

RANDOM HOUSE: SHIFTING TO E-BOOKS IN A GLOBALIZED WORLD¹

Sarah Bickert, Volker Diestegge, Thorsten Knauer, Katja Möslang, Andrea Schroer and Friedrich Sommer wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

This publication may not be transmitted, photocopied, digitized or otherwise reproduced in any form or by any means without the permission of the copyright holder. Reproduction of this material is not covered under authorization by any reproduction rights organization. To order copies or request permission to reproduce materials, contact Ivey Publishing, Ivey Business School, Western University, London, Ontario, Canada, N6G 0N1; (t) 519.661.3208; (e) cases@ivey.ca; www.iveycases.com.

Copyright © 2013, Richard Ivey School of Business Foundation

Version: 2013-09-24

Since 1835, publishing printed books has long been the foundation of the German media group Bertelsmann SE & Co. KGaA (Bertelsmann), renowned for its history of prosperity and managerial innovation. What had begun as a publishing business grew into a diverse company managed by Dr. Thomas Rabe, who served as chairman and chief executive officer (CEO). Activities within the book publishing business had been focused within Random House, Bertelsmann's book division.²

Although Bertelsmann's overall business situation appeared satisfactory at the end of 2012, in fact Random House was facing significant changes in its markets and internal structure. The digitalization of media was causing shifting demands: while printed books had been Random House's core competence from its earliest years, with the advent of the Internet, customers started to prefer electronic books (e-books) instead.³ How was the firm to approach this development? Would printed books be completely replaced by digital ones, or would e-books remain a niche market? How would this development affect business processes, e.g., the distribution process? Moreover, an additional need for action resulted from the planned merger with the British publisher Penguin Group. Post-merger integration preparations had just started, and the time had come to develop a strategy for the market approach. How could the new Penguin Random House strengthen its position as the world's biggest and most successful publisher? In addition, could the newly merged firm make a successful entry into the Chinese market? How should management pursue this goal? Such important decisions required consideration of many aspects.

COMPANY HISTORY OF BERTELSMANN

Bertelsmann's headquarters is located in Gütersloh, a mid-sized city with about 100,000 inhabitants in central Germany.⁴ The premises with modern buildings and an artificial lake reflected both the company's successful past and its continuous growth through many years.⁵

The company was founded in 1835 by the printer Carl Bertelsmann as a publishing house. Many of the first books and newspapers it printed were related to the Protestant Church and contained, for example, sacred hymns. This connection to Christianity was also retained after the handover of the company to three successive generations of the Bertelsmann family, during which time the publishing house grew

rapidly. While Bertelsmann employed only 14 people in 1850, that employee number had risen to 80 by 1910. During the leadership of Heinrich Mohn, who represented the family company's fourth generation, new segments were introduced, for example, a fiction department in 1927. At the same time, the publishing house cultivated a modern image by introducing and consequently employing new marketing methods. One notable form was promotional contests in which (potential) customers were given the opportunity to perform a rather simple task such as completing a slogan and sending in their solutions. Afterwards, prizewinners were drawn randomly from all correct entries.

During the years of the Third Reich (1933—45), Bertelsmann focused on publishing special book editions for the German armed forces and became one of the most important publishing houses in Germany. Just before the beginning of the Second World War, Bertelsmann reached a new maximum of 440 employees. Despite such growth, subsequent problems occurred due to censorship in later years and rationing of paper stocks. When Bertelsmann started procuring additional paper illegally, the publishing house was shut down in 1944. One year later, a significant part of the company's operations was destroyed during a British air raid.

After the end of the war, business operations resumed under Reinhard Mohn, Heinrich Mohn's son. From this period forward and due to Mohn's leadership, a culture was inculcated that supported new and modern ideas, such as the foundation of a club for customers. This idea was the cornerstone for the still existing successful community *Der Club Bertelsmann* (the Bertelsmann Club), which built on the innovative idea of delivering books directly from the publishing house to customers without intermediaries, resulting in considerably lower prices for the buyer.⁶ In addition, new market segments were explored; for example, in 1956, the company entered the music business with gramophone records. Bertelsmann took its first steps toward international markets by taking a share in an Austrian book association. These entrepreneurial activities built the basis for the Bertelsmann group with its four divisions that exist today (see Exhibit 1 for financial details).

