COMPETITION AND CONSOLIDATION: STRATEGIES IN THE HIGHER EDUCATION TEXTBOOK MARKET

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In the Fall of 2018, Cengage publishers unveiled a flat fee subscription to access their entire catalog of higher education materials in an attempt to improve their financial standing. Then, in May 2019, Cengage announced a potential merger with Mc-Graw Hill publishers. In an already highly competitive market, complicated by the proliferation of open access materials, textbooks rental programs and seemingly lower numbers of students purchasing textbooks, what will the impacts on the market be as a result of such a merger? How can the Department of Justice and the Federal Trade Commission evaluate these impacts?

INTRODUCTION

The United States Department of Justice (DOJ) and the Federal Trade Commission (FTC) work together "to identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that are either competitively beneficial or neutral" (DOJ 2010). The two governmental agencies must use an analytical process, collecting data and making predictions, to measure the level of competition in a given market to make this determination.

On May 1, 2019, Cengage and McGraw-Hill, the second and third largest college textbook suppliers, announced they had agreed to an all stock merger on equal terms. Michael E. Hansen, CEO of Cengage, described the merger as a "…new company [that] will offer a broad range of best-in-class content – delivered through digital platforms at an affordable price,…Together, we will usher in an era in which all students can afford the quality learning materials needed to succeed – regardless of their socioeconomic status or the institution they attend…." (Cengage 2019).

David Cicilline, Chairman of the US House of Representatives Subcommittee on Antitrust, Commercial and Administrative Law, and Jan Schakowsky, Chairwoman of the US House of Representatives Subcommittee on Consumer Protection and Commerce, wrote in a letter to the Department of Justice, that they had "serious

concerns with this merger's impact on the cost of higher-educational textbooks" due to the "significant consolidation" where "three companies reportedly dominate more than 80% of the market" (Cicilline and Schakowsky 2020). In particular, they ask the Antitrust Division of the Department of Justice to "closely scrutinize this merger" because "it appears that the proposed Cengage-McGraw Hill merger will significantly reduce competition in the college textbook market, creating a duopoly that may increase the financial burden on American students…and unduly influence their education" (Cicilline and Schakowsky 2020).

THE TEXTBOOK INDUSTRY

The Major Players

The roughly $14 billion-dollar United States textbook industry is largely served by five publishing houses divided across the K-12 and higher education textbook markets. In the higher education market, Pearson, McGraw-Hill, Cengage, and Wiley account for the overwhelming majority of the market. Altogether these four companies have a market share of about 90% of the U.S. higher education textbook market (Marketwatch 2019). Table 1 presents market share data and stock pricing information for the top firms in the textbook market in 2019.

Table 1
Stock Valuation and Market Share of Top Firms, 2019

Company	Stock Symbol	Historical Quote	52 week High-Low	Market Share
Cengage Learning Holdings II Inc.	CNGO: OTC	$12.75	$5.63 - 16.25	22%
McGraw-Hill Education (Apollo Global Management Inc.)	APO: NYS	$47.32	$27.69 - 52.67	21%
Pearson PLC ADR	PSO: NYS	$7.42	$7.28 – 12.22	40%
John Wiley & Sons	JW.A: NYS	$43.62	$40.66 – 52.97	7%
Macmillan, Oxford University Press and others (combined)				10%

(Sources: CNGO, APO, PSO, JW.A: (Marketwatch/financials 2020), Market shares (Bartz 2020))

Revenues for the last five years are given in Table 2. While market share is high for Pearson, Cengage and McGraw-Hill, revenues have declined or stagnated for each of the top four market participants.

