

Making Profitable Financial Choices: **How to Find Your Best Options**

Introduction

Book publishers are always faced with a huge number of choices, and very small margins of error. Since most publishers also find working with estimates and numbers uncomfortable, any tool that can help you assess your choices is important.

Picking your most profitable option is a little bit complicated, but we're going to break things down into steps. We'll start with techniques you can use to estimate your most important numbers. Then, we'll discuss my favorite tool for collecting and analyzing these numbers. We'll cover how to build your own version of this tool, and look at ways to use it as we run through a couple of examples.

Estimating Techniques

All the analysis in the world is useless if you don't have some data to work with. You will occasionally be doing analysis of books at the end of your life, but more commonly, you'll be trying to predict the future, to estimate what might happen. These estimates generally cover fall into three important categories: sales, cost of goods sold and marketing campaigns.

Estimates start with ball-park figures, and are refined with quotes or other actual figures as you get them. If you have done a similar project before, exhume the final P&L, and look at how the numbers finally ended up. You might also want to look at the original estimates and see why there were any big changes in them, if there were any.

Sales: The best way to estimate sales of your book is to look at books that are very similar to yours. We call these comparables. The best comparables are

- from companies similar to yours,
- serve your readers' needs in similar ways, and
- have similar amounts of marketing support.

Amazon is definitely the research tool of choice for this, but should be augmented by industry news sources such as Publishers' Marketplace or their free newsletter, Publishers' Lunch, Publishers Weekly, Foreword, Booklist, etc.

Gropen Associates, Inc.

Email: Marion.Gropen@GropenAssoc.com • Web: www.GropenAssoc.com

Making Profitable Choices, #5B Speaker: Marion Gropen

Finding sales figures for those comparables you pick is more difficult. I suggest that you make several sets of estimates, and then average them. Sources of data include:

- **Your contacts** in the other publisher. Expect to get gross sales, rather than net, and to trade favor for favor, but these are often the best possible source.
- **Bookscan**, if the book is sold primarily through bookstores. Bookscan is said to collect about 70% of the sales by bookstores. This figure will be slightly less than the publishers' net sales, and will be less accurate for books that sell in other distribution channels. Bookscan subscriptions are just under \$800 per year, with the PMA discount. If you don't have one, you may be able to prevail upon your distributor or some other friend to look up a few numbers for you.
- **Ingram's iPage** account records all sales through Ingram. This will be a smaller fraction of the sales through traditional channels, often said to be about 40 to 50%. It also will report sales for a particular period only, rather than life of title. Still, it is a solid number.
- **Amazon's sales ranks** are roughly inversely proportional to sales through Amazon within a given range. If you compare bestsellers to mid-list or lower, you won't get very good results, but if your comparables are close to your book, you can use this relationship. Amazon sales are generally about 12% of a trade book's total sales. For niche books that number may be lower or higher. If you know your niche, you should be able to estimate this.

Cost of Goods Sold divides into 3 types, plant, PPB and royalties. Plant costs are the ones where the total doesn't change no matter how many copies you print or sell. Examples include cover designs, editorial work, and indexing. PPB stands for Paper, Printing and Binding, but also includes freight from the printer to your warehouse. And we all know what royalties are.

Plant costs are estimated best from your most recent books, and their costs. If you don't have that, you might consider checking some of the free-lance websites, to see what people are bidding for jobs, or looking at prices on the sites of some of the professionals listed on web directories like mine. (You'll find that on the Reference Desk section of my site.) You can also ask on the publishing listservs and get a range of prices people have paid for similar work.

PPB should also be estimated from your own recent history, but if you haven't done any similar books, you can either send out RFQs to a

Gropen Associates, Inc.

Email: Marion.Gropen@GropenAssoc.com • Web: www.GropenAssoc.com

group of printers, (the best list I know is on Pete Masterson's Aeonix.com site), or use an on-line estimator like the one at BooksJustBooks.com.

Royalties are determined by your contract with the author. If you haven't yet signed the author, you can still estimate them by using your standard royalty rates and expected sales for the first year. Try to avoid giving too high an advance. Most editors over-pay on the advance, which can be reasonable, unless you do it accidentally.

