

Covid-19

and the challenge to
chain retail bookstores
in Canada's cultural landscape

A discussion paper
prepared by the
More Canada think tank project steering
committee

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ABOUT THIS PAPER

This discussion paper has been prepared by the More Canada think tank project steering committee. It is based on discussions by an advisory group of trade and academic Canadian publishers drawn from across the country. These videoconference discussions are held using “Chatham House” rules, meaning that participants are free to share information and analysis from the discussions, without attribution to individual participants.

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Susanne Alexander, publisher, Goose Lane Editions, Fredericton

Philip Cercone, executive director, McGill-Queens University Press, Montreal

Marc Côté, publisher, Cormorant Books, Toronto

Anna Comfort-O’Keeffe, publisher, Douglas & McIntyre, Vancouver

Robert Dees, president, Robert Rose, Toronto

Don Gorman, publisher, Rocky Mountain Books, Victoria

Lionel Koffler, president, Firefly Books, Toronto

James Lorimer, president, Formac Publishing/James Lorimer & Company, Halifax & Toronto

Jeff Miller, publisher, Irwin Law, Toronto

John Yates, chief executive officer, University of Toronto Press, Toronto

Howard White, publisher, Harbour Publishing

This report is offered to contribute to public information and discussion on Canadian cultural policy matters. More reports and documents arising from our project including the More Canada report can be found at morecanada.ca.

— The More Canada think tank project steering committee
Philip Cercone, James Lorimer, Jeff Miller

The More Canada think tank project is an activity of the Canadian Forum Foundation
5502 Atlantic Street
Halifax NS B3H 1G4
info@morecanadareport.ca
www.morecanada.ca

EXECUTIVE SUMMARY

Covid-19 has created crisis conditions for Canada's troubled retail bookstore sector, and that has serious implications for Canadian cultural life.

Indigo Books, whose bricks and mortar Indigo, Chapters and Coles stores dominate retail bookselling in English Canada, was already in financial difficulty pre-Covid. The company lost \$49 million in 2019, and was on track for another loss in 2020. In the last two years its shares have skidded from near \$20 to \$1.35 today. Its CEO Heather Riesman warned a month ago that there was a danger of large retailers going into bankruptcy if government help was not provided.

For the 100+ independent publishers who publish most new Canadian-authored books, Indigo is their biggest customer. Their fate is closely tied to Indigo's.

The independent bookstore sector appears to have weathered Covid-19 reasonably well. Stores offered customers home delivery and curbside pickup. Sales have been low, but the booksellers are surviving.

Independent publishers worry that Indigo could seek new foreign owners to tackle its ongoing business issues. Publishers' experience with foreign companies selling books in Canada is that foreign ownership undermines Canadian identity reflected on bookstore shelves.

Indigo could seek help from Ottawa under the emergency LEEFF program for large businesses. Publishers urge fast action on any Indigo request, and urge that support come with conditions reflecting government cultural policy goals.

Over the medium term, publishers see a need for new government measures that recognize the cultural importance of bookstores in giving Canadians access to a wide range of Canadian books. Many other countries already treat bookstores as cultural organizations deserving support, and have devised a wide range of measures to do so. Quebec today has policies that direct public institutions like libraries and schools to spend their public funds in retail bookstores. The result is a robust network of bookstores in virtually every town in that province – in fact, Quebec has more independent bookstores than all of English Canada.

Publishers identify four actions to sustain bookstores in English Canada:

- Maintaining the long-standing policy requiring Canadian ownership of retail bookselling and distribution
- Help for independent bookstores to do more to promote Canadian authors and their books, building on their current success in doing so
- Cultural policy measures accompanying any financial support for Indigo, including an agreement by Indigo to devote 20% of store bookshelf and display space to Canadian books
- New measures for public spending on books to go to retail bookstores that agree to offer Canadians a wide range of Canadian and international books

COVID-19 AND THE CHALLENGE TO CHAIN RETAIL BOOKSTORES IN CANADA'S CULTURAL LANDSCAPE

In early May Indigo Books CEO Heather Riesman was part of a group of large Canadian retailers and large commercial landlords seeking federal support for a rent relief program. Later in May, Riesman warned publicly of possible bankruptcies due to the impact of the Covid-19 pandemic.

This possibility is a major risk to Canadian cultural life, and specifically to the access Canadians have to Canadian books. As governments consider actions to ensure that retail bookselling is sustained, there are cultural policy issues that should be taken into account.

