at the end as buyers.

An innovative way for Mondadori to reach this ambitious goal is to strengthen the online presence on social media, following up heavily on the investment in Anobii: blogs, communities and image sharing websites (like for example Reddit, 4chan, Imgur and Tumblr) are a valuable source of underground, not mainstream and emerging products as the “User Generated Contents” (UGC) ¹⁷ can represent the reader’s preferences from a new point of view. Moreover, not only UGC is typically free to the owner of the platform, but also it would create valuable information inside a niche, or various niches, still unexplored by the international big players. Following the example of global crowdfunding platforms like “kick-starter” (or other websites such as “teetee.eu” where t-shirts or other kind of clothing are produced just following the real time demand of the web population), Mondadori could open a new online platform, or expand the existing Anobii’s one, opening the opportunity to new authors to post their ideas about books, comics or short stories.

These contents can be at any stage of their complement and don’t need to be already published to access a social media platform: all what is asked to the author is to provide a short description (between 200 and 400 words) explaining their idea well enough to catch the interest of the crowd, and short enough to not have problems with copycats.

The next step would be to gain the consensus of the user base, which is involved mainly through the “likes” system: voting the ideas that they perceive as more interesting and that they would invest in when it will come to the final product. The final decision for Mondadori

¹⁷ Defined as "any form of content such as blogs, wikis, discussion forums, posts, chats, tweets, podcasting, pins, digital images, video, audio files, and other forms of media that was created by users of an online system or service, often made available via social media websites". [an]

is to publish the monthly most liked idea, giving support to its author and locking him/her with an exclusivity contract.

In its best implementation, this tool would create a win-win situation, where the publisher analyzes the market needs and it chooses a product that should already have a popular consensus in the digital world, as the interest from a big pool of users should already represent a share of the actual market, which will later purchase the book based on the idea they previously liked. The users feel empowered in the decision on new trends and finally even the least known author can find itself published and valued.

This kind of social research and use of UGC is barely explored in the modern publishing industry, where only Amazon is starting to work on it with its “*Kindle Scout*”, so Mondadori can become a precursor in the field and acquire the “*first mover advantage*” and it can start building a legacy of amateur authors with the potential of becoming bestsellers.

An example of the kind of author that Mondadori could find through this innovative tool is J.K. Rowling, the well-known creator of the Harry Potter saga. She was not a professional writer when she developed her precious idea in 1990, on a four-hour-delayed train trip from Manchester to London, while she was commuting to the Manchester’s Chamber of Commerce. After five years, the first manuscript was ready with the title of “*Harry Potter And The Philosopher’s Stone*” and it got rejected by twelve different publishers, before being financed with £1500 in 1996. The rest of the story is well known, with the saga becoming one of the best sellers in history with more than 400 million copies sold and eight movies based on the books. Mondadori would just need one of the twelve books published with the monthly selection, to not only cover the costs but also gaining in terms of sales and publicity.

If implemented correctly, this new tool should be able to anticipate trends and it would have the possibility of lowering the risk of myopia for innovative ideas not fully understood by the editors. The main concern in the creation of such a platform, or social media, should be to get quickly a user base big enough to create user lock-in, creating barriers against future copycats, positive network externalities, to keep attracting new users being the biggest player in the market.

My suggestion to Mondadori would be to strongly implement this new tool, as soon as the new pricing strategy for e-books is completed and it is showing solid results in terms of

market response. This first step is needed to create enough awareness around the e-book format, to gain people's interest. The geographical focus should be on national level, due to the strong language barrier and due to high national consumption of contents (almost 75% in 2013).

3) The E-book Subscription Business Model

The subscription business model is a new concept, based on a streaming service for digital books and it is not different from what Spotify is for the “*Music*” and Netflix for the “*Motion Picture Entertainment*” industries: the user is offered an online and on-demand access to potentially unlimited contents, freely or through a monthly fee payment. [ap] What it is not sure, is how well this model can fit the book publishing industry: are the music and book industries similar enough to justify this particular business model?

