Finance Textbook Prices: Fact and Fantasy

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ABSTRACT

A copy of a core corporate finance textbook can cost a student more than $150. Is this too much? Why are university textbooks so much more expensive than other books? This paper examines the market for finance textbooks and considers various approaches to the textbook pricing problem.

INTRODUCTION

Textbook prices are a concern to many constituencies of public universities, including students, parents, faculty, regents, and legislators because they appear to be inordinately high. In a report to Congress, the Government Accountability Office (GAO) documents that the estimated cost of textbooks and supplies during the 2003-2004 academic year was 26% of total tuition and fees for students attending public institutions. A study by the State Public Interest Research Groups (PIRGs) reports that wholesale prices charged by textbook publishers increased 62% from 1994 to 2004, whereas prices charged for all finished goods increased only 14% and prices charged by publishers for general books increased just 19% during the same period (Rube, 2005). The study by the GAO (2005) reports similar findings. Since the 1987-1988 academic year textbook prices have increased by 186% while overall prices grew by 72%.

Both studies find that the market for university textbooks has the following characteristics:

- Textbook prices are high and are increasing at a rapid rate;
- New editions of textbooks are expensive and reduce the usefulness of used books as substitutes for new books;
- Packaging other instructional materials, such as CD-ROMs and study guides, with textbooks increases textbook prices; and
- Textbook publishers charge American students much higher prices than students overseas for the same textbooks.

The market for finance textbooks is essentially the same as the overall market for university textbooks. Table 1 shows the prices of the four most widely-used undergraduate core corporate finance books and the four most widely-used graduate core corporate finance books.

Table 1: Prices of Select Corporate Finance Textbooks

Name of Textbook	List Price[a]	New Price[b]	Sales Price[b]
Undergraduate Corporate Finance Texts			
1. Brigham and Houston, *Fundamentals of Financial Management*, 11th ed., ISBN-13 9780324319804	$167.95	$174.95	$127.91
2. Brigham and Houston, *Fundamentals of Financial Management Concise Edition*, 5th ed., ISBN-13 9780324319835	$123.95	$128.96	$102.83
3. Ross, Westerfield, and Jordan, *Essentials of Corporate Finance*, 5th ed.,ISBN-13 9780072946734	$106.25	$109.69	$109.69
4. Block and Hirt, *Foundations of Corporate Financial Management*, 12th ed., ISBN-13 9780073295817.	$144.69	$149.06	$132.41
Graduate Corporate Finance Texts			
1. Brigham and Ehrhardt, *Financial Management: Theory and Practice*, 11th ed., ISBN-13 9780324259681.	$161.95	$161.95	$152.23
2. Ross, Westerfield, and Jaffe, *Corporate Finance*, 8th ed., ISBN-13 9780073337180.	$152.19	$152.19	$135.08
3. Brealey, Myers, and Allen, *Principles of Corporate Finance*, 8th ed., ISBN-13 9780073130828.	$152.19	$152.19	$110.09
4. Brigham and Daves, *Intermediate Financial Management*, 9th ed., ISBN-13-9780324319866.	$168.95	$175.95	$130.38

[a]Source: www.bigwords.com
[b]Source: www.amazaon.com

The list price is the average price being charged in university bookstores as reported by www.bigwords.com. The average list price for the undergraduate texts is $136 and the average list price for the graduate texts is $159. The column labeled “sales price” shows the price at which a new copy of the book was available from Amazon.com at the same time. The average sales price for the undergraduate books is $118 and for the graduate books it is $132. As a comparison, *Harry Potter and the Deathly Hallows* has a cover price of $34.99 and Amazon.com is currently selling a hardcover copy of for $19.95. Why are finance textbooks so expensive?

This paper investigates three facets of this issue. First, what explanations have been proposed for this phenomenon? Second, what does economic analysis tell us about publishers' behavior in pricing textbooks? and Third, what can students and faculty do in response these rapacious publishers?

EXPLANATIONS

The GAO (2005) study concludes that the price of textbooks has increased so much in recent years as a result of the costs associated with new features, such as Web sites, CD-ROMs, and other instructional supplements that are bundled with textbooks. The report also states that other factors affecting textbook pricing include production costs, the availability of used books, and the demand for textbooks. The primary source of information about textbook prices in the GAO report appears to be asking textbook publishers.