Marketing expenses should be estimated at 5% of your expected revenue, if you have no other information. You should try to plan out the campaign, and estimate the cost of ARCs, mailings, etc. wherever possible. Never commit to a project unless you have a very good idea how it will be sold to your readers.

My Favorite Analysis Tool

My favorite decision assessment tool is the single title profit and loss spreadsheet. It may sound like a bean-counter's hubris, but in my experience, it's quite useful in preparing and evaluating marketing plans, design decisions and general publishing strategies, among many other things.

It has been particularly helpful to me in situations such as:

- Signing a new title, and deciding if the deal will be a good one for all concerned.
- Deciding whether a manuscript should be accepted as is, or sent back for another revision.
- Deciding how many copies to print initially or on a re-order.
- Deciding whether to take a special sales or bookclub deal or not
- Analyzing proposed marketing strategies
- Looking at a particular acquiring editor's track record, in order to help him or her improve performance in the future.

A good decision analysis spreadsheet will help you to organize all of your estimates, understand how each of the expense categories will change as the others do, and compare at least a few different situations to each other easily.

The P&L you use for analysis will be a little different from the financial statements that conform to Generally Accepted Accounting Principles. Internal reports can be designed to meet your needs, rather than the more general formats.

How to Build One

All that's very nice, you may say, but what if I don't have such a thing. Where do I get it, or how do I build it? Well, there are some standardized ones available, but they're not too tough to build from scratch, and tailor to your particular needs.

Some general advice: automate as many formulas as you can. That way, when you make a change in one place, the effects will flow through the calculations seamlessly, and you'll have fewer errors.

It helps if you have your assumptions and basic data set out clearly on a separate sheet of the workbook. That way you can be clear about what calculations you're really looking at. Excel also has a very clever feature that allows you to look at both pages simultaneously.

Split your work into separate pages of a workbook rather than separate areas of the same page. That way, you don't accidentally delete part of one section when you're adjusting the format of a different section.

Now, for the actual construction: the basic theory is that you compute the revenue, subtract the expenses directly connected to this title, and then look at the contribution it makes to covering your overhead and profit.

Start with Sales, Discounts and Returns. Estimate your sales in number of copies, at a given list price, then factor in the average discount rate for your distribution channels, and the returns rates you will endure. Make your calculations explicit, because you may be looking at these sheets months or years later.

Don't forget to add subsidiary rights revenue. In the income statement this is a part of your revenue, but this isn't a financial report, it's an analysis tool, so we're going to add it in when all else is done. That way we remember that it's even less of a sure thing than all of the other estimates you're using, and still keep track of the possibility.

Separate variable expenses from fixed. Variable expenses are the ones where the total changes when the number of copies changes. It is critical to clear thinking that you keep these expenses distinct from the fixed ones. Only one element of your cost of goods sold is usually a fixed cost (that's your plant).

Distribution and Fulfillment: In an income statement, this would come later. I put it up here for this report, because it's usually not a variable, and because it's sometimes deducted from revenue before you're paid. Some publishers are paying a fee per copy, per pallet, whatever. Others are paying a commission on net sales (net of discounts and returns), and some are selling their books to the distributor at a set discount.

For the first two, the formula to handle this expense is fairly obvious. But, if you are selling the books at a set rate to your distributor, so that

Gropen Associates, Inc.

Email: Marion.Gropen@GropenAssoc.com • Web: www.GropenAssoc.com

the distributor can re-sell them to the wholesalers and retailers, you probably don't want to make that the discount rate at the top of the sheet, and leave this section blank.

Why? Because you won't be quite so conscious of the amount your distribution is costing you.

Cost of Good Sold (PPB, Royalties and Plant): The first two are variable expenses. The last is fixed. But they're all COGS.

PPB If you are doing POD printing, this will be a simple dollars per copy number. But, if you are printing offset, and we want to be selling enough copies that offset is a good idea, then the amount per copy will drop quickly with an increase in the number of copies, until you get between 5,000 and 10,000 in a run. Thereafter, it will drop much more slowly.