Table 2
Revenues, sales growth, Earnings Per Share of Top Firms, 2015-2019

	2015	2016	2017	2018	2019
Cengage (CNGO)					
Revenue (USD)	1.66B	1.63B	1.46B	1.47B	1.45B
Sales Growth		-1.98%	-10.46%	0.42%	-1.41%
EPS (Basic)		(1.02)	(0.63)	(0.03)	(1.58)
McGraw-Hill (APO holdings company)					
Revenue (USD)	2.39B	1.09B	2.01B	2.66B	1.16B
Sales Growth		-54.62%	85.05%	32.26%	-56.22%
EPS (Basic)	0.62	0.61	2.11	3.12	(0.30)
Pearson (PSO)					
Revenue (USD)	4.87B	4.47B	4.55B	4.51B	4.13B
Sales Growth		-8.33%	1.88%	-0.86%	-8.51%
EPS (Basic)	0.30	(0.38)	(2.87)	0.50	0.76
Wiley (JW.A)					
Revenue (USD)	1.82B	1.73B	1.72B	1.8B	1.8B
Sales Growth		-5.23%	-0.49%	4.51%	0.22%
EPS (Basic)	3.01	2.51	1.98	3.37	2.94

(Sources: CNGO, APO, PSO, JW.A: (Marketwatch/financials, 2020)

While revenues are substantial, higher education textbook companies have been seeing a downward trend in revenues. In 2014, Pearson began a major restructuring towards digital through acquisitions and investment. However, as recently as 2017, the "US higher education [digital] courseware, remains challenging" (Publisher's Weekly 2018). Others have also faced a difficult and rapidly changing market. Cengage emerged from bankruptcy on April 1, 2014 after eliminating

approximately $4 billion in debt accumulated through a declining paper textbook market and acquisitions (Publisher's Weekly August 2017). McGraw-Hill Education declared bankruptcy September 17, 2018 and sales of print books also fell sharply for Wiley (Publisher's Weekly 2016, March 2017).

On May 1, 2019, Cengage and McGraw-Hill announced a proposed merger. If the merger were to go through, the combined company under the McGraw-Hill name would have nearly $3 billion in sales (Marketwatch 2019). While estimates of market share vary considerably depending on how narrowly higher education textbook markets are defined, in general, if the two merged, they would be about 45% of the market, with Pearson being another 40%. However, Cengage and McGraw-Hill contend their combined market share would be considerably lower at 30% (Bartz 2020).

DEPARTMENT OF JUSTICE, MERGERS, AND ANTITRUST LAW

The Department of Justice's (DOJ) Antitrust Division is tasked with assessing mergers that have the potential to significantly affect market power within an industry in a way that could adversely affect market competition. Their authority primarily derives from the Sherman Antitrust Act, which makes it a crime to monopolize any part of interstate commerce, the Clayton Antitrust Act, which is "…a civil statute (carrying no criminal penalties) that prohibits mergers or acquisitions that are likely to lessen competition," and the Federal Trade Commission Act, which "…prohibits unfair methods of competition in interstate commerce." The DOJ holds authority to reject a merger or require changes in the terms of the merger in order to protect the competitive environment in the industry. The Horizontal Merger Guidelines provide guidance regarding what constitutes evidence of adverse competitive effects of a potential merger (DOJ 2010).

In general, the DOJ will examine evidence of adverse competitive effects such as increases in market concentration and market share from before to after the proposed merger. The DOJ's experience with prior mergers, knowledge of the industry, information about substitute and complementary markets, as well as market tests of monopoly power, pricing, profitability are all relevant to the DOJ's approval process. Essentially, anything that gives insight into how the merger might adversely affect the consumer and the competitive market are weighed for costs and benefits. In this case, since the merger also has international implications, both the Australian Competition and Consumer Commission and Britain's Competition and Markets Authority have also raised questions about the merger (Bartz 2020).