A slightly different cost-based is offered by Granoff (2004, 2007). Granoff concludes that the used book market causes high prices for new textbooks. He reasons that publishers must recover almost all of their costs in the first year of a new edition because new sales will subsequently drop substantially do to the availability of used books. However, there is an active market in used products for many consumer durable goods, such as cars, which doesn't seem to drive prices in the new product market in the manner described by Granoff. Thus, it is difficult to place much credence in Granoff's conjecture. Of course, if a new Honda Accord cost $70,000 instead of $22,000, the influence of the market for one-year old Hondas on sales of new Hondas might change dramatically.

Chevalier and Goolsbee (2005) analyze the market for textbooks as consumer durables. They find that students are forward-looking, with low short-run discount rates, and that they have rational expectations regarding publishers' textbook revision behavior. When the students buy their textbooks, they take account of the probability that they will not be able to resell their books at the end of the semester due to a new edition. In Chevalier and Goolsbee's analysis, sales of new books actually benefit from the existence of an active resale market.

THE MARKET FOR TEXTBOOKS

The market for textbooks has some special characteristics that enable publishers to charge exorbitant prices. Figure 1 depicts a competitive market for books, where in equilibrium the price (P) of a textbook equals the long-run average total cost (ATC). Note that this depiction uses the economic definition of "cost," which includes appropriate profits for publishers, bookstores, and other distributors. The area above the dashed line denotes the publisher's profit.

What would happen if an especially voracious publisher, or a cartel of such publishers, attempted to charge a price equal to P_0 for a finance book in this market, as depicted in Figure 2? An important characteristic of a competitive market is low barriers to entry. Competitors, who could also produce finance books at ATC, would enter the market in an attempt to also earn excess profits, and in short order prices would be bid back down to the point where P = ATC.