BERTELSMANN'S DIVISIONS AND ACTIVITIES

The first division in terms of consumer visibility was the RTL Group. In 1964, Bertelsmann entered the film and television sector by investing in corresponding companies. In 1984, when commercial television was established in Germany, Bertelsmann participated in the first German-speaking private TV channel with a 40 per cent stake. Based on this initial channel, the RTL Group, with its five TV channels — RTL Television, VOX, Super RTL, RTL 2 and N-TV — was developed, becoming the most successful television network financed by commercial advertising. In 2011, the RTL Group was Bertelsmann's most successful division with a turnover of €5,814 million, an operating earnings before interest and taxes (EBIT) of €1,121 million, and 12,184 employees.⁷

The second division, Gruner + Jahr, was a magazine publishing house headquartered in Hamburg that Bertelsmann acquired in 1969 as a 25 per cent stake. Gruner + Jahr was well-known for *Stern*, a weekly magazine offering political and societal reports. In 1973, Bertelsmann obtained a majority interest by a stock swap with Gerd Bucerius, who became chairman of the supervisory board when the Bertelsmann AG was formed as an explicit parent company in 1971. After the 1989 fall of the Berlin Wall, the company expanded into Eastern and Central Europe, as well as into the daily newspaper business. *Financial Times Deutschland* was founded in the year 2000 in cooperation with the British publisher Pearson Group. Financial losses, however, led to production of the newspaper being abandoned in 2012.⁸ One reason cited was declining sales, ascribed to a shift in demand from printed to digital newspapers.⁹

Arvato, Bertelsmann's third division, developed out of the service of sending books to customers for the Bertelsmann Club towards being a provider of comprehensive outsourcing services that included customer loyalty programs, call centres and other services. In 2011, it had 110 locations, 68,325 employees worldwide, services in 30 languages, a business volume of €5,357 million and an operating EBIT of €341 million.¹⁰ A prominent example of its service range was the German airline *Lufthansa's* customer retention program *Miles & More*, which had been launched in 1993.

The fourth division was the publisher Random House, which embedded Bertelsmann's traditional book publishing activities. The division name had developed from a U.S. acquisition in 1998 that also provided the base for Bertelsmann's success in the U.S. market (53.8 per cent of Random House's total sales in 2011), with the headquarters continuing to be located in New York City. Because Bertelsmann had been founded as a publishing house, this division held special meaning for the founders, despite its generating the lowest profit of the four divisions, with a business volume of €1,749 million and an operating EBIT €185 million in 2011.¹¹

Over the years, Bertelsmann also had been operating in several other market segments, such as music with Sony BMG (Bertelsmann Music Group) as early as 1956 until 2008, and even had been involved in agricultural projects circa 1970. In 2012, two new divisions were planned for the near future.

One matter that always had been important to the company was social commitment. While Bertelsmann, from its founding, had supported the Christian church, in 1977 a foundation named *Bertelsmann Stiftung* (Bertelsmann Foundation) was established to provide an impetus in tackling a wide variety of societal issues in, for example, politics, education and the health care system. Furthermore, Bertelsmann took into consideration the concerns of its employees, for example, through a regularly conducted worldwide employee survey and a system of profit participation.

BERTELSMANN'S CORE STRATEGIES

All of Bertelsmann's actions were guided by its four strategic pillars.¹² The first was understood to be the strengthening of its core business. Secondary activities were reduced to concentration on securing leading market positions within successful business segments. The second strategic pillar was growth through new businesses in the product portfolio. Potential segments had to fulfill the criteria of having strong, long-term growth potential and the possibility of consolidation, as concerned the company's existing divisions. The third strategic pillar focused on regional growth. Due to the saturation and demographic development in Bertelsmann's core markets, expanding to new regions was important for the company's future success. The fourth strategic pillar was the response to the altered consumption of media. Customers increasingly demanded digital media, making it critical for Bertelsmann's future that its management responds to this trend. Doing so required new channels of distribution, for example, but also offered the potential of gaining new customers. The success of these strategies was measured by the Bertelsmann Value Added (BVA), a value-based management concept similar to Economic Value Added® by Stern Stewart & Company.

Since becoming chairman and CEO of Bertelsmann in early 2012 subsequent to his position as the company's chief financial officer (CFO), Rabe has focused on an international growth strategy. After a few years of stagnation, the company had already proven his initial growth prospects with a change of its legal form: the former Bertelsmann AG was converted to the Bertelsmann SE & Co. KGaA, a European company limited by shares.¹³