

Low Newsstand Sell-through: Problem or Symptom?

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The statistics are familiar to us all by now. Despite centralized access to store level data that was only a dream ten years ago, industry sales efficiencies are still hovering in the mid-30% range. In addition to publishers spending over \$1.2 billion annually printing and distributing over 2.5 billion copies of returns, significant non-value added handling costs are borne by wholesalers and retailers.

Sales Efficiency as a key indicator for Goal (mis)Alignment

How many times have you been in a meeting of industry partners where in the middle of a contentious debate, someone says something like “Well, we’re all in the business of selling more magazines.” Then the debate stops with everyone nodding their heads in agreement, assuming we all want the same thing. Is that really true? Isn’t it a bit more complicated than that? In fact, I believe that our mid-30% sell-through rate points directly to a structural misalignment of goals throughout the supply chain, and even between divisions of large publishing companies. Many different people in the channel and their respective goals influence how many copies are printed and how they are distributed. The underlying motivation behind that influence is often in conflict, making what could otherwise be a smoothly functioning supply chain look more like a perpetual tug-of-war.

“Most efforts to improve efficiency have been based on the belief that technology will solve the problem”

Why the lack of industry-wide progress?

We have more data than ever before. Many publishers have hired top (and expensive) consulting firms and analysts with advanced math degrees. The industry has spent millions of dollars in systems development to use store level sale data and demographic databases in meeting consumer demand more profitably. And yet, the industry efficiency needle hasn’t budged.

Most efforts to improve efficiency have been based on the belief that technology will solve the problem – that more and more data, analysis, advanced information systems and statistical techniques in the hands of smarter people will inevitably fix whatever it is that’s broken.

I would like to propose that the underlying nature of the problem (thus, the nature of the solution) is not primarily mathematical or technological; rather, it is structural. I’d like to suggest that we’ve been asking the wrong questions and looking for answers in the wrong places. Rather than primarily looking for the magic formula in ever-larger

spreadsheets and databases, honestly answering a few basic questions will turn up some valuable clues on where to redirect our attention and efforts:

1. How do I “win?” In other words, what maximizes your personal level of reward in the form of compensation, recognition, and career advancement?
2. How does my company win?
3. How do my trading partners and overall industry win?
4. To what degree are the above aligned? Where and when are they in conflict?
5. When they are in conflict, do you choose to act in your own interest or in the interest of the “greater good?”

Untangling the messy knot of inefficiency

How do you know which thread to pull on first when trying to untangle the messy knot of inefficiency?

Clue: Who profits from all incremental sale, but bears none of the incremental cost of draw or returns? They would naturally have the strongest incentive to perpetuate the oversupply of product by:

1. pushing as many copies and titles into as many dealers as possible.
2. maintaining the dreaded “cut the draw, cut the sale” taboo that rate-base fearing publishers are reluctant to question or challenge.
3. treating every unit of sale as equally profitable, because for

them it is...but not for others that have to bear the associated costs, especially publishers.

Consider the charts on the right:

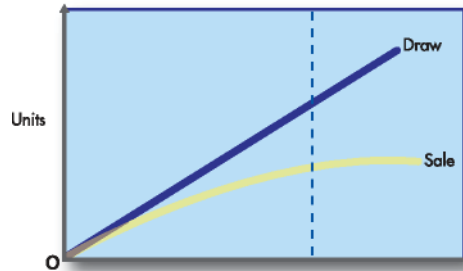
“Rational bad business”

This illustrates how publisher and national distributor economic incentives are in alignment up to a point, after which they are increasingly in conflict. It also illustrates the powerful structural influence that the traditional brokerage rate has in motivating national distributors to perpetuate systemic oversupply of product into a channel of finite retailers with finite merchandising space. It is rationale for a business to do whatever maximizes its profit. Since national distributors earn brokerage revenue on all incremental sale, but absorb none of the incremental cost associated with achieving that sale, it is rational for them to apply resources toward distributing as many titles and as many copies into as many dealers as the marketplace will allow.

