Self-publishing and the Supposed Downfall of Publishing Houses: Contributions of the Transaction Cost Theory to Analyze the Publishing Value Chain

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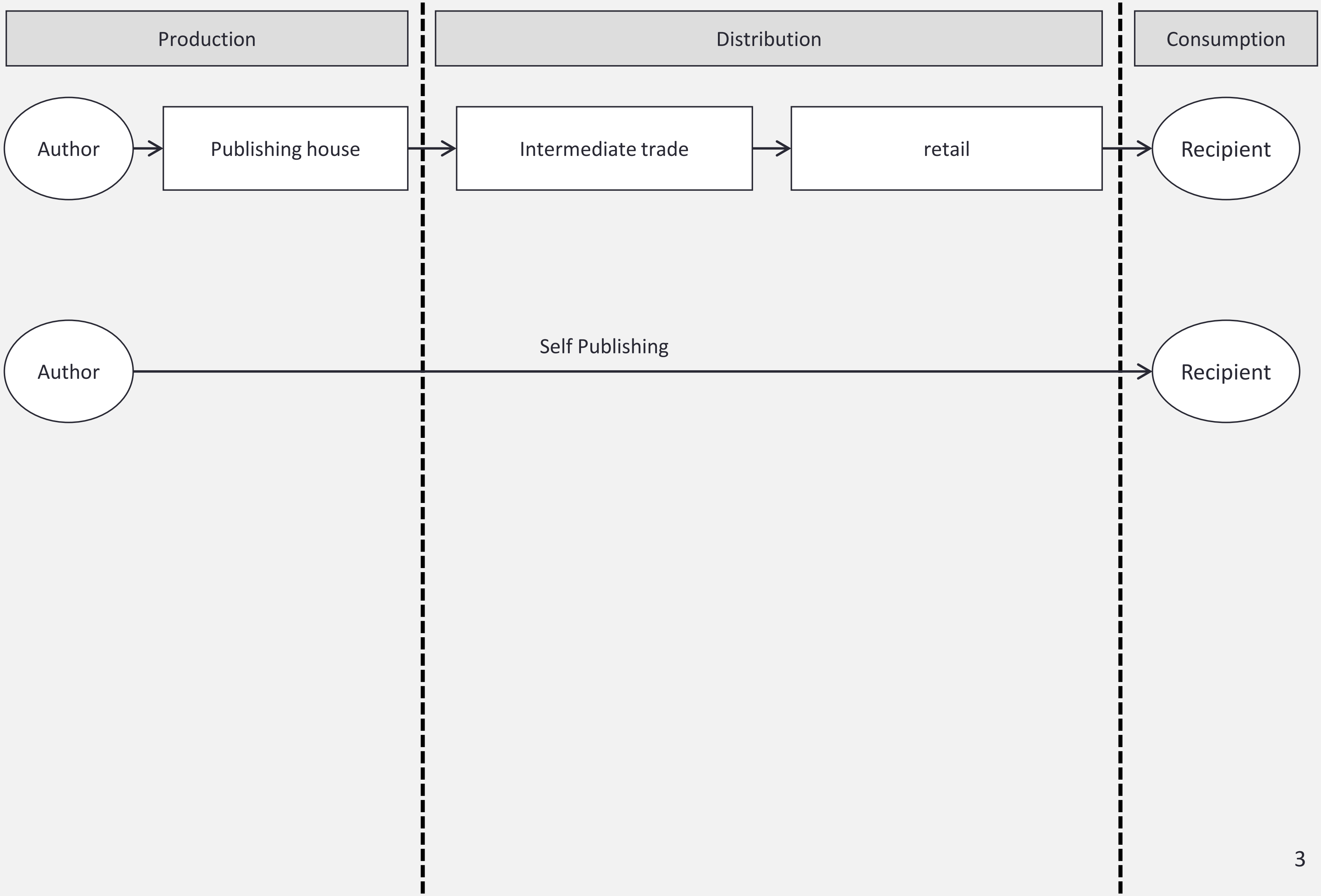
BUCH
WISSEN
SCHAFT
ERLANGEN

Outline

1. **Motivation**
2. Transaction Cost Theory: Basis Idea
3. Value Chain of the Publishing Industry
4. Utility of Transaction Cost Theory
5. Conclusion

The digital world supersedes some players (!/?)



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Why is added value organized like this?