THE CHAIN BOOKSTORE RETAIL LANDSCAPE IN CANADA TODAY

As the sole chain retailer operating bookstores in English Canada, the Indigo retail bookstore chain is central to book writing, publishing and reading in this country. Since gaining its dominant market position 19 years ago (when Indigo and Chapters were merged with the acquiescence of the Competition Bureau) Indigo has had a mixed history of success and challenge. Book retailing in other national markets has also proven to be a difficult business. Indigo has implemented a variety of strategies to maintain and grow sales and profits, but in the past two years it experienced a loss of \$49 million in fiscal 2019 and somewhat higher losses in the first nine months of fiscal 2020. Shares have gone from close to \$20 in March 2018 to \$1.35 in early June 2020.

In this context, the impact of Covid-19 on Indigo has been particularly severe. CEO Heather Riesman described the situation to the Globe and Mail on May 22: “As retailers, we know we have to accept some pain, but we can’t accept 100 per cent of it. It’s not like the money we lose is coming back. It’s gone. Do we imagine that there could be a lot more bankruptcies if no help comes? Yes.”

In the context of this warning, it is imperative to underline Indigo’s presence in the English Canadian book market. Indigo together with its Chapters and Coles brands is by far the most important single source of the books that people buy and read – and also the most important source of awareness of books. Browsing and display in bricks and mortar bookstores is how people discover books to read, more than any other source.

Indigo is also a major online book retailer. It remains a serious competitor to Amazon in Canada for online book sales, even though its share of those sales has been declining. Canadian consumers are able to benefit from a competitive online marketplace, whereas in most English-language countries Amazon dominates. Amazon is a ruthless competitor, but Indigo’s Canadian identity offers it an opportunity to win customers in a post-pandemic world where people are looking to purchase locally and “on-shore.”

Canadian writers and publishers have a complex relationship with Indigo. For many independent publishers, the company is their most important single customer. The decisions its buyers make about which books to stock, and how to display and promote them, are crucial. Their presence in stores represents the most important opportunity publishers have to see their books generate awareness and

purchase. The amounts owing to publishers by Indigo for pre-Covid purchases – and the fact that unsold books can be sent back to publishers for credit, and to pay bills – represents the publishers’ biggest single financial risk today.

A bankruptcy or receivership of such an important customer would be financially disastrous for Canada’s 100 or more independent publishing houses across the country. If publishers found themselves unable to collect the amounts owing to them, there would be a cascade of follow-on bankruptcies and receiverships among Canadian publishing houses.

More important, any loss of such an important player in the supply chain for books would suddenly collapse the opportunities for Canadian writers to reach readers. While independent bookstores are the most successful champions of Canadian writers and books in the marketplace, they collectively account for a small share of all retail book sales. Many town, communities and neighbourhoods rely exclusively on the Indigo chain for retail bricks and mortar bookselling. Canadian cultural life would take a severe hit from any interruption or cession in Indigo’s operations.

While the initiative in early May led by Heather Riesman on behalf of major retail chains to get support from Ottawa has not borne fruit, there are now federal programs that can benefit large retail chains. They can access the wage subsidy program, now extended to August 31. In addition, Ottawa has put in place the Large Employers Emergency Financing Facility (LEEFF) which is available to Canadian companies that generate in excess of \$300 million in annual revenue. It will provide loans of a minimum of \$60 million. Then, 20% of that loan will need to be secured senior debt, and come affixed with an interest rate of 5% applicable for the first year, followed by 8% in the second year. However, the company also has the option to pay the loan in full before the year is up without any penalties. LEEFF support comes with provisions that could allow the federal government to take up ownership of shares, and to name an observer to the borrower’s board of directors. There are other requirements regarding employee pension plans and ensuring action to achieve federal government environmental policy goals.

In the context of Covid-19, some key Canadian retailers have had to take drastic action. Among them are Aldo Shoes and Reitmans, both of which have recently filed for protection from creditors under the Companies’ Creditors Arrangement Act. Canadian landlords of shopping malls and other retail space report very high percentages of unpaid rents from their tenants for April, and May is not expected to be different.

In this context, independent Canadian book publishers are highly concerned about Indigo’s short-term prospects.