Royalties are variable as long as the advance earns out. There are usually several different rates for different volumes. For hardback trade books, the rate is generally 10% to 5,000 copies, 12.5% to 10,000 and 15% thereafter. For mass market paperback, the rates run something like 6% to 150,000, and 8% thereafter, although I hear tell that this is shifting to 8% to 100,000 and 10% thereafter, in larger houses. These rates are all on list price, for sales net of returns.

Smaller houses often pay lower rates, and other market segments often pay on sales net discounts and returns, rather than on list.

Plant Costs: These are the fixed cost elements of your operation. They include text design, cover design and art, editorial costs. None of these expenses change once the book is ready for printing, so the number of copies has no effect on the total. (NB: You will need to tune your design expenses to the intended market and level of your book. So "big" books do have more expense here than little, but that's a different thing.)

Other Costs, Marketing: In other analyses, you'll itemize these costs. Here, you may use a separate worksheet to compile them or you may just want to use a line or two. You may have a dollars per copy cost and you may allocate a % of sales to this line.

Adding a Summary to the Mix: Then you just add in the formulas to sum to totals, and subtract the costs from the revenue. You're done.

How to Use Your Spreadsheets

It sounds obvious, but: start with what you know already, and use your estimation techniques to fill in as much as possible.

Look for a range of possible outcomes, including the best case, worst case, and the most likely outcome. It's very easy to fall in love with a book, so it's important that you look hard at the possibilities for disaster. You can't know if the risk is too large, unless you become very cold-

Gropen Associates, Inc.

Email: Marion.Gropen@GropenAssoc.com • Web: www.GropenAssoc.com

blooded in assessing exactly what you might lose. And never doubt that publishing is high-stakes gambling. There are no sureties here.

The First Example: To buy or not to buy (this ms.)

This hypothetical book is a small trade paperback original, for a limited, mildly price-sensitive, non-trade market niche. It's being considered for publication by a cash-poor house. The acquiring editor thinks that this book might do reasonably, but also might be a dog, so here we are looking at a best of the best cases, a worst of the worst, and one in the middle.

You can see, in the first page of your handouts, that the best case has a high price, and a pretty high sell-through. The worst case has poor gross sales, despite a very low price.

The royalty rates are determined by the prevailing customs in this niche. The PPB per copy is a function of many things, but number of copies, paper and trim size will lead the way.

Note that the worst case scenario allows for extra plant expenses, a symptom that the company has tried to prevent the disaster. The results show that this was probably money down the drain, but it may have prevented something still worse.

The best case version even allows for the sale of serial rights, and consequently shows a small amount of subsidiary rights revenue.

Now, flip to the next page. Note that there is a huge variation in the revenues expected between your three possible results, and then note that the difference in expenses between your worst case and your most likely is pretty small.

This is because you are committed on many fronts before it becomes clear that your newest title barks. So, you actually spend a little more, in an effort to prevent the situation from deteriorating any further. This is even, sometimes, a good idea, but it is one that must be carefully judged.

Notice also, that your most likely situation does not earn out its advance, yet it still makes money for the company. Many new publishers, editors and authors aren't quite clear on the difference between a profitable book and one that earns out its advance.

In your best case situation, the increased expenses are mostly royalties and commissions. These are a function of the higher sales, and aren't going to occur unless the sales do.

The AE and publisher are going to need to think hard about whether the company can risk having a disaster, like the worst case, in order to take a chance on the best case. The most likely case is also going to be good enough for the company to carry forward, as long as this AE can produce a number of equivalent titles every season.

Gropen Associates, Inc.

Email: Marion.Gropen@GropenAssoc.com • Web: www.GropenAssoc.com

In order to accurately assess this risk, the AE and the company's marketing guru and CFO are going to need to sit down and run a few more cases.

The next page of your handout shows a different, more normative way of looking at these numbers. Every line is shown as a percent of revenue. This allows you to compare your numbers to those of other companies, or to other titles, without regard to scale. Since we're looking at only one title here, we won't use it, but you should include it in your battery of techniques and tools.