BERTELSMANN

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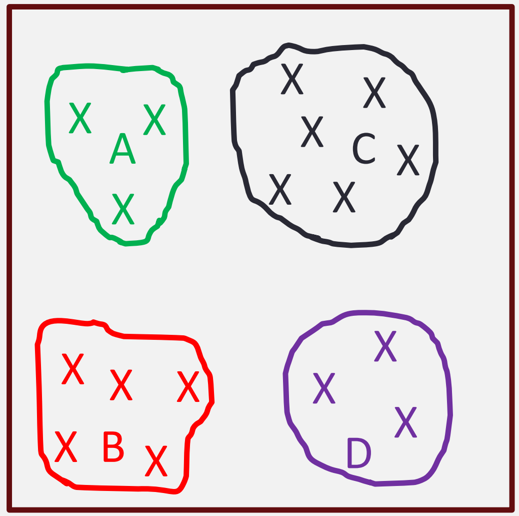


Vandenhoeck & Ruprecht

ullsteinbuchverlage

See Bofinger, P.: Grundzüge der Volkswirtschaftslehre, München 2003, pp. 65.

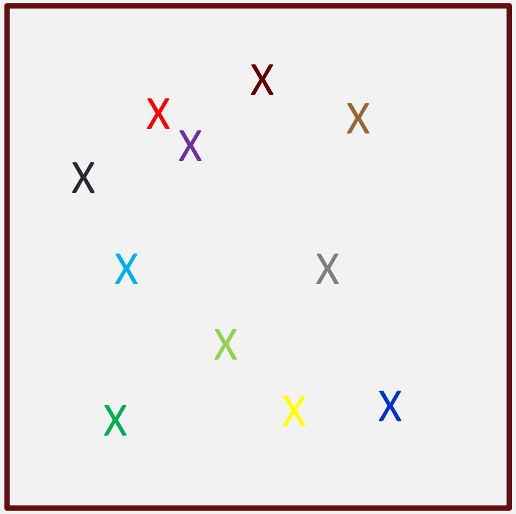
And not like that?

See Bofinger, P.: Grundzüge der Volkswirtschaftslehre, München 2003, pp. 65.

Or like that?

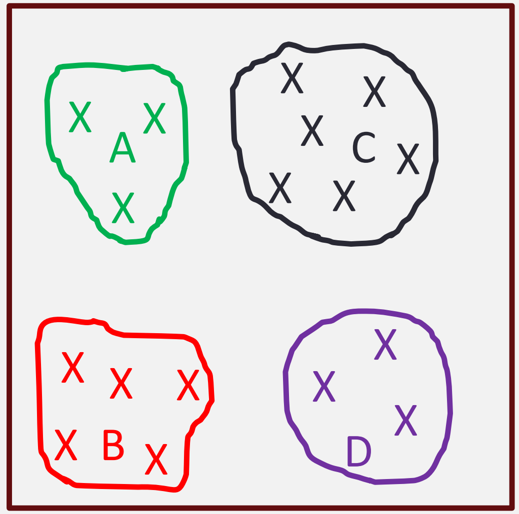
See Bofinger, P.: Grundzüge der Volkswirtschaftslehre, München 2003, pp. 65.

Different institutional arrangements



Atomistic division of labour: 17 manufacturers being autarchic

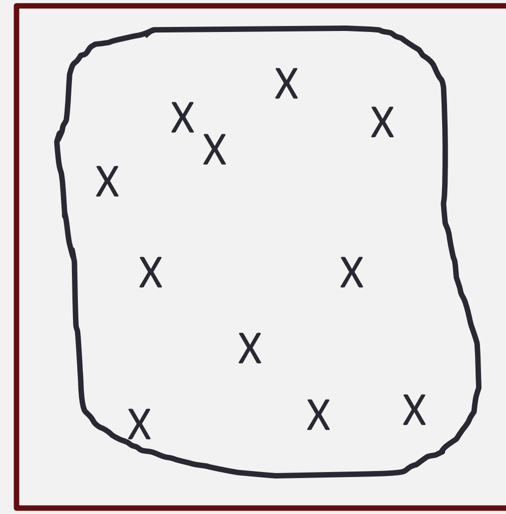
Organization **among** the producers through short-term exchange contracts



Division of labour: smaller and bigger firms

Organization through long-term employment contracts **within** the firms

Organization through short-term exchange contracts **between** the firms



Planned economy: one big firm

Organization through lifelong employment contracts

See Bofinger, P.: Grundzüge der Volkswirtschaftslehre, München 2003, pp. 65.