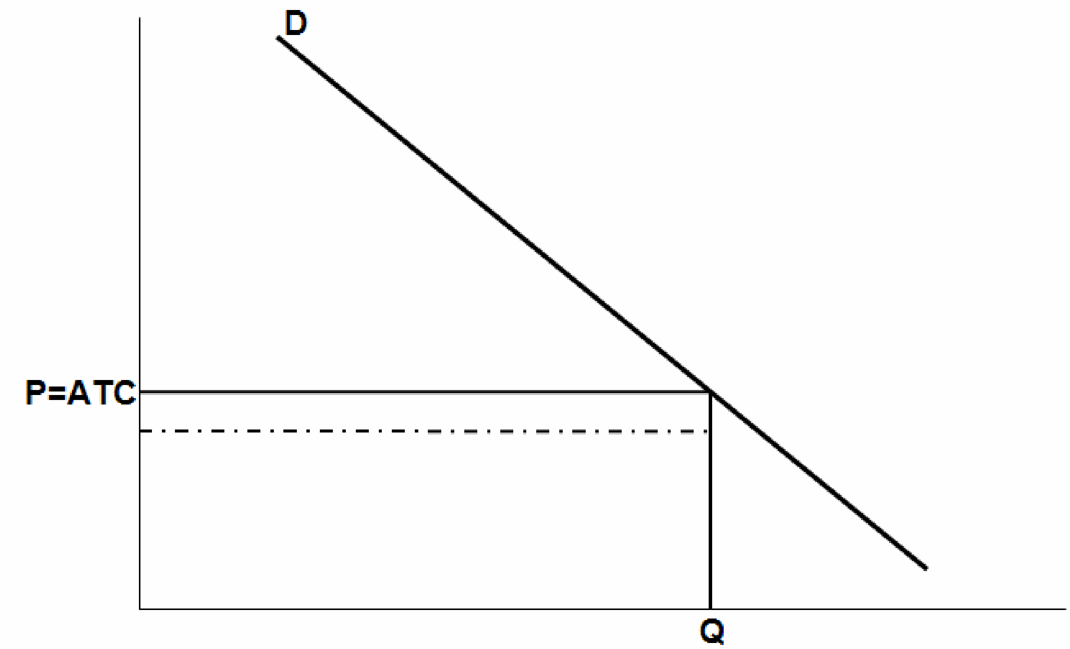

Figure 1: Equilibrium Price in a Competitive Market

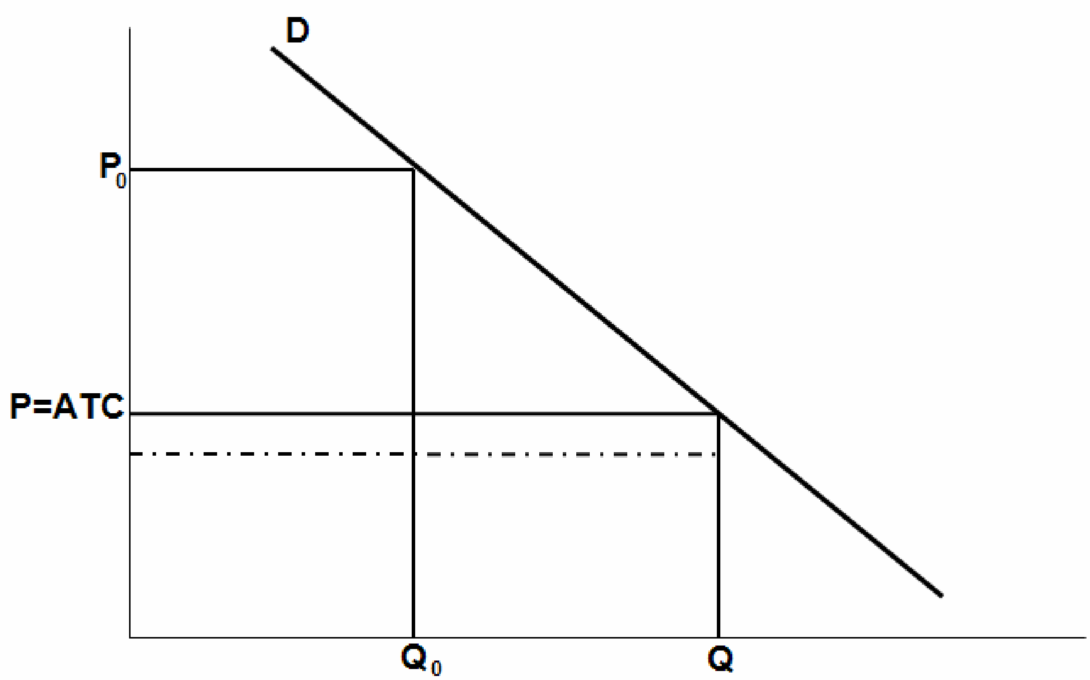

Figure 2: P_0 is Unsustainable in a Competitive Market

We saw in Table 1 that the median price of a top-selling finance textbook is about $150, and undergraduate books are a little less expensive than the graduate texts. How does a median price of $140-150 compare with the average total cost (ATC) of producing that book?

Since the ATC of producing a book depends, in part, on the size of the print run, we need some information regarding annual textbook sales. Some very rough sales data from industry sources are reported in Tables 2 and 3. Table 2 shows average annual sales for the 13 leading undergraduate corporate finance textbooks from 2001-2005. These data are based on annual surveys of university bookstores regarding the sales of particular titles, and they include both new and used books. The average number of bookstores participating in this survey was 1,428 per year. The "Other" category is apparently sales of the more obscure finance texts. It is evident from Table 2 that the market for undergraduate corporate finance texts is fairly concentrated. The two versions of Brigham and Houston's *Fundamentals* have over 25% of the market, the top five books have over 50% of the market, and the top eight books have 70% of the market. The top five books have annual average sales of 26,000 copies and the top eight books have annual average sales of 22,000 copies.

Table 3 shows similar date for the four leading graduate corporate finance books. The graduate data are based on an average of 1,452 bookstores per year. The top three books account for 68% of the market, and their average annual sales are about 19,000 copies. The market for the core undergraduate finance textbook is about three times larger than the market for the core graduate finance book.

