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## THE ROLE OF E-BOOKS IN THE FUTURE OF THE SUPPLY CHAIN OF THE PUBLISHING INDUSTRY

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### ABSTRACT

The intent of this paper is to explore the future role of e-books in the publishing industry. Emphasis is put on the impact it has on the supply chain of the industry. Issues dealing with the legal ramifications and financial implications, such as sales taxes, will also be addressed. The first section describes characteristics of e-books and the current developments in e-books from the consumer's point of view. With the handling of the content of publications in digital form, intellectual property rights will become more complex and will require new regulations to deal with the new medium. These and other related legal issues are addressed in the third section. With the likelihood of utilizing the Internet for the distribution of the e-book to consumers, the collection of sales taxes will be difficult for government agencies to handle. The situation will be further complicated due to the globalization of the market place. Which policies are in effect, how will they be enforced, and who are responsible for their collection are emerging issues that will need to be addressed in the global and local arenas. Then it will be followed by the impact it has on the supply chain of the industry. For example, one of the benefits of e-books is the reduction of logistical costs throughout the supply chain. Also, due to the ease of distribution, there most likely will be consolidation of certain levels within the supply chain. It may trigger a shift of competitive power among the various levels. The likely scenario of the future business environment of the publishing industry is discussed in the concluding section.

### INTRODUCTION

Electronic publishing allows consumers to download files to either a personal computer or an e-book viewer. The advantages over the traditional printed book (p-book) include reduced printing costs and reduced time to market through streamlined editing, proofing, and printing processes. Binding, distribution and shipping are eliminated. Revisions are simple. The need for physical bookstores and inventories are eliminated. Thus, the entire supply chain is shortened.

Writers can now post directly to a website. Readability is enhanced and multimedia possible. Usability is increased through hypertext links.

Leaving e-books in personal libraries on the Internet allows 24/7 access and enhances portability. Out-of-print books become available, and are immediately downloadable. Searchability exists and consumers have the flexibility to download (and pay for) a single page, a chapter or several volumes. Space, physical damage and depreciation are no longer issues for either producers or consumers. User feedback and input give authors and producers quick and increased information about the market, and the Web gives immediate access to international markets. Finally, the e-book expands possibilities for persons with disabilities by enabling large text formats and text-to-audio synchronization of e-books

On the other hand, disadvantages include the high cost to the consumer, if an e-book viewer (PDA) or other reader device is required. Although there is a growing industry of e-book authors, publishers and bookstores, lack of content is a constant complaint. Although some critics will always fear technological change and point to the cost to society of laid-off workers, most economists believe lower costs, efficiency and productivity have a positive effect on our standard of living. Finally, there are the effects on the supply chain management, copyright and tax issues that need to be addressed before larger gains can be attained.

### LEGAL ASPECTS OF E-BOOKS

The age of electronic publishing has presented many challenges to traditional notions of enterprise and ownership of intellectual property, and in particular, that of copyright protections. Recent U.S. court decisions would seem to reflect the present state of confusion and conflict in interpretations of copyright holder's rights.

Copyright provides the owner of a creative work the right to keep others from using the work without the owner's

permission. A creative work (a work of authorship) currently is protected under U.S. Copyright Law the moment the work assumes a tangible form. It is not necessary to obtain basic copyright protection; however, it is desirable in terms of enforcing one's rights in the courts.

There are some exceptions to use of a copyrighted work without the permission of the copyright holder. One such use is a doctrine known as "fair use". The use is still considered infringement, but under the doctrine of fair use, the "infringing use" is "excused" because the work is being used for a condoned purpose such as research, scholarship, criticism or journalism. Courts typically balance a combination of factors in determining if the use exceeds the reasonable boundaries of "fair use". The factors considered include the purpose and character of the use, the amount and substantiality of the use, and the effect of the use on the commercial or market value of the work.

In a February 2001 case, a federal court denied Random House Inc.'s (a well-known and successful publishing house) request for a preliminary injunction against an electronic publisher, Rosetta Books LLC. Random House asserted that Rosetta violated the publisher's contracts with its authors, including non-compete clauses. Random House held the right to publish the author's titles "in book form" extended broadly to all types of publishing, including e-books. Rights are licensed by authors to publishers by way of contract. Any rights specified in the contract generally contain provisions outlining royalties. Rosetta said Random House's contracts covered only the print version. Rosetta argued that the authors, not the publisher, continued to hold the electronic rights, and Rosetta said the authors could sell (transfer) those rights as they wished. The court agreed. This decision was based on the fact that the contracts in question were written long before the introduction of "e-book" technology. Thus, this case, which will be appealed, is an industry "test case" concerning previously published or "backlisted" books. The case is significant in terms of the supply chain and the revenue stream.

This is the first case to directly tackle the question of who owns electronic rights in book publishing. The courts have been reviewing numerous cases involving electronic publishing. In January 2001, the U.S. Supreme Court ruled that newspaper publishers infringed the copyright of freelance writers by reproducing articles in electronic databases without their permission. That case focused on the specific aspects of copyright law as opposed to contract law.