Why do we have firms?

- Question: “Outside the firm, price movements direct production, which is co-ordinated through a series of exchange transactions on the market. […]. Yet, having regard to the fact that if production is regulated by price movements, production could be carried on without any organisation at all, well we might ask, why is there any organisation?”
  (Coase 1988)

- Answer: in a collaborative economy transactions are processed and understood as the transfer of property rights. Since costs develop through this, it cannot happen without some friction.

Coase, R.: The Nature of the Firm. In : Coase, R.: The Firm, the Market and the Law. Chicago 1988.

Transaction costs

- Costs that develop during the transfer of property rights
- Rated consumption of ressources for the organization and execution of this transfer

- Transaction phases *(Picot 2003, p. 49)*
    - Initiation
    - Agreement
    - Processing
    - Control
    - Adjustment

- Costs mainly arise for information and communication processes

  (Wohlgemuth 2002, p. 49)

Picot et al.: Die grenzenlose Unternehmung. Wiesbaden 2003.
Wohlgemuth, O.: Management netzwerkartiger Kooperationen. Wiesbaden 2002.

Determinants of Transaction Costs

- Factor specificity:
  - Customization of the transaction object for the respective exchange relation
  - Alternative usage possibilities of the transaction object

- Strategic significance of the transaction: the transaction‘s contribution to the competitive position

- Insecurity of transaction factors regarding the number and extent of changes

- Transaction frequency: number of transactions of a certain type

Picot et al.: Die grenzenlose Unternehmung. Wiesbaden 2003, pp. 51.

Yet, the market is less efficient if…

- Factor specificity is high

  (high opportunity costs, high transaction costs for replacement transactions, high grade of dependency of the transaction partners, no partner to be found)

- The transaction is of high importance

  (need for hedging and improvement of transaction conditions is high)

- A high level of insecurity exists

  (alternative plans, hedging)

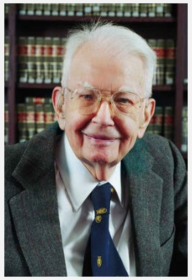
- A type of transaction is repeated often

Picot et al.: Die grenzenlose Unternehmung. Wiesbaden 2003, pp. 51.

Who has had these ideas?

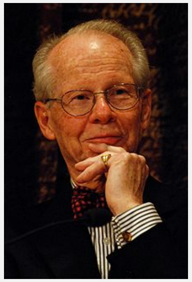
- Ronald Coase (1910-2013)
  - Nobel Memorial Prize in Economics 1991:

    “for his discovery and clarification of the significance of transaction costs and property rights for the institutional structure and functioning of the economy”
  - Main contribution: The Nature of the Firm (1937)



- Oliver Williamson (*1932)
  - Nobel Memorial Prize in Economics 2009

    “for his analysis of economic governance, especially the boundaries of the firm”
  - Main contribution: Markets and Hierarchies (1975)



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Activities within the value chain

Production

- Generate content
- Select content
- Refine assets
- Aggregate assets

Result: First Copy

- Producing varieties

Distribution

- Acquisitive distribution
  - Qualitative function
  - Information function
  - Sales fulfillment
- Logistic distribution
  - Covering time
  - Covering space