As the charts illustrate, however, after a certain optimal point, distributing more becomes bad business for publishers, wholesalers and retailers. It runs contrary to sound retail category management practices and publisher marginal circulation economics. While everyone is acting rationally and in their own best short-term interest, the resulting structural misalignment of their respective economic incentives is compromising the efficiency and long-term viability of the magazine category at retail.

Publishers share the responsibility for this model even though it's their bottom-lines that are being hurt, and the future of their retail sales that is being mortgaged. This is largely due to one or more of the following factors:

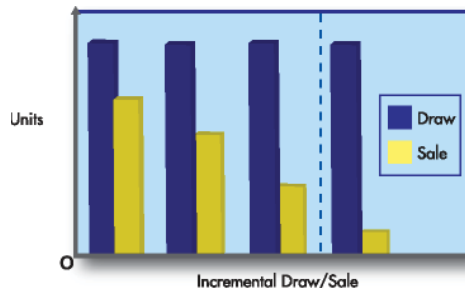
Aligned Economics ← → Misaligned Economics



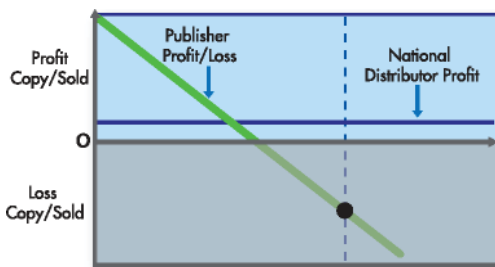
As print order for a magazine increases, sales increase at a decreasing rate until they finally plateau.



As print order increases, both average sales % and marginal sales % decline. Marginal sales % declines at a more rapid rate, however. Depending on overall publishing economics, there is a "break-even point" past which all subsequent incremental sale is not worth the incremental expense.



For every 100 copies of incremental draw that a publisher adds, the associated marginal sale generated by that incremental draw becomes smaller.



Since the publisher absorbs all of the PP&D cost, as draw increases their average and marginal profit/copy sold decreases and eventually reaches a point where all incremental sale generates an increasingly large net loss. For the national distributor making a brokerage on all copies sold, all sale comes at an equal level of profit. While it varies by publisher, there is a point on the marginal sales curve that represents an optimal balance of sale and profit for the publisher. There is no such point for a national distributor – more is always better, so there is no such thing as "oversupply". In fact, national distributors have a financial disincentive to improve sales efficiency.