The three industries quoted (Music - Publishing – Film) are sub-categories of the media industry, each one of them enabled digital contents in different years due to the difference in the contents produced and each one of them is facing the issue of online piracy. Despite of the similar context, the outcome was quite different: the music industry got hit the hardest, with the creation in 1999 of the P2P¹⁸ sharing website “*Napster*” that reached 26,4 million users in less than two years, followed by the motion picture industry that started strong campaigns against piracy. The publishing industry managed to remain almost untouched, mainly due to the absence of a digital reading device; but now times have changed.

Subscription models are now popular within music and films, as it is currently a fact that music labels consider streaming services as an alternative (maybe the only alternative) to survive in a market torn apart by online piracy and most of the players adapted their business to this new model.

Publishers have the opportunity to anticipate the wave of piracy, through a new model that looks suitable to defeat online piracy (as it worked for the other two industries) when still in its embryonic phase, because it would satisfy some of the key needs that are pushing

¹⁸ Peer-to-peer file sharing is the distribution and sharing of digital media using peer-to-peer (P2P) networking technology. P2P file sharing allows users to access media files such as books, music, movies, and games using a P2P software program that searches for other connected computers on a P2P network to locate the desired content. [aq] Carmack,Carman. “How Bit Torrent Works”

consumers to illegally download contents. There would be unlimited offer at a reasonably affordable price, online and on demand, giving the customer a legal option to get what he wants, when he wants it.

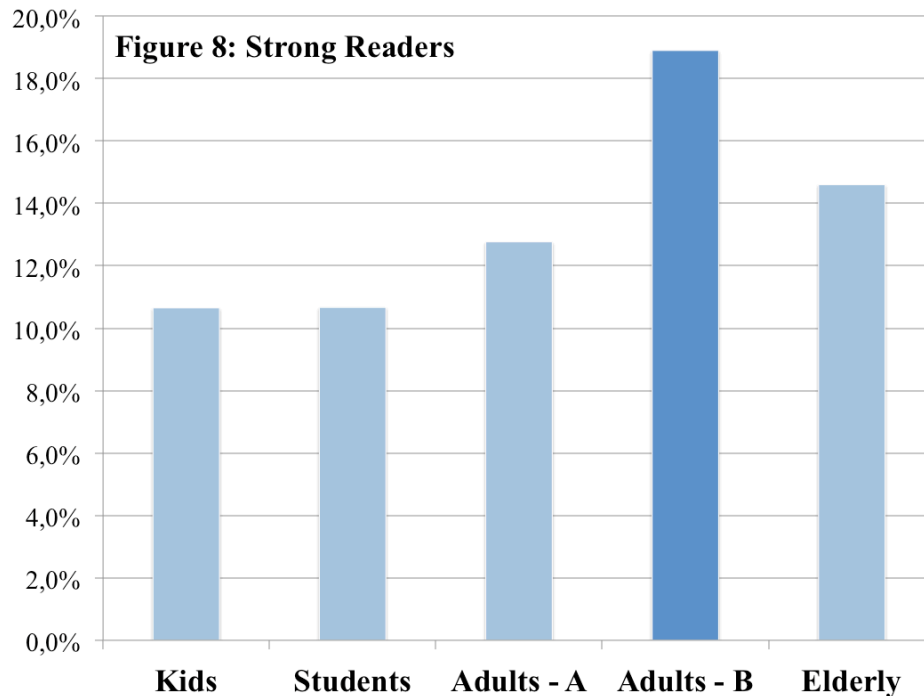
The substantial differences between books, movies and songs are in terms of time and energy consumption: the time needed to find and appreciate a song on Spotify can be summed up in an average of five minutes and the task can be accomplished in parallel with other activities. While with books this is obviously not possible: the average subscriber¹⁹ would be able to read a maximum of four books per month, making the real price paid around \$2.49 per book. [as] [at] The feeling is that for the music industry, being cost effective is crucial and easy to accomplish, thanks to the massive quantity of songs that the user can actually listen to in a month period. While, in the comparison, the lack in providing enough value might be the highest obstacle to overcome in this new service for books. Therefore, the issue is now to understand how to increase the value provided, knowing that just pushing on costs saving would, probably, not be well accepted.

This is clearly not aimed to become a marketing system to attract more readers, even though it is expected to have a positive impact in terms of market expansion; it will work if it is a value creator for who already enjoys reading and consumes many books per year. It should also be kept in mind that readers tend to be loyal to authors rather than publishers and Mondadori being the first Italian company providing an innovative tool to access e-books, would increase the user lock-in and a return on image should also be considerate.