Incremental vs. Life of Title Totals

Look at these handouts. There are numbers everywhere. Think that experienced financial analysts find that any less confusing or distracting than you do? Not so much. They do, however, have a very powerful and useful technique for looking at the key elements.

They look only at the lines that change between one option and the next, and only at the amount of the change. That serves to clear out the underbrush quite nicely, thank you. You'll see 2 examples of this in the special sales case that follows.

I should note that, while it is easier to see the trees without the whole forest, trying to find all and only the changes can be confusing. When in doubt, use every bit of information.

The Second Example: A Special Sale

Let's start by defining the three cases. The first column represents the expected results for this book if the special sale is not made. The second and third columns show the incremental costs and revenues for two ways that the sale might be made. Note that they do NOT include things like the royalties to be paid on the normal sales, or the cost of making those books or those sales.

Now, this is a hard-bound non-fiction title designed for the professional market. Perhaps it's for bond traders or doctors. Whatever. It's expensive, and people will, we hope, gladly pay for it. That means that the target audience has money, and that there are other people trying to sell them much more expensive things than our book. Some of those folks are considering a bulk purchase of your book for use as a gift to their customers. It's called a premium.

The two possible deals are: selling a subsidiary right (printing 5,000 copies, to be given away, not sold). For this privilege, the purchaser will

Gropen Associates, Inc.

Email: Marion.Gropen@GropenAssoc.com • Web: www.GropenAssoc.com

Making Profitable Choices, #5B
Speaker: Marion Gropen

pay our company \$2 per copy, or \$10,000. We'll send them the disks for the cost of copying them.

The other alternative, is that the purchaser will buy 5,000 copies non-returnable, for 20% of list.

In neither case are we being asked, yet, to customize the cover, or anything like that.

The royalty sale is pretty simple to analyze. We receive a payment of \$10,000. We have no extra costs, and split it 50/50 with the author. There are lots of zeros in that column.

The high discount sale is a little more complicated. When we print 10,000 copies of the book, our PPB is going to go from \$16,250 (\$3.25 per copy) to \$31,250. You might think that the PPB would be \$3.125 for every copy. And, on your inventory valuation, that would be true. BUT, since the drop is due to the special sale, to analyze whether we're making money, we handle it differently. The old cost is assigned to the original case, and the increase is all that we count for the new copies to be printed. The increase is \$15,000 (\$31,250 - \$16,250). Divide that by 5,000 copies, and we have a PPB of only \$3 for our incremental cost.

Similarly, our original case shows a gross sale of 4750, returns of 725, for a net sale of 4025. That means that there are 975 copies more to be sold before hitting the royalty breakpoint of 5,000 copies.

The royalty terms on this contract are 10% of NET CASH received for the first 5,000 copies, and 12.5% for the next 5,000. So, the authors will get 10% of receipts on the first 975 copies of the incremental sale, and 12.5% of the next, in this analysis.

There are other possibilities, which you might run in later iterations. For example, you could assume that the special sales copies shipped first. In that case, you would have to look at the difference in the total royalty payment, because the normal sales would all be in the 12.5% royalty rate. But let's keep it a little simpler right now.

The special sales incur no distribution fees, and no commissions. There's no shipping or fulfillment, because the books will shipped from the printer to the purchaser's warehouse instead of your own, and that's included in the PPB.

There's no extra marketing to be done, and no extra design work or editorial to be done, so there are no other incremental costs or revenues.

Which deal is better? For the publisher, selling the books at 80% off works out quite well, if you'll look at the bottom of the next page. It's also the better deal for the author. It doesn't work quite so well for the purchaser, but if you're smart, you haven't offered them the options without running the numbers first, so they may well be pleased to get a \$57.95 book for less than \$12.

There are a number of things about this case that haven't been tossed into the mix yet. First, any time your book is offered as a pre-

Gropen Associates, Inc.

Email: Marion.Gropen@GropenAssoc.com • Web: www.GropenAssoc.com

mium, or to a book club, your normal sales go up. For an example of why, consider the company that buys your book to give to their own customers upon purchase of something else. The advertising done to make the premium seem desirable reaches more than the people who will be given it. Some of them will buy your book.