Key points of concern are:

- With most payments on account to publishers temporarily suspended by Indigo, publishers are financially at risk for substantial sums owing to them
- Industry terms of trade allowing for return of product in lieu of payment, and recent Indigo announcements of major incoming returns and lower overall store inventory levels put publishers at high risk of greatly reduced net sales and shrunken cash flow over the next months
- These developments, on top of the drastic short-term collapse of demand and sales for books in Canada, are putting enormous financial strain on independent Canadian publishers. So far, this

strain has been offset only partly by accelerated payment of industry support by federal agencies, a modest top-up in federal support and the wage and rent subsidies available to all businesses

- Indigo's short-term strategies for reopening are promising in terms of boosting Canadian-authored book sales, but reduced store inventories combined with a slow return to normal bookstore browsing will likely generate a substantial medium-term reduction in bookstore sales of Canadian-authored books
- Covid-related precautionary measures are dramatically reducing the opportunities for publishers to promote new books with Indigo – events, book launches, and other activities are drastically cut back, or cancelled entirely

THE NEED AND OPPORTUNITY FOR ACTION: SHORT-TERM

Bookstores are a key link in the supply chain linking authors and publishers to readers, and are critically important contributors to their communities' cultural life. Independent bookstores are particularly valuable to their communities, particularly because they are most successful at connecting Canadian authors to readers. Canadian books currently account for 18-20% of independent bookstore sales in English Canada.

Smaller independent bookstores have received support from the federal wage subsidy program. Many could be eligible for rent relief, although take-up of that program is reported to be low in part because of the requirement that landlords make application and accept a 25% rent reduction. Most independent stores have been able to remain active through the Covid-19 period, offering home delivery and curb-side pickup.

Independent stores are well on their way to setting up a new organization to represent their sector of the industry. Independent Canadian publishers place a high value on seeing this initiative supported.

Sustaining chain bookstores is also important for Canadian cultural life. The LEEFF program could prove to be a lifeline for Indigo. If Indigo seeks LEEFF support, a prompt response is vital for ensuring its needs are addressed. Any response should take account of its role as a cultural presence.

Along with the environmental measures baked into LEEFF terms, there is an opportunity and a need to build in provisions that ensure that, in exchange for government support, Indigo contributes to Canadian cultural goals and the vitality of the Canadian book market. There is a precedent for this: when the country's two English-language bookstore chains, Chapters and Indigo, were allowed to merge in the early 2000s, Indigo entered into an agreement with independent Canadian publishers under which it guaranteed to devote 15% of its total store display space to Canadian-authored books. This commitment expired after five years, but something similar could be put in place. This would help ensure that the chain's sales of Canadian authored books, now around 12%, would grow towards the 20% levels already achieved by independent bookstores.

Indigo has already responded to consumers' post-Covid interest in buying and reading local with programs to emphasize local authors and local and regional interest books in reopened stores. A provision in any federal funding support guaranteeing that this priority would continue would serve to reinforce that new approach.

In the short term, it is possible that Indigo's majority owners may opt to take the company private. A very low share price makes this relatively inexpensive. Going private would give management more flexibility in addressing the company's issues in the short and medium term. But it does not address the challenge caused by the declining store sales and ongoing losses that Indigo was experiencing in the two-year period prior to Covid.

THE MEDIUM-TERM BOOKSELLING CHALLENGE

In the medium term, there is a need for innovative measures that ensure the viability of chain bookselling in English Canada.

In circumstances of business distress, Canadian businesses and investors often turn to foreign ownership. While long-time federal cultural policy prohibits foreign takeovers of Canadian-owned businesses in book publishing and distribution, an exemption can be made for companies in distress. The history of this policy is that virtually every case of a major publishing or book distribution company seeking an exemption has been granted. Indigo has in the past explored a link-up with Barnes & Noble. Now that Barnes & Noble is controlled by British private equity firm Elliott Investors Ltd who also own the dominant UK chain Waterstones run by CEO James Daunt, a sale to Elliott could be an option under consideration. Daunt has managed a successful turnaround of Waterstones based in part on empowering local store managers to respond to their local communities.

A foreign takeover of Indigo could be seen as a positive outcome to a very challenging situation. Our view is that it could be a business success – but it would be a cultural disaster for Canada.

We say this based on industry experience with the successful major foreign-owned retailers which sell books in English Canada. Their business practices are developed reflecting the needs and interests of the US market, and Canada is at best differentiated simply as a region of America. Buyers are usually based in the US, with scant knowledge of the complexities of the Canadian market and little willingness or ability to respond regionally to local interests and local activities. Canadian books are undifferentiated from other books, and are effectively treated as if they have no specific relevance or importance to Canadian readers. Business-to-business relationships reflect the position of Canadian suppliers judged by their overall North American sales, so publishers important to Canada are regarded as minor players North America-wide.