As soon as it is clear why Mondadori should be interested in investing in a subscription model, the focus should swift to the consumer's segment that would appreciate and benefit the most from it.

¹⁹ The data about the average reading speed in Italy is not available, the assumption here is based on the American population.

In this analysis the most suitable target segment to address is defined as “*strong readers*”²⁰, which in Italy consists of 8,4 million people and whose yearly willingness to pay for books is high and currently quantified around €200.

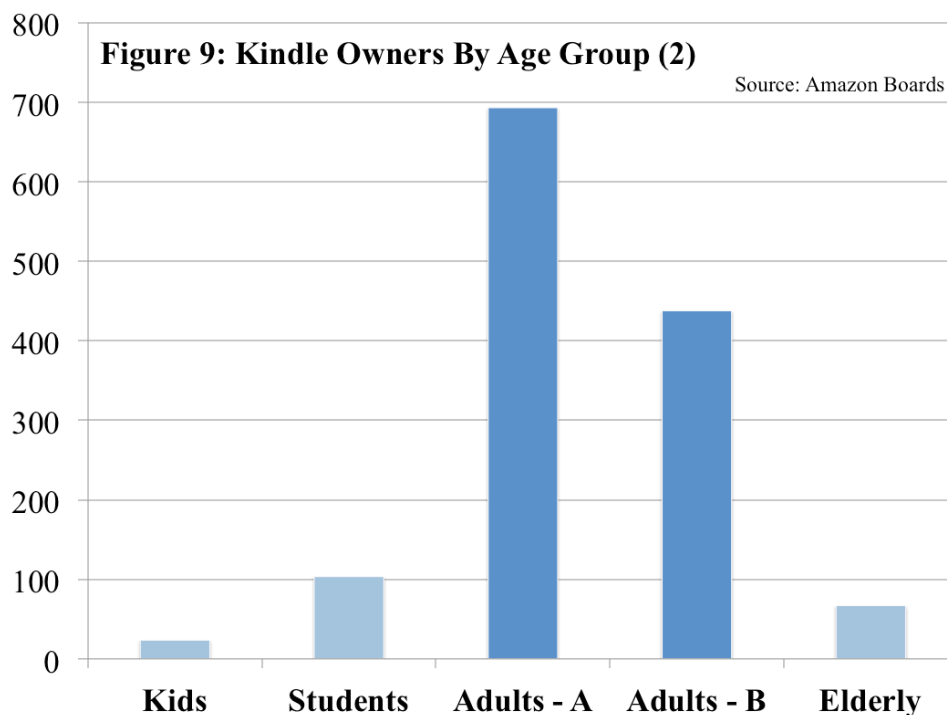


This new model has not only the objective of providing more books at a lower price, the advertisement should be focused on the new type of experience: enabling new books discovery, improving flexibility in switching titles, authors and genres through a new way to browse books and to search for information within them. Where with the physical books, people rely on the librarian for suggestions, here there would be thousands of readers with similar tastes ready to share their favorite ones, comment on them and receiving advices from other users. The discovering feature can be enhanced even more through a social use of the platform: people will be able to check what is the last book read by their neighbor, their friends and even by authors, critics/reviewers and also celebrities, willing to share information on what they are currently reading and what they liked.

²⁰ “*Weak readers*” (46,6% in Italy) are the people who read not more than three books in one year, while the “*strong readers*” (13,9% in Italy) segment is composed of people who read at least twelve books in the same time period. [i]

One barrier for this model could be the unlikeliness of all Italian publishers to create a collective online library, or to collaborate in such a complex project; therefore, it would be easier for Mondadori to develop an individual website/application, with just the titles it already owns. This situation might drive down the public interest for a library with a relative small amount of titles available, but it is also to consider that the only costs would be the initialization and some annual fees for keeping the website operative: meaning that the price to the customers can be heavily reduced. In addition to that, Mondadori can already rely on a strong appreciation on the market, as they, together with the group of controlled publishers, produce more than 50% of the best sellers in Italy.