TRENDS IN PRODUCT OFFERINGS

The types of products offered by publishers in higher education has undergone major changes. In the past, students typically purchased a physical textbook

because there were limited options or substitutes. Now, however, the market faces challenges as the number of substitutes has grown, which has resulted in falling sales for traditional textbook publishers. Faculty now have more options than ever to provide students with resources. Traditional textbooks are now offered in print and digital format. Print textbooks maintain high price points, but digital "e-books" offer a more economical choice, despite research indicating that student outcomes are not positively affected (Daniel and Woody 2013). Within the traditional market is also the rental option, where students can choose a specified time period of 4-12 months. This provides the benefit of a physical textbook, but the downside of being without the use of the book as a long-term resource for the student.

Open source textbooks are also becoming more prevalent, especially in large enrollment courses. Open source textbooks allow students to access materials for little to no costs. These materials are maintained by the open community and typically updated frequently. However, these resources do not undergo as rigorous an editorial review as traditional textbooks, leading to relatively lower rates of adoption.

As profitability becomes more challenging for traditional textbook publishers, other ways of product differentiation are now a common strategy. First, especially with introductory courses, instructors commonly choose textbooks that offer ample resources for faculty to use: instructor's manuals, test banks, and PowerPoint slides. But as class sizes at the introductory level grow, online course management tools, such as homework managers, also add value. These programs allow publishers to bundle together resources for instructors, while keeping costs of delivery low. These programs are also advantageous for instructors as they provide a simple, direct way to provide students with automatically graded homework systems, especially in large enrollment courses (Nguyen and Trimarchi 2010). Additionally, as assessment requirements have risen, the utilization of the programs has increased to provide a tangible way to assess student performance over a semester in large courses (Settlage and Settlage 2015).

Enter the most recent trend: subscription services. These programs are offered in a wide array of consumer markets, such as music and television streaming services. These programs typically charge a fixed fee that grants unlimited access for a designated time period. Cengage Unlimited was initially launched in Fall of 2018 – this subscription program allows students unlimited access to over 10,000 Cengage titles and homework managers for a flat charge of $120 for a 4-month time period. For some colleges and universities, this leads to the campus-wide adoption of Cengage texts to keep costs low for students.

Because of higher traditional textbook prices, students and professors do appear to be utilizing some of these lower cost alternatives. According to surveys conducted by the National Association of College Stores (NACS), average student spending on required course materials including print and digital textbooks fell from $701 in 2007-2008 to $484 2017-2018 (NACS 2019, Student Watch 2019).

Digital formats continue to make inroads rising from 10% of purchases in Spring 2016 to 25% in Spring 2018. Of overall purchases, 63% of students buy new materials, 56% used and 25% digital. Students report buying course materials from the Campus Bookstore (77%), Amazon (42%), as well as publisher websites (9%), peers (9%), and Chegg.com (7%) (NACS 2019).

Despite all of this, college textbook prices significantly increased over the last 20 years (BLS 2020). Average textbook prices from 2005-2015 increased by over five times the rate of overall consumer prices (BLS 2015). The average price of a 'new' textbook rose from $58 in the 2011-2012 academic year to $90 by 2016-2017 (NACS 2017). Further, textbooks account for about 3% of financial aid dollars (Marketwatch 2019). Many students choose not to purchase texts or wait until after the first week to purchase a text. Others share or choose digital texts even though they prefer paper texts. Professors seem to be taking notice, assigning fewer texts, seeking out less expensive alternatives and using more open educational resources (Harris 2018).

THE DECISION

The Department of Justice and Federal Trade Commission must evaluate the proposed merger using the federal guidelines with respect to the Clayton and Sherman Antitrust Acts and the Federal Trade Commission Act (DOJ 2010). In this evaluation, they must consider many different aspects of the market, including, but not limited to:

- Determining whether the merger will markedly reduce competition
- Investigating if there is a possibility of price discrimination by treating groups of consumers differently
- Identifying the market to determine where competition may be affected and who may be affected
- Assessing the market share and concentration of participants
- Determining whether the firms produce differentiated products and how product variety may be impacted
- Considering whether the merger will encourage coordination among remaining firms
- Gauging possible efficiency gains in quality, cost and service

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