Second, the royalty calculations should be done again, assuming that the special sale happens earlier in the book's history.

Third, you might run this assuming that you do some customization of the cover or bookblock.

And, as you look at such a deal, other issues may arise. You might need to pay a bonus to the employee who lands a good deal, or a commission to an outside broker.

Running the numbers just once is never quite enough.

The Third Example: Setting a Price for this Title

The old rule-of-thumb that you multiply your PPB by 8 to find the lowest price you can use is a shortcut, one that I believe is no longer justifiable in this age of spreadsheets and computers. I understand that your time is valuable, but I don't think it takes much extra time to run the numbers and get a better grip on what price point might make the most profit for you.

The basic idea is to find the point where the revenue less the costs is the largest number, given that you will sell fewer copies for each increase in price, and that your PPB per copy will drop with larger volumes, but your other expenses may need to be raised to support higher volumes. Juggling all of those curves can be very complex, if you have to do it manually.

Estimating Your Sales: Once you have estimates for your competitors' sales, using the techniques we discussed at the beginning of our session, you fit a curve to the price vs. sales data. Your book will probably also fall on that curve, more or less.

The problem with all this is that the resulting estimate for sales of your own book is very rough. Still, the % change in sales for each change in price should be in the right range.

Pages 6 through 9 in your handouts show how to derive such an estimate: Start with page 6, which shows your hypothetical competition, and their Amazon ranks. It then estimates their annual sales through Amazon.

Page 7 adds hypothetical sales information from Ingram and Bookscan. At the top, you see the annual sales reported by these two, and the Amazon sales we estimated.

Making Profitable Choices, #5B Speaker: Marion Gropen

Dividing the annual sales at the top, by each channel's expected share of total sales (shown in the middle lines) gives an estimate of total annual sales through all channels. These are the numbers in the bottom section. That last column is the average annual sales estimate across all channels.

For whatever reason, it seems that most of these books are selling through bookstores, but aren't running through Ingram. Therefore, Ingram's fraction of the total sales, shown in the middle section, is unusually low.

Page 8 in your handouts pairs prices with sales estimates for each comparable title. Then it fits a line to this data set. We need one more point: the expected sales of your book at one particular price. You get that by looking at your book, and your marketing plan, in the light of all the other books out there, the needs of your readers, and your experience.

The bottom of page 8 takes that point, and the slope of the line from your comparables, and estimates how other prices will influence your sales volume.

Page 9 graphs out your comparables' sales, and the line you have deduced from them. You can easily see that this line isn't a very close fit.

The price vs sales data is more like a mob or a fog than a line. This signals one of two things: you have a poor group of comparables, or your market isn't very consistent in its response to price. I suggest that you go looking for books that more closely resemble yours if you see something like this when you graph your data.

Finding The Highest Profit: Having predicted the likely sales for different prices, you are now going to try to look at the likely profit for each number of copies and price. We're rounding the sales estimates, and the prices, for convenience.

Your PPB is significantly lower as you go from 2750 copies printed to 4250, but drops much less precipitously when you go to 10,000.

The highest sales also require an increase in plant costs, to make the cover design more commercial.

Your marketing budget will be more or less proportional to the revenue expected. And, lastly, you are estimating that you might be able to make some serial sales, or perhaps a tiny foreign rights sale with the bigger volume.

Turn to the next page of this example, and you'll see which price point looks like the best idea, with these assumptions. The high volume, low price version is working out much better than the others. This may, however, be a result of some of our assumptions, or even of the comparables we picked.

Gropen Associates, Inc.

Email: Marion.Gropen@GropenAssoc.com • Web: www.GropenAssoc.com

If this were a real world effort, I'd be looking for comparables that are more like my project. I would also be running at least a half-dozen versions of this to get an idea of the range of possible outcomes, and to be sure that I could live with the best and worst cases for my choice of price point.

The Fourth Example: Comparing Predictions with Final Results

Everyone needs feedback to improve. The best way to improve your judgment and ability to predict the outcome of your publishing decisions is to compare the final results with your guesstimates along the way, and to try to understand what you did right and wrong. This next example shows you one way to do just that.