Consumption

- Reading
- Giving away
- Owning

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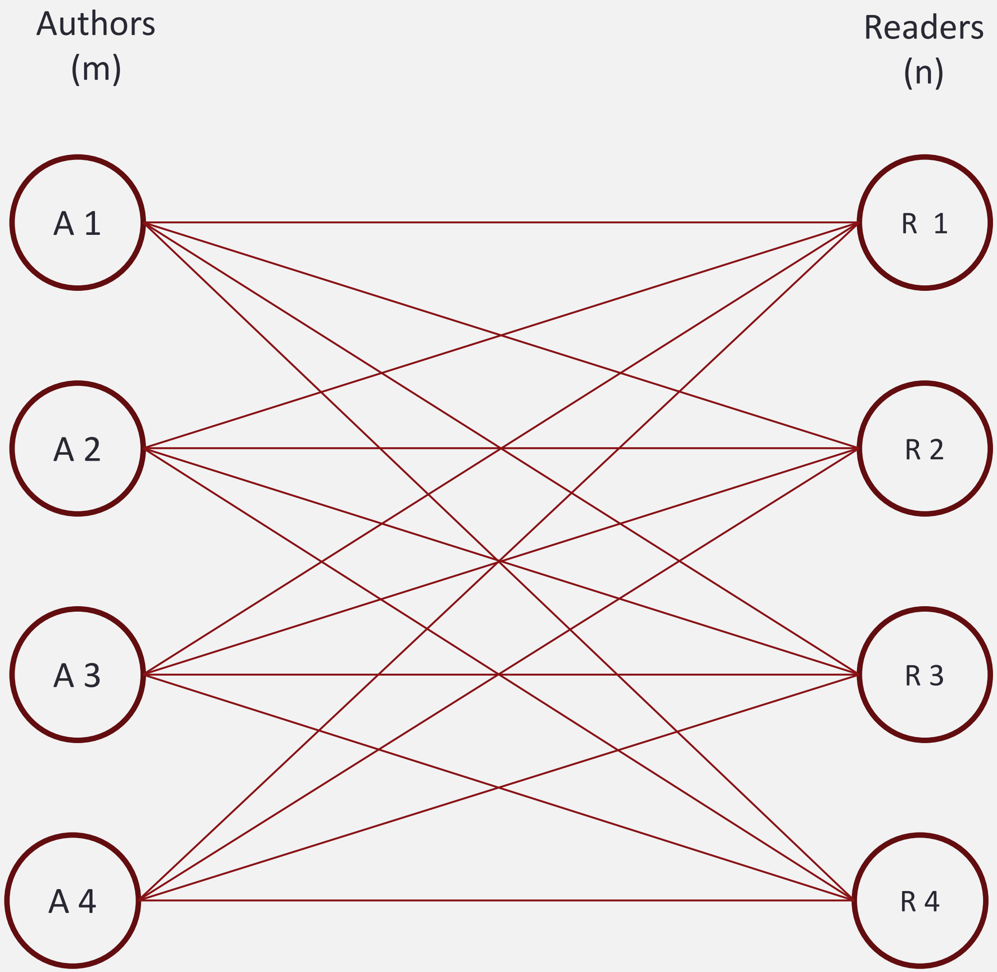
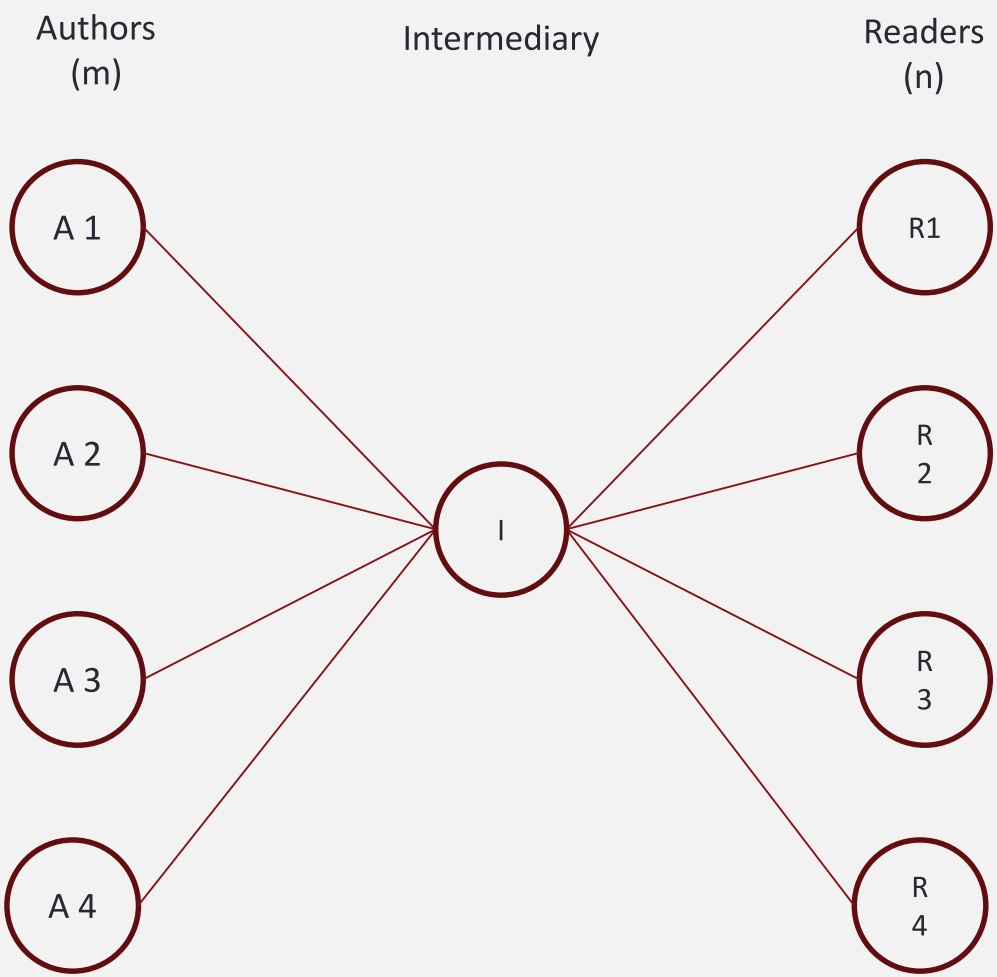
Frequency Criterion of a Transaction Type