Aligned Economics ← → Misaligned Economics

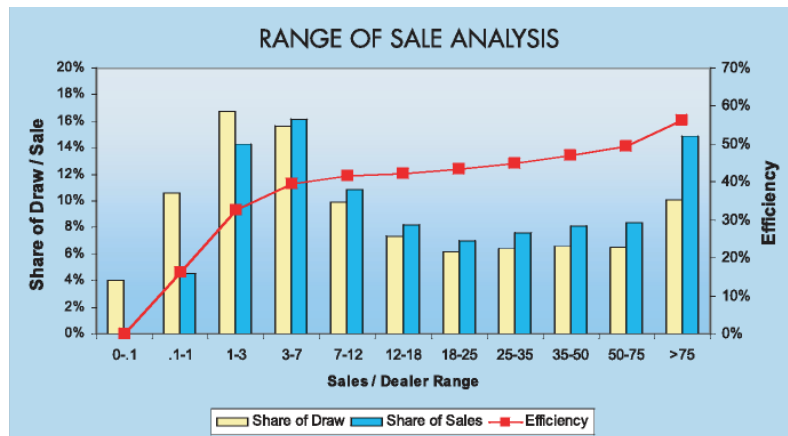
MARGINAL BREAK-EVEN EFFICIENCY MATRIX

ANNUAL ADV REV PER READER	COVER PRICES								
	\$2.00	2.50	3.00	3.50	4.00	4.50	5.00	5.50	6.00
0	51.1%	40.9%	34.1%	29.2%	25.6%	22.7%	20.4%	18.6%	17.0%
5	34.9%	29.8%	26.0%	23.1%	20.8%	18.8%	17.3%	15.9%	14.8%
10	26.5%	23.5%	21.1%	19.1%	17.5%	16.1%	14.9%	13.9%	13.0%
15	21.4%	19.4%	17.7%	16.3%	15.1%	14.0%	13.1%	12.3%	11.6%
20	17.9%	16.5%	15.2%	14.2%	13.3%	12.5%	11.7%	11.1%	10.5%
25	15.4%	14.3%	13.4%	12.6%	11.8%	11.2%	10.6%	10.1%	9.6%
30	13.5%	12.7%	11.9%	11.3%	10.7%	10.2%	9.7%	9.2%	8.8%
35	12.1%	11.4%	10.8%	10.2%	9.8%	9.3%	8.9%	8.5%	8.2%
40	10.9%	10.3%	9.8%	9.4%	9.0%	8.6%	8.2%	7.9%	7.6%
45	9.9%	9.4%	9.0%	8.6%	8.3%	8.0%	7.7%	7.4%	7.1%
50	9.1%	8.7%	8.3%	8.0%	7.7%	7.4%	7.2%	6.9%	6.7%
55	8.4%	8.1%	7.8%	7.5%	7.2%	7.0%	6.7%	6.5%	6.3%
60	7.8%	7.5%	7.2%	7.0%	6.8%	6.5%	6.3%	6.2%	6.0%

- Most publishers don't know their own marginal breakeven sales efficiency – the point at which additional sale comes at too great an expense given their own circulation and rate base economics. While the cost and risk of missing rate base are serious considerations, most publishers overcompensate by printing too many copies and distributing them to unproductive dealers that have little or no rate base contribution. (See chart above.)
- Many publishers don't have access to sales information which will help them "manage at the margin" by identifying segments of the business which are below their breakeven threshold, then optimizing their print orders and distribution guidelines accordingly. Of those that do

have access to this data, many still rely on newsstand circulators or consultants that do not have the analytic skills to leverage the value of the data. (See chart below.)

- Many publishers rely on their national distributor to set and manage their print orders for them, while other publishers expect their national distributor to maximize how many copies they can distribute into the retail marketplace.
- Publishers help perpetuate this brokerage model with each new contract or renewal, and often evaluate national distributor effectiveness based on dealer coverage versus competitive titles, and how many copies they can force into the channel.



The Imperative of a New Brokerage Model

While the current brokerage rate model is not the only driver behind the complex issue of improving sales efficiency, it certainly has one of the strongest reinforcing influences in what is currently a positive feedback loop of sales inefficiency. At this point, creating a new brokerage model which better aligns national distributor and publisher economic incentives will do more to improve industry efficiency than will the accumulation of more data in larger databases. While databases are invaluable tools, they alone do not change behavior – changing economic incentives leads to changed behavior, and databases can be used to inform that behavior in an effort to maximize the benefit of the incentive. While creating a more appropriate brokerage model should be collaborative between publishers and their national distributors, publishers have the greatest incentive to take the initiative in this type of reform. Measuring and compensating national distributors for their ability to help publishers optimize sales at acceptable profitability levels will:

- Lead to immediate and ongoing sales efficiency improvements.
- Mitigate the problem (symptom, rather) of overcrowded mainlines and reading centers.
- Mitigate or eliminate the problems (again, symptoms) of premature returns and withholding.
- Lead to more structural alignment in the economics and goals of all channel partners.
- Convert the time and energy currently wasted in distribution tug-of-wars with each other (internal focus), and redirect it toward more effectively competing with other categories in the increasingly challenging battle for valuable retail merchandising space (market focus).

...or we could just wait until retailers and wholesalers force us to get more efficient.