Take the case you thought most probable from the numbers you ran when you signed the project, and when you decided on your print run and pre-release marketing, and compare those two to the final numbers your book achieved. Do this for every book as it gets close to going OP, or just afterwards.

The Basic Assumptions Used: For this example, the acquiring editor thought that the market would bear a higher price, initially, than turned out to be the case, and, as usual, thought that they would be able to move more copies than turned out to be the case. Fortunately, they also over-estimated the return rate.

Royalty rates and advance were set at signing, of course, so there's no change in that area.

Plant costs were underestimated at signing. When we flip forward to the next page, you'll see why.

PPB was also higher, perhaps because the cost of paper rose unexpectedly quickly.

The marketing budget turned out to be low. This is also quite common, as there is always the temptation to spend just a little more to try to get the last few sales. It can even be a good idea, although most of us don't have a good way to accumulate the data needed to assess that.

Our next handout page shows estimated plant costs in a number of categories. Plant costs on this book were all finalized between the signing of the deal and the first print run, so the third column is, as usual, the same as the second. Here, you can see that the copyediting required a little more work than was originally forecast. Cover expenses were increased in an attempt, perhaps, to compete with unexpectedly strong new titles from other houses. And, to top it off, the house needed to clear some permissions at its own expense, which is unusual.

In all, this book has \$575 in added fixed costs, to be supported by 500 fewer copies at a \$5 per copy lower list price.

The Resulting Predictions: If you flip to the last page of your hand-outs, you'll see that this book brought in \$13,700 in contribution to profit and overhead, instead of the nearly \$25,000 that the AE expected.

The CFO of this company is probably NOT surprised at this result. Acquiring Editors are generally optimists, and that may well be a good thing. This book's results have a normal discrepancy from the predictions.

NOTE: expecting this kind of discrepancy is a required part of the CFO's job, especially when laying out the budget and projecting cash flows. You should build in a secret fund for such shortfalls in every company wide prediction. You'll usually need it. But do keep it secret. If your colleagues figure out what you're doing, they may ease off on their efforts to make their predictions work!

You Can't Do Just One

Using this tool is like an old potato chip ad: you can't do just one. In fact, you have to run the numbers through spreadsheets like these over and over again, in order to understand fully what the best and worst outcomes might be.

Your end results will depend heavily on the estimates you use. That sounds obvious, but when you're looking at numbers on a computer, it can be easy to forget.

Your numbers will have errors. Usually those errors will tend to cancel each other out. Unfortunately, and unpredictably, they will sometimes all reinforce each other, and your bottom-line predictions will be wildly astray.

You are more likely to encounter errors that reinforce each other if the estimates depend upon each other or upon the same number. For example, if you make your plant and marketing budgets as a percent of your expected sales, then all three numbers will err in the same way.

Final Comments, or, Things I've Learned the Hard Way!

Nothing replaces experience and judgment. Use your nose to test your results. If it smells bad, go back and find where it went wrong.

Remember to check your accuracy after you know some results, and again after you have the final totals. It can be chastening, but you'll also learn more from the errors than from doing it right, and you'll do better next time.

Gropen Associates, Inc.

Email: Marion.Gropen@GropenAssoc.com • Web: www.GropenAssoc.com

Making Profitable Choices, #5B
Speaker: Marion Gropen

There will be a next time. Publishing is an awful lot of fun. In fact, I think it's addictive, and should probably come with a warning label. Too bad it's too late for all of us!

Go forth and publish more profitably.

About Marion and Gropen Associates, Inc.

Marion has been in publishing for the last 16 years, including 8 as an executive in charge of finance and operations for a modest-sized company (\$5 to 10 million/year in sales). For the last 3 years, she has helped very small publishers rise above many different types of challenges. You can find out more about her at www.GropenAssoc.com.

The texts and handouts from many of the other courses she has given are freely available from that site. While you are there, you may also want to explore the other resources (also offered without charge) in the Reference Desk section.

The handouts for this course use parts of the downloadable tools available on that site for a nominal fee.

Gropen Associates, Inc.

Email: Marion.Gropen@GropenAssoc.com • Web: www.GropenAssoc.com