- Number of contacts: m·n
- Here: 4 · 4 = 16

Similar Tporowski, W.: Der Baligh-Richartz-Effekt. Kontaktkostenreduktion durch die Einschaltung von Handelsbetrieben. In: WiSt, 28 (1999) 2, pp. 81-83 .

Frequency Criterion of a Transaction Type



- Number of contacts : m + n
- Here: 4 + 4 = 8
- Contact cost savings
  (m · n) - (m+n)

m	n	m · n	m+n	m · n – (m+n)
3	3	9	6	3
5	5	25	10	15
10	10	100	20	80
50	50	2 500	100	2400
100	100	10 000	200	9800

Baligh-Richartz-Effect

See Toporowski, W.: Der Baligh-Richartz-Effekt. Kontaktkostenreduktion durch die Einschaltung von Handelsbetrieben. In: WiSt, 28 (1999) 2, pp. 81-83 .
Baligh, H.; Richartz, L.: An Analysis of Vertical Market Structure. In: Management Science 10 (1964) 4, pp. 667-689.

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Lessons Learned and Outlook

- The transaction cost theory is a main theory in the discipline of economics
- It is part of “New institutional economics“:
    - Transaction Cost Theory
    - Property Rights Theory
    - Principal Agent Theory
- It contributes to the question why certain services are performed in specific institutional arrangements which are a market on the one hand or a hierarchy (firm) on the other
- The transaction costs can be used to base the discussion about changes in the publishing industry’s value chains in a digitized world on solid theory instead of opinions and wishful thinking
- For this purpose we have to analyze each activity within the value chain concerning the mentioned determinants of transaction costs

Self-publishing and the Supposed Downfall of Publishing Houses: Contributions of the Transaction Cost Theory to Analyze the Publishing Value Chain

The lecture is structured as follows: After the motivation I will introduce the basic ideas of the transaction cost theory (TCT), then I will elaborate on the activities in the value chain and lastly I will illustrate the benefits of the TCT within the analysis of the value chain with an example. The talk will end with a conclusion.

Motivation

Already during the first internet and new economy wave in the 1990s great potentials for superseding players from the value chain had been foreseen. Especially the traditional trade had been classified as dispensable, since powerful IT infrastructures were supposed to enable "everyone to inform themselves on anything at any time" and to obtain goods directly from the producer while avoiding the market. For business branches that act with entirely digitized products a far greater potential exists for massive structure changes of the whole value chain by established actors becoming dispensable.

The publishing industry is such an industry: The means for producing and distributing text-based communication is in the hands of many people, the bottlenecks of the world of physical goods are partly abolished. This could have significant consequences with regard to the question which actors are still involved in the value chain, which ones disappear and which ones emerge.

Transaction Cost Theory: Basic Idea

Have you ever asked yourself why division of labour and its coordination are organized in the form of businesses? An organization in the form of several autarkic acting experts, which relate with each other through short-term contracts in order to create a product, is possible. Within the publishing industry this is not uncommon, many people act as freelancers. As an alternative form of organization the "big business" of an all-coordinating central administration economy has to be mentioned. Yet, in reality a number of experts get together in bigger or smaller firms and work is coordinated through long-term work contracts within the organisation, and outside the organization through short-term exchange contracts.

