**Why e-books cost so much**

Book publishers are being sued by the Justice Department for allegedly colluding to raise e-book prices. This isn't a case of simple greed.

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Here's something that tends to get lost in the debate over e-book prices: Paper doesn't cost very much.

There's a perception among consumers that an e-book should cost very little or next to nothing because there is no paper, printing, and shipping involved.

But in fact, for a new best-selling hardcover, all of the costs associated with print, from the printing to the shipping to the distribution to the warehousing to returns, amount to a mere few dollars per copy, depending on the size of the print run.

The vast majority of a publisher's costs come from expenses that still exist in an e-book world: Author advances, design, marketing, publicity, office space, and staff.

You can therefore imagine the fear that e-book prices instill in publishing executives' hearts. They're only saving a few dollars per copy in the switch to the e-book world, but the prices of books were slashed more than half: from $24.99 to $9.99 and even lower.

That begins to explain why publishers are trying to keep e-book prices high. But it doesn't tell the whole story.

**Along came the iPad**

Before the introduction of the iPad, publishers sold e-books according to the "wholesale" model. Publishers set a list price for a book, they took roughly half, e-book vendors like Amazon took roughly half, and the vendor could set whatever price they want.

So for instance, for a new e-book, let's say the list price was around $24.99. Amazon paid publishers $12.50 per copy, but then turned around and sold the e-book for $9.99. They took a loss on e-book copies to help sell Kindles and to build a huge early lead in the e-book market.

This created several pressing concerns for publishers. For one, Amazon was helping devalue consumers' notion of what a new book "should" cost. And two, publishers badly wanted competition in the marketplace, but they were hearing from other companies that wanted to get into the game that they couldn't compete with Amazon's prices.

So along came Steve Jobs and the "agency" model: Publishers set the price of e-books and receive 70 percent. Publishers took that deal and then imposed it on Amazon, as detailed by my colleague Greg Sandoval.

But here's the irony of the agency model: It wasn't about making more money in the short term, even though e-book prices went up. Publishers raised prices and made less money per e-book copy sold.

Take that $24.99 list price. Let's say the e-book would have sold for $9.99 at Amazon in the old days but now the publisher charges the consumer $12.99:

Wholesale model e-book:

Publisher: $12.50 (roughly 50 percent of $24.99 hardcover retail price)

Amazon: - $2.50 (selling at $9.99)

Agency model e-book:

Publisher: $9.09 (70 percent of $12.99)

E-bookseller: $3.90 (30 percent of $12.99)

This wasn't a story of money-grubbing publishers trying to stick it to consumers. They actually left money on the table.

The result: The e-book marketplace competition that publishers wanted began to take place. Rather than competing on price, e-book sellers like Apple, Barnes & Noble, Amazon, and others have, up until now, mainly been competing on user experience.

And if higher prices slowed down consumers' adoption of e-books and kept people attached to print, publishers were OK with that. Here's why.

**It's still a print world**

Not only are publishers' margins better on higher-priced print books, but when bookstores close it has enormous ramifications for the industry. When Borders went bankrupt, for instance, Penguin Group was its single largest creditor, with $41.1 million outstanding.

And even aside from financial considerations, publishers' entire reason for existence is bound up in print. The major publishers are, quite simply, the best companies in the world at getting print books from authors to readers. Most of the tools at their disposal for making a book a hit are tied to a print world, from buying front-of-the-bookstore placement (yes, publishers pay for that) to book tours.

As the exponential growth of e-books has slowed, some publishers are even whispering their hopes that perhaps the rate of e-book adoption will slow further and print will be viable well into the future.

But meanwhile, on the other side of the e-book price divide are consumers. Whatever the cost of paper, $10-plus e-books look mighty expensive when they're undercut by 99-cent Kindle best sellers sold by authors who don't have a publisher's overhead.

Publishers have a massive problem with perception of value. When you can't hold it in your hands and easily pass it along to a friend, $10-plus just feels too expensive to many people.

And because publishers have been selling print books via the wholesale model and e-books via the agency model, this results in the confusing situation of e-books sometimes costing more than their print counterparts. With print, Amazon and other booksellers are allowed to charge whatever they want. With e-books, the publishers set the price and e-booksellers aren't allowed to discount. So Amazon, for instance, might discount the print books under the e-book price and publishers have little control over that.

Whether publishers want it or not, change may be on the horizon. Three of the publishers named in the Justice Department suit have already settled and have agreed to variable pricing. Lower prices seem inevitable.

Publishers may have bought themselves some time with higher e-book prices, but they won't be able to hold the line forever.