### **SALES AND USE TAXES ON INTERNET SALES OF E-BOOKS**

The sale of goods on the Internet, such as e-books, has created a complexity in the area of sales and use taxes. Sales tax is imposed typically when the seller and buyer are in the same state. If the seller is outside the buyer's state, then a use tax is imposed by the buyer's state to compensate for the lost sales tax. In the case of Internet sales, state boundaries

become blurred. The challenge becomes how to determine the state in which the sale occurred. A sale transaction that utilizes the Internet may involve multiple locations. For example, the buyer's computer may be in one state, the seller's computer in a second state, the seller's web site in a third state, and the seller's server in a fourth state. There are no clear rules governing which state is entitled to receive the sales tax or whether and how it should be allocated between multiple states.

The concept of nexus is essential to the understanding of how sales taxes work. Nexus means that a seller has a physical presence in a state, such as a business office or salespeople working in that state. The physical presence creates a connection between the state and the sales transaction that it seeks to tax. There are two important U.S. Supreme Court cases that reinforce this concept of nexus. In the National Bellas Hess case (1967), the court concluded that a mail order business whose only connection with customers in the State was by common carrier or the mail lacked the requisite minimum contacts with the State. Therefore, the company was not required to collect the sales tax from the customer. The second case is the Quill Corporation case (1992). The court concluded in this case that companies who operate out-of-state and do not have a physical presence in the taxing state are not required to collect use taxes.

Another complexity with sales taxes arises in connection with the determination of what is taxable. If we look to the basic rules for sales tax, we find that sales tax is calculated using the gross receipts from the sale of tangible personal property unless specifically exempted by law. Tangible personal property is not clearly defined for products delivered over the Internet. For example, the sale of an e-book on a CD-ROM that is mailed to the customer is likely to be a taxable transaction. On the other hand, if the e-book is delivered electronically, then it may or may not be taxable depending on the state in which the transaction occurred. This sales tax issue is further complicated by the fact that there is not just one uniform rate for sales and use taxes. Instead, there are probably as many different rates as there are state and local governments. With most states imposing a sales tax, the result is thousands of different sales tax jurisdictions with a broad array of sales and use tax rates.

In recent years, important initiatives have been undertaken to develop approaches to resolving these sales and use tax problems. First, the Streamlined Sales Tax Project (SSTP) was begun in 1998 for the purpose of addressing inconsistencies in sales tax rules. Its primary objective is to simplify the sales and use tax system. The premise is that simplification will lead to a more effective tax collection process, thereby, increasing tax revenues. The SSTP is looking to technology to advance the simplification process. Taxware International and Hewlett-Packard have developed an online tax collection system that will be pilot tested in four states. The system is designed to receive sales data through the Internet from unrelated sellers, calculate the

sales tax, and send the tax amount back to the sellers within a matter of seconds.

The second initiative is called the Internet Tax Freedom Act. It came into existence in 1998 with a sunset date of October 2001. It provided for the prohibition of multiple and discriminatory taxes on electronic commerce and placed a moratorium on new sales taxation of Internet access services. In addition, it established the Advisory Commission on Electronic Commerce. This Commission, however, was disbanded in the past year because it was unable to reach agreement on an official recommendation to Congress. However, even if they had submitted a recommendation to Congress, the potential for tax revenues from e-commerce would have diminished as a result of many dot.com companies going out of business in recent months.

There are several stakeholders who could be significantly impacted by the sales tax strategies and methodologies that are ultimately adopted. On one side of the issue are the brick-and-mortar retailers who claim that they are at a competitive disadvantage if Internet commerce continues to be largely tax-free and the state and local governments who need the revenues from sales and use taxes. Most states use the sales tax revenues to provide up to 50% of the funding needed for education programs. On the other side of the issue are the Internet-based retailers who need the tax-free advantage in order to attract new Internet customers and the consumers, themselves, who want to be rewarded for purchasing goods and services from the Internet by being exempted from paying sales and use taxes.

Several Congressional bills have been proposed and discussed in recent times. One that is getting much attention and growing in favor is The Internet Tax Moratorium and Equity Act that was introduced in the Senate (S. 512, 107<sup>th</sup> Congress, 1<sup>st</sup> Session) on March 9, 2001. As stated in the bill, the purpose of this bill is to foster innovation and technological advancement in the development of the Internet and electronic commerce, and to assist the States in simplifying their sales and use taxes. In addition, The Internet Tax Moratorium and Equity Act supports the decision in the Quill Corporation case discussed previously and places responsibility for developing and implementing sales and use tax collection systems with the States.