In this business model the consumer acceptance is a major concern, considering both the low market share of e-books and the low technological skills of the Italian population. Through a further analysis of the tables provided inside the case [Figure 9], it is clear that the most interesting customer segment is the “Adults – A”, followed by the “Adults – B”. The two groups are both the strongest readers and the ones adapting themselves more to the digital innovation, therefore the subscription model would be particularly effective on them.



Together with the customer acceptance, as previously discussed in the first strategic option, one of the main concerns about this model is related to the cannibalization risk.

Taking into consideration the low market share of e-books in current times in Italy (4% in 2013), it looks already clear how cannibalization is not as big as a threat as people might think. In order to be more rigorous, it is offered in the table below a revenue analysis, comparing the cannibalization rate of e-books as currently offered (average price of €10,44) and offered through the subscription model (monthly fee at €6). The calculation is based on the customer segment “*strong readers*”, consuming twelve books per year and contributing by 1.814,4 million euros to the Italian publishing industry revenues (16,8% of the market). The results are showing a low impact of less than 2% lost in sales due to cannibalizations for both options, leading to a plausible market expansion of the specific segment of 0,8% and 0,5%.

Table 6: CURRENT SCENARIO - In Million Euros							
Physical Revenues (No E-books)	€ 1.016,06	Physical Revenues (E-books)	%	Cannibalization	%	Market Expantion	%
Ebook Classic	€ 25,69	€ 990,37	97,5%	€ 17,13	0,94%	€ 8,56	0,84%
Subscription Model	€ 14,77	€ 1.001,30	98,5%	€ 9,84	0,54%	€ 4,92	0,48%
Ebook New	€ 9,82	€ 1.006,24	99,0%	€ 6,55	0,4%	€ 3,27	0,3%

Within this scenario, the market cannibalization impacts the total revenues for a percentage too small to a fundamental the driver of the decision: with current numbers, the rate of e-books read online, instead of being physically purchased, would be only 0,5%.

In conclusion, after the accurate analysis, the suggestion for Mondadori is here not to proceed immediately with this strategic option.

Even though the cannibalization rate is not a key decision factor, the revenue impact in current days is too small to be interesting, even considering the market expansion rate, due to the low market share of e-books in Italy: the subscription model would account for the 1,5% when comparing it with the core business.

Mondadori shouldn't completely discard the option, as if we consider a future situation where e-books can reach a 30% market-share the Subscription model is becoming immediately more interesting; moreover people will be adapting even more to digital contents, lowering the technological acceptance as a barrier.

Table 7: COEXISTENCE SCENARIO (30% in ?) - In Million Euros							
Physical Revenues (No E-books)	€ 1.016,06	Physical Revenues (E-books)	%	Cannibalization	%	Market Expansion	%
Ebook Classic	€ 192,71	€ 823,36	81,0%	€ 128,47	7,1%	€ 64,24	6,3%
Subscription Model	€ 110,75	€ 905,31	89,1%	€ 73,83	4,1%	€ 36,92	3,6%
Ebook New	€ 73,65	€ 942,41	92,8%	€ 49,10	2,7%	€ 24,55	2,4%

As it is shown by this second table, total sales and expansion margins are here creating a more lucrative scenario for the Subscription model, without cannibalizing the core business too much. Mondadori should be ready to implement the model as soon as the market is ready to accept it.

7) Conclusion

The three strategies have their benefits and risks and they are all linked to the previous events and strategies the company has been following.

In my study, I strongly believe that in the near future it would make more sense to give priority to the first and second options, as the times are not ready for the subscription model to become a major success; this means that the idea and the model are valuable for Mondadori and that its implementation should be as immediate as possible, when e-books become a reality in the Italian market.

E-book price reduction should be the main concern and the very first modification needed in the digital strategy of Mondadori, as it would engage the readers, and perhaps increase also their number, while impacting positively on the number of sales by a 4,3 factor creating interesting returns, when compared to the current results of the physical books. In addition to that, the public engagement could set the right basis for the following subscription model and, if implemented correctly, the social media suggested is the right way to forecast trends and winning authors in the Italian environment.

The three strategies offered have been, therefore, deeply analyzed and ranked following their order of importance; even though many questions may still arise, as a consequence of the assumptions and speculations of the case, they all should be secondary and not undermining the solution of the core issues presented in the thesis.

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