It is evident that it is quite lucrative to be the author of one of the top finance books. Authors receive a royalty of 15% of the price to the bookstore on each book sold. The university bookstore's markup is generally 25% of the price to the bookstore, which is $28 for a $140 textbook, so the price to the bookstore is $112 and the authors' royalty is $16.80 per book on a $140 text. (Royalty rates are more like 10% on international or paperback editions not intended for sale in the domestic market.) However, if the price to the bookstore is lower and authors' royalty will be corresponding lower.

The following estimate of the ATC of a top selling finance book is based on a hypothetical finance textbook with a print run of 20,000 copies. We estimate the various costs of producing and distributing this book as follows:[1]

Production Costs. Publishers do not print books. They use contract printers who are generally based in China to actually print the books that they publish. There are two elements to the cost of production: a fixed set-up cost for the print run, which depends on the number of colors in the book; and a variable cost per book, which depends on the size of the print run. The setup cost for a four-color printing of our hypothetical finance textbook might be $100,000, or $5.00 per book for a run of 20,000 copies. The variable cost per book depends on the size of the

[1] These cost estimates are based on conversations with people in the publishing industry, but they may be wildly inaccurate. If the reader has any additional information about the cost of producing finance textbooks, please let me know. My e-mail is edy@eller.arizona.edu.

Table 2: Annual Sales of Undergraduate Corporate Finance Textbooks, 2001-2005

Name of Textbook	Average Annual Sales, 2001-2005	Average Market Share
1. Brigham and Houston, *Fundamentals of Financial Management*	35,573	13.9%
2. Brigham and Houston, *Fundamentals of Financial Management Concise Edition*	29,615	11.5%
3. Ross, Westerfield, and Jordan, *Essentials of Corporate Finance*	24,436	9.5%
4. Block and Hirt, *Foundations of Corporate Financial Management*	22,647	8.8%
5. Ross, Westerfield, and Jordan, *Foundations of Corporate Finance*	18,586	7.2%
6. Ross, Westerfield, and Jordan, *Foundations of Corporate Finance Alternate Edition*	16,822	6.6%
7. Brealey, Myers, and Marcus, *Fundamentals of Corporate Finance*	16,389	6.4%
8. Keown, Petty, Martin, and Scott, *Foundations of Finance: The Logic and Practice of Finance Mgmt.*	15,306	6.0%
9. Gitman, *Principles of Managerial Finance*	12,389	4.8%
10. Besley and Brigham, *Essentials of Managerial Finance*	12,170	4.7%
11. Moyer, McGuigan, and Kretlow, *Contemporary Financial Management*	9,263	3.6%
12. Keown, Martin, Petty, and Scott, *Financial Management: Principles and Applications*	9,164	3.6%
13. Gitman, *Principles of Managerial Finance Brief*	8,114	3.2%
Other	42,539	16.6%
Estimated Total Units	256,624	100%

Table 3: Annual Sales of Graduate Corporate Finance Textbooks, 2001-2005

Name of Textbook	Average Annual Sales, 2001-2005	Average Market Share
1. Brigham and Ehrhardt, *Financial Management: Theory and Practice*	23,725	28.3%
2. Ross, Westerfield, and Jaffe, *Corporate Finance*	18,917	22.6%
3. Brealey, Myers, and Allen, *Principles of Corporate Finance*	14,592	17.4%
4. Brigham and Daves, *Intermediate Financial Management*	12,397	14.8%
Other	14,130	16.9%
Estimated Total Units	83,761	100%

print run, and might be as low as $5.50 per book for 20,000 copies.[2] The out-of-pocket production cost is therefore $10.50 per book.

Other Direct Costs. This category includes editors, salespersons, and other personnel, advertising expense such as free examination copies, warehouse and distribution costs, and sufficient profit to both provide the publisher with both an adequate return on its working capital investment and to cover a share of the firm's indirect costs. Our guesstimate for this cost is $20.00 per book.

Average Total Cost. An approximate production cost of $30.50 per book means that the price to the bookstore will have to be about $36.00 to cover both the cost of the book and a royalty to the authors equal to 15% of the price to the bookstore. If the bookstore adds a 25% markup to cover its costs and profits, the final price where P = ATC is $45.00

The bottom line of this rough analysis is that a typical $140-150 finance textbook should perhaps sell for $45.00. Why doesn't it?