Ronald Coase already asked himself this question in the 1930s: "Outside the firm, price movements direct production, which is co-ordinated through a series of exchange transactions on the market. […]. Yet, having regard to the fact that if production is regulated by price movements, production could be carried on without any organisation at all, well we might ask, why is there any organisation?" The answer to this question lies in the realization that in a collaborative economy transactions are processed and understood as the transfer of property rights between partners. Since costs develop through this, it cannot happen without some friction.

These costs arise in all phases of a transaction, which are Initiation, Agreement, Processing Control, and Adjustment. They mainly develop due to necessary information and communication between the transaction partners.

The following determinants have been identified as significant for the height of transaction costs:

- Factor specificity is concerned with the customization of the transaction object for the respective exchange relation and asks for its alternative usage possibilities.
- The strategic significance of the transaction asks for the transaction's contribution to the competitive position of an actor.
- The insecurity of transaction factors focuses on the number and extent of changes during a transaction.

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- The transaction frequency answers the question regarding the number of transactions of a certain type.

Concerning the question which institutional arrangement is efficient, the following can be determined: the market is, in contrast to the firm, not efficient, if

- Factor specificity is high, i.e. when a particular service can only be given to a certain transaction partner or alternatively no customer for this service can be found. The grade of specificity of a transaction is higher if the loss of value that develops when the resources necessary for the fulfilment of tasks are not used in the aspirated manner but in their next best usage.
- The strategic importance of a transaction is high and therefore the need for hedging and improvement of transaction conditions is high.
- A high level of insecurity is linked to the transaction and alternative plans and hedging against false investments are necessary
- A type of transaction is repeated often and therefore new transaction partners repeatedly have to be found, rated and controlled

The transaction cost theory has been developed by Ronald Coase, whose works Oliver Williamson used as a basis for his writings. Both have been awarded a Nobel Memorial Prize in Economic Sciences for their works on institutional arrangements.

Value Chain of the Publishing Industry

The value chain of the publishing industry consists of a production stage and a distribution stage. On the level of production the following activities accrue: generating content, selecting content, refining assets (assets are improved in their quality). This includes tasks like proofreading, correcting, colouring, and typesetting). Many generated contents cannot be sold as singular assets yet. Often several assets have to be aggregated into a marketable product, for

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example into an article consisting of text and images, or a book consisting of a text body, title page, author information and blurb. The result of the production stage at this point is the so-called First Copy. Digital objects available for download should work properly on devices with different operating systems and standards. So at this point there is no more mass production of a standardized good, instead a variety of an original product depending on the technology used are produced.

At the distribution stage of value creation the acquisitive and the logistic distribution have to be differentiated. Activities which have to be fulfilled are

- The quality function which forms assortments by selecting print products according to different criteria and transposing production-related programs into demand-oriented assortments.
- The information function refers to the actual coordination of supply and demand through analyzing and influencing the market by providing information about available products
- Furthermore sales are acquired and processed; this particularly includes the processing of payment streams
- Covering space focusses on bridging geographic distances between the place of the print medium's creation and its reception
- As the production time of an eBook is not identical with the reception time, time needs to be bridged.

Utility of transaction cost theory

By means of the frequency criterion of a transaction type I will show which difference exists between the processing of a transaction through the market and the internalization of some tasks in a broader firm. First we will look at the situation when production and distribution of a book are processed from the author at the beginning of the value chain to the reader at the end of the value chain directly between these actors. In an economy with four actors the number of transaction relations results from a multiplicative connection: 16. Now we insert a intermediary between author and readers. This can be a

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publishing house or trade, we will abstract from the concrete function here. The number of transaction relations results from an additive connection: 8. The shift of activities from the market to a firm has led to contact cost savings that are higher when more transactions of the same type are performed within the value chain.

Conclusion

The transaction cost theory is a main theory in the discipline of economics. It is part of the so-called “New institutional economics” which consist of three theories: Transaction Cost Theory, Property Rights Theory, and Principal Agent Theory.

The transaction cost theory contributes to the question why certain services are performed in specific institutional arrangements within a value chain, which are a market on the one hand or a hierarchy (firm) on the other.

The transaction costs can be used to base the discussion about changes in the publishing industry’s value chains in a digitized world on solid theory instead of opinions and wishful thinking of lobbyists of the one or the other camp.

For this purpose we have to analyze each single activity within the value chain concerning the mentioned determinants of transaction costs.