Canadian publishers have been very successful at developing working relationships with US-based retailers, and at exporting to the US. But foreign ownership of retailers operating in Canada has proven to lead to a failure to consider Canada as a separate nation with its own cultural identity and life. For a bookstore chain, the consequence of foreign ownership would be stores which offer the same range of books that are offered in the U.S. – effectively making our bookstores American bookstores selling mostly American books, which happen to be located in Canada. Canadian readers need Canadian bookstores that reflect an understanding of their distinctive reading interests and tastes, and that put Canadian-authored books front and centre. That can happen only when the primary interest of the bookstore owners is Canadian sales. Only when bookstores are owned by Canadians, will those owners put Canadian interests first.

For concerns that parallel those that require television networks and newspapers to be Canadian-owned and controlled, the primary distribution channel for books in Canada needs to remain owned, controlled and operated in Canada by Canadian hands.

Foreign ownership is not the medium-term answer to the viability of chain bookstores in Canada, even though this course of action may seem to be an easy and obvious step to take.

PUBLIC POLICY AND BOOKSTORES IN ENGLISH CANADA

There is a clear need for new policy measures to establish the medium-term viability of bookselling, both chain and independent, in English Canada. We note that as in many European countries the important cultural distribution channel of retail bookselling has been the object of a variety of government cultural policies. The best and most relevant example of successful policies is near at hand, in Quebec. In that province, the “accredited bookstore” program has ensured a healthy bookstore industry, with 280 retail stores covering virtually every city and town in the province. The dominant chain has about 40 outlets, and independents account for the balance of 240.

The foundational idea of the Quebec model is to channel the purchases of all books by public institutions, using public funds, through retail bookstores. In exchange for benefitting from this flow of purchases, bookstores agree to stock virtually all new Canadian-authored books when they appear, and always to offer customers a wide range of Canadian books along with international authors. The cultural benefit of this model is that Quebec’s book readers discover and read a far larger proportion of Canadian authors than is the case in the rest of Canada. Professional book buyers, like school and public librarians, are also able to discover new Canadian books, and select them for their readers in much higher proportions than occurs now in English Canada.

English Canada would need variants and innovations to develop the policies that would achieve the results achieved by the Quebec model. In the medium term, governments need to collaborate with publishers and the book supply chain to devise the new measures that would ensure the viability of bookstores in English Canada, both chain and independent.

Books can be and are sold by a wide variety of retailers, both bricks and mortar and online. But readers need and value one particular kind of book retailer – bricks and mortar bookstores – over the others. Only in these bookstores can readers discover and access the wide range of books, including the 3,000 new Canadian-authored books published every year in English Canada, that will engage, inform and entertain them.

Readers need bookstores. It is the task of Canadian public policy today to find the measures that will ensure that Canadian readers will continue to have Canadian bookstores where they can discover and obtain the books they want to read.

ACTION RECOMMENDATIONS

Government support for retail bookselling in Canada is an essential component of Canadian cultural policy. Retail bookstores have an important cultural role as well as a commercial function, and public policy needs to ensure they remain viable.

The key action points are:

- The federal government should reaffirm its commitment to maintaining Canadian ownership in book publishing and distribution, including Canadian ownership and control of all retail bookstores

- Independent bookstores have a special importance because of their proven success in connecting Canadian writers to Canadian readers. Government measures to strengthen that role, especially regarding books published by independent Canadian publishers, should be provided on an ongoing basis to stores committing to dedicating 20% of bookshelf space to Canadian-authored books.
- The Chapters-Coles-Indigo bookstore chain store also plays a key role in Canadian cultural life, and government measures should ensure that the chain is a viable commercial entity. Support should be conditional on:
 - Contributing to government cultural policy goals, specifically by committing to dedicating 20% of total bookshelf space for Canadian-authored books
 - Returning to pre-Covid payment terms and store inventory practices for all Canadian-owned publishers
 - Continued participation in industry-wide supply chain initiatives, including the industry-wide EDI ordering system and sales data reporting system
- Governments should develop measures regarding book purchasing involving public funds appropriate to the English language book supply chain to mirror the achievement of Quebec in ensuring the viability of retail bookselling and the discoverability of a wide and diverse range of Canadian as well as international books for Canadian readers