When an instructor adopts a particular textbook for a course, the local market for that book becomes distorted. The elasticity of demand for that book by that particular instructor's students changes dramatically. The demand schedule is now much less elastic, because the student must have that particular book. This process is illustrated by shift in the demand schedule from D to D_m in Figure 3. There are now few substitutes for the book that has been adopted and so the publisher, who is now a quasi-monopolist, can charge an exorbitant price like P_m.

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[2] The fixed cost would be lower for one-color or two-colors printing ($15,000+ and $50,000, respectively) and the variable cost is also lower. The variable cost per book is higher for a smaller run of a four-color book (e.g., perhaps $7.00 per book for a print run of 5,000-10,000 copies).

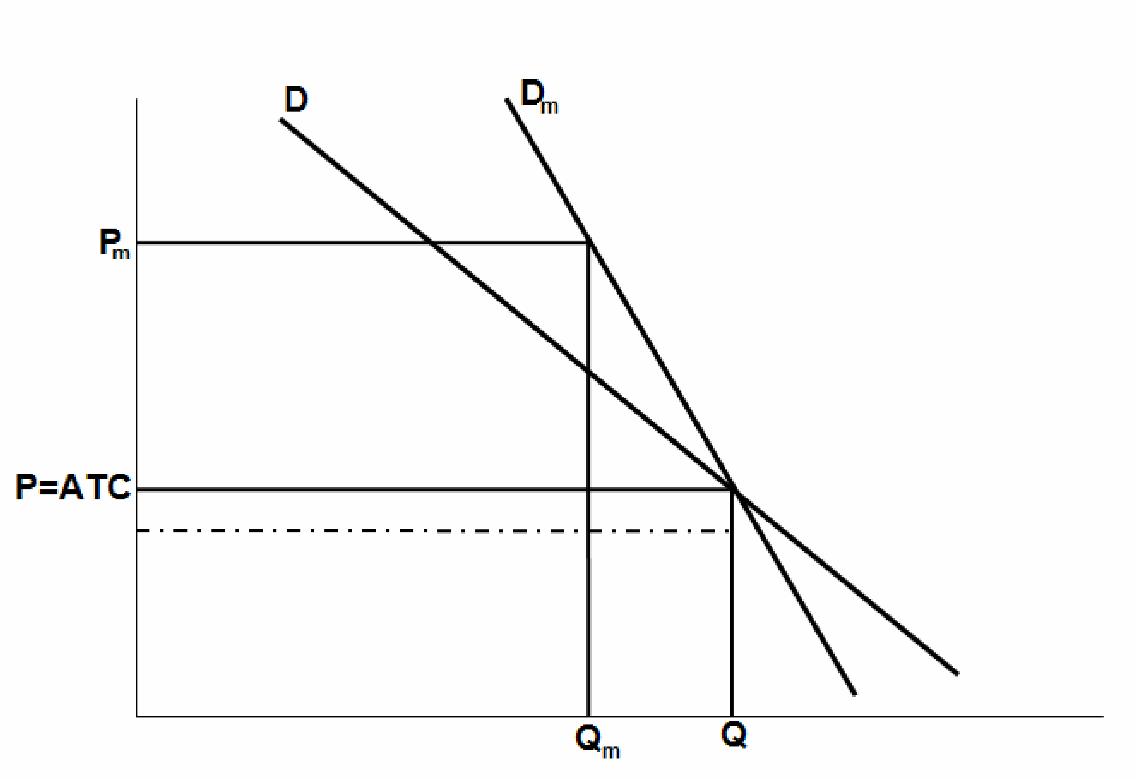

Figure 3: P_m is Sustainable in a Monopolistic Market

The demand schedule is not perfectly inelastic (i.e., vertical), because there are some alternatives to buying a new copy of the book from the publisher. These include buying a used book, buying an inexpensive international edition of the book issued for the market in Asia or Europe, sharing a book with other students, using a copy from the library, illegally copying material from a friend's book during the semester, or simply doing without the book and hoping for the best.