An important provision of this bill is an extension of the moratorium under the Internet Tax Freedom Act until December 31, 2005. Beyond this, the bill sets forth a model for a streamlined sales and use tax system to promote simplicity, uniformity, neutrality, efficiency, and fairness. Some of the key features include: a "centralized, one-stop, multi-state registration system for sellers"; uniform definitions for goods or services and for attributing transactions to particular taxing jurisdictions; equal treatment of purchasers exempt from sales and use taxes; relief from liability for sellers; uniform procedures for the certification of sales and use tax rate software; uniform format for tax returns and remittance forms; consistent

electronic filing and remittance methods; reasonable compensation for tax collection by sellers; and exemption from use tax collection requirements for remote sellers falling below a *de minimis* threshold of \$5,000,000 in gross annual sales.

Opponents of the Internet Tax Moratorium and Equity Act cite privacy issues because it would authorize the government to track online purchases by consumers--although the bill acknowledges that online consumer privacy must be protected. Furthermore, they claim that it would add to the bureaucracy at the state and federal levels. States argue that if they cannot tax Internet sales, they need the power to impose Internet access fees to raise revenue as is done for telephone and cable services.

### SUPPLY CHAIN AND LOGISTICS ISSUES

Even though e-books will have a significant impact in the reduction of cost and will improve the distribution of published materials throughout the world, it does present a tremendous threat to the core business model of the industry in terms of financial distribution.

By focusing on the major levels of the supply chain (the authors, the publishers, the distributors, the retailers, and the consumers), one can easily see that legal issues will most likely impact the upstream portion of the chain more than the downstream. From a legal point of view, the most valuable asset along the chain is the content, which is traditionally protected internationally by copyright laws. The content owner/provider, in this case, the publishers, should bear most of the burden of the changes due to the difficulties in protecting the copyright of their materials in the new electronic media. Since most of the content can easily be digitized and be exposed via computers and distributed via the Internet with practically no effort or cost, traditional means of protection will not work effectively.

Some new media forms such as the Internet may challenge traditional distribution channels through major distributors. There is a risk of these traditional distribution channels being bypassed in the long run as in the case of a large number of industries. This is especially true in industries where the product can be easily digitized. Unless there will be enhancement or modification of the digitized products at the distribution level, electronic distribution by the traditional distributors will add no value to the supply chain.

The originators of the content, authors that are well known or not, can expect to see their positions improved in terms of bargaining power. In particular, unknown authors may have a better opportunity to gain new access to the consumers through the Internet if they can provide their content in digitized form. But these authors will have difficulty handling the legal aspect of the content due to the complexity and cost involved. So, in some sense, the publishers will have to be involved with the publishing end of the content with a new and improved distribution system.

If the new distribution system is sound enough and is strategically designed to eliminate the traditional distributors, then it will significantly impact the survival of distributors in the industry. If carried out to an extreme, in other words, the powers within the industry will do nothing innovative, the publishing industry supply chain may see a repeat of the movie industry over the past fifty years. That is, the movie studios have lost their power and grip over the actors/actresses and directors/producers and only act as the distribution channel for these newfound powerhouses.

By observing the recent corporate activities of such giants as Bertelsmann AG, it is doubtful that they will let history repeat itself. Even if it does, the balance of power and the roles of each level upstream and downstream along the supply chain of the publishing industry will be altered dramatically by the arrival of e-books within the next decade.

### CONCLUSIONS AND DISCUSSION

Some, such as author Peter McWilliams, believes copyrights are a thing of the past. With the revolution of the WWW and electronic publishing, enforcement of copyright is virtually impossible. Writers and publishers, in his opinion, must instead explore new ways of collecting payment. For example, receiving five cents from each of a million people is the same as receiving \$2.00 from 25,000 people. Especially with the content being published and distributed in digital form, the logistical costs will be significantly reduced. Players along the various stages of the supply chain would be able to maintain profit levels and reduce price/revenue at the same time. The difference is in the economies of scale realized by the electronic publishing media and passed along to the user, makes paying for the accessible copies more palatable to users. McWilliams even goes one step further. His company, Prelude Press publishes his books for profit in traditional markets, but posts the entire contents of his books online (<http://222.mcwilliams.com>) for free. McWilliams compares the on-line service to users picking up a book in a bookstore and leafing through it to decide if they want to purchase it. McWilliams asserts that since placing his books on the Web, his sales numbers have risen. Paying a relatively small fee to access books on-line is the answer, he believes. [Meeks]

But, if as McWilliams says, "There's no way to control the Internet . . . It's as though the printing press has been invented again . . . You can move text around the world at the speed of light at almost no cost", why would users pay even nominal fees, if they can use it without penalty?

The ultimate answer will more than likely lie in-between. New information technology will advance and provide copyright owners the ability to more effectively monitor and enforce their rights, and, because of the cost reductions in delivering electronic, as opposed to print materials, the copyright fee (license) will likewise be significantly reduced to a level that the "market can bear". But no doubt, the

redistribution of power along the supply chain will materialize within the next decade.

Although the e-book may never exceed 20 to 30 % of the total publishing market, the authors believe it is here to stay; and that for many purposes, it will enhance the reading experience of the consumer at a potentially lower cost, while providing profits to authors and publishers.

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