Buying a used book is the most widely-used of these alternatives. The bookstore pays 50% of the new retail price of the book for used books, whether from students or wholesalers, and then sells the book to students for 75% of the new price. In this scenario, the bookstore is charging a markup of 50% on used books compared to a markup of 25% on new books. Publishers are not the only ones who understand about charging "what the market will bear." However, bookstores sometimes have a problem getting sufficient used books to meet the demand at their university. This problem is exacerbated when instructors are tardy in notifying the bookstore that they will be using the same book next semester, since the best source of used books is an end-of-semester buyback program at the bookstore's home university. Improving the efficiency of the used book market is certainly the easiest way to mitigate the high price of new textbooks, and so it receives the most attention. For example, when the Arizona Board of Regents recently looked at textbook prices, many of their concrete recommendations pertained to improving the used book market at Arizona's three universities.

OTHER APPROACHES

In this section we examine four other potential ways to mitigate to the textbook pricing problem—international arbitrage; changing textbook adoption practices; having the university collect a fee for textbooks (the Granoff tax); and making textbooks free (the Google model).

International Arbitrage. Most publishers of major finance textbooks also issue an international edition intended for sale in Asia or Europe. This edition is generally soft cover, perhaps printed in black and white only instead of color, and priced to sell well below the domestic four-color hard cover edition of the same book. Although publishers try different ploys to prevent the importation of these editions, arbitrageurs are nonetheless quite active in the textbook market. Students can locate these sources on the Internet through various websites, including amazon.com, textbookhound.com, cheapesttextbooks.com, campusbooks.com, allbookstores.com, and bigwords.com. These sites also offer used books.

Change Textbook Adoption Practices. Most finance textbooks targeted for the same course contain roughly the same material. If an instructor is teaching students how to deal with the usual set of financial issues, there is no need to assign a particular textbook. It would be a trivial endeavor to provide reading assignments guiding the students to the relevant material in three or four different texts. The pedagogical implications of this proposal warrant further discussion. If an instructor is teaching fundamental truths most good-quality textbooks are reasonable substitutes for each other. However, if an instructor is simply regurgitating material from the particular textbook used in the class, arguably the students might benefit from owning that book.

Granoff's Universal Tax Scheme. Michael Granoff (2004, 2007), an accounting professor at UT-Austin who believes that the used book market causes high textbook prices, proposes that universities levy a fee on every student registered for each course and that they remit this money to the publisher of the textbook will be used in the course. In return, the publisher will provide an electronic link to the book, and a hard copy for a nominal additional amount if the student wants one. This fee would be about $41.00 for the typical $140-150 finance text discussed in this paper. I believe that there is at least one pilot project underway to test this approach. It appears that under this scheme would-be purchases of new books have much to gain and would-be purchasers of used books lose just a little. The fallacy with this proposal is that the publisher now has as perfect monopoly from which no student—however clever—can escape. Can good-hearted publishers be relied upon to keep prices down? Recall that these same good-hearted publishers currently sell $45 books to starving students for $150! If you like this proposal, there is a nice suspension bridge linking Manhattan and Brooklyn that you should consider buying.

Free Books (The Google Model). A Googlesque approach to providing textbooks is to make the book available online for free, and to cover the costs of this service (including the author's remuneration) by selling advertising. One company that is currently offering finance textbooks using this model is Freeload Press, Inc. (at www.freeloadpress.com). They currently offer two undergraduate corporate finance textbooks (Gallagher and Andrew (2006) and Werner and Stoner (2007a)). Electronic versions of the textbooks can be downloaded gratis, and printed paperback copies are available for $25.00. The also offer a free graduate text by Werner and Stoner (2007b) with a print copy available for $40.00.

Although the current economic success of this enterprise in unclear, it demonstrates and feasibility of providing textbooks for free over the Internet. Scale will be an important issue here. However, this model may not be economically viable for major textbooks. The authors of a print book that sells 15,000 copies per year domestically will earn over $80,000 in royalties on these sales alone. It will take a lot of advertisers and a lot of clicks to lure authors away from the print market and to the electronic market.

CONCLUDING COMMENTS

This paper characterizes textbook publishers as behaving like rational quasi-monopolists in the market for university textbooks. Such behavior is neither good nor bad; it is simply a fact of life. Both students and faculty members can find ways to mitigate much of the financial impact of this behavior if they choose to do so.

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