Fact Finding and the Single Copy Newspaper Business:

PICKING YOUR SCAN BASED TRADING PARTNER

iControl

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Jim Ryan
Vice President of GM/HBC at A&P

It seems straight forward enough

You are a large regional or a national retail chain whose stores resell newspapers to consumers. Those consumers, known in newspaper parlance as "single copy" buyers, are in turn some of your most loyal and repeat customers, skewing more affluent, better educated, more likely to be married, more likely to be a parent, and older than the general population, according to data from the 2012 Scarborough report on newspaper readership.

And yet, re-selling newspapers can be a pain for a large regional or a national retailer. For one thing, deliveries – which are seven days per week – normally arrive hours before your stores open, and sit strapped but unsecured by store door fronts. Moreover, small, local distributors deliver nearly all newspapers; newspaper distributors may be running small businesses but are rarely businesspeople. According to a survey of 383 nationwide distributors conducted in 2004 by Dow Jones, the national distribution arm of the Wall Street Journal and Barron's, individuals for whom newspaper delivery is not a primary occupation deliver 81% of newspapers sold at retail. 76% of deliveries made by such distributors are made without a delivery "ticket", or receipt. 91% of the invoices generated by these distributors were manually constructed – compiled by hand. Most startling of all, less than 2% of these distributors reported updating a retailer before adding or subtracting a title from distribution, and only 8% reported notifying a retailer when the cost or retail price of a newspaper changed, assuming that either "it did not matter to the retailer" (32%) or "someone else must be doing it" (58%).

For most retailers, therefore, newspapers have historically been a product line that is endured, not championed.

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- 2012 NAA Study

98.1%

of newspapers with daily circulation greater than 25,000 are currently participating in an SBT program with at least one retailer.

- 2011 iControl Study

"Shrink in newspapers for a large retailer can easily be 15-20%, even more," said Jim Ryan, Vice President of GM/HBC at A&P, whose career in retail spans more than four decades. "The newspapers are delivered to our stores daily at the crack of dawn. As often as not we don't know how many copies we received; no one counted them in; we don't know what we bought them for and sometimes we don't even know what price to resell them. The distributor comes in once a week to "settle up" and writes an invoice, by hand, that our store is asked to pay on the spot, usually in cash and sometimes by money order. Invariably, no one at the store knows whether the hand-written invoice matches what we received, because no one counted the papers in. No one can confirm that the hand-written cost had been agreed to, because rarely does headquarters even know the costs. In sum, it's a mess of epic proportions, nothing less."

So why carry newspapers at all?

Retailers carry newspapers because consumers who buy them are among the most habitual creatures known to man. Individuals who buy single copy newspapers buy, on average, 3.7 days a week, and 78% of the time they buy them from the same location, according to studies by the Newspaper Association of America. That's upwards of 192 store visits per year per customer. Moreover, people who buy newspapers often buy other things. According to a 2012 study by NAA, consumers who buy a newspaper buy $15.60 in additional goods when they buy a daily paper, and $23.00 in additional goods if they are buying a Sunday newspaper.

"A customer who buys a newspaper from you is a customer who also buys gum, candy, cigarettes, a lighter, a lottery ticket, prescription drugs, a bottle of soda, a bag of chips, a magazine," said Vince Casanova, former president of the Tribune Media Group and a long time executive in the industry. "For a retailer, the risk/reward of carrying newspapers is pretty simple: Carry the local newspaper, or the out of town paper, or the weekly sports paper, and gain the loyalty of those habitual customers. Or don't – and watch them buy their newspapers ***and other goods*** across the street from your competitor who does."

It's a conundrum, and one that most retail chains have looked to solve in recent years through the adoption of the sometimes-controversial practice of scan-based-trading, more commonly known by its acronym, SBT. In SBT, a retailer does not pay for newspapers sold on the basis of a delivery invoice generated by the distributor, but rather pays on the basis of sales scanned at its

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Director of Retail Sales & Marketing, Financial Times

registers, tallied by the retailer, frequently aided by a third-party aggregator.

The role of a third-party aggregator, of which there are two in the marketplace, iControl Systems and The Nexxus Group, is to aggregate the community of distributors who deliver newspaper to the retailer; collect and manage on an on-going basis the pricebook and item file information of those distributors, including when new distributors replace old; capture the retailer's daily register sales data; compile sales by store and by item daily; invoice the retailer on behalf of distributors; collect the payment from the retailer; and issue payments and remittance advice to each distributor.

A 2011 study by third party aggregator iControl concluded that 98.1% of newspapers nationwide, including 99.8% of newspapers with daily circulation greater than 25,000, are currently participating in an SBT program with at least one retailer. More than 92% of survey respondents report participating in SBT programs with five retailers or more. Among those respondents, 63% said SBT "can be a good thing". As one respondent noted, "we used to be a circulation department of eight, and now we are a department of three. We no longer have the resources to do the work of manual collection and data entry. Having most of our sales paid for by iControl makes our jobs manageable. I honestly don't think we could even do it without you anymore."

But not all SBT is the same – a fact not lost on newspaper distribution executives.

"Some retailers are under the impression that SBT is a one-size thing for newspapers, and it's simply not," wrote long-time circulation executive Nicola Halstead, Director of Retail Sales & Marketing for the Financial Times newspaper in the Americas. "There are clear differences between the two companies that offer SBT services to retailers, and retailers should take the time to understand those differences, because they are not semantic, and the impact is not only on the newspapers but on retailers and their customers as well."

So what are some of those differences?

"I think what separates us in the eyes of distributors is that our technology is designed to integrate into their world," said Tal J. Zlotnitsky, CEO of iControl Systems, the leading provider of SBT services to large regional and national retailers. "We understand that just because our retail customers pay a distributor on scan doesn't mean that all of that distributor's customers pay on scan.

Using the fee itself as the sole or even primary metric of "a good deal" and "value" misses far weightier variables, chief among them *the wholesale cost of the newspapers themselves.*

Most distributor route accounting software needs "delivered" and "returned" data in order to properly capture, record and report "sales" to publishers, to the audit bureau of circulation, and into their own accounting software. If all we sent them is the scan, or the "sales" information, they need to reverse engineer their system to make it work, a highly manual and frustrating task for most."

iControl's software allows distributors to include their deliveries in the data they submit, which iControl then uses to automatically convert the data from retailers – the POS scan sales - into the familiar "delivered less returned, equaled sale" format that are nearly universal in newspaper route accounting software.

"Yes, the end result is the same number of sales," said iControl's Zlotnitsky, "but for distributors who need this conversion in order to populate their route accounting and bookkeeping software and operate their business, our approach saves a ton of time, cost and effort."

Moreover, iControl uses the data provided by distributors and combines them with current and historical data from both the distributor and each store, along with proprietary algorithms in it software, to identify and exception-out anomalies that might indicate a UPC is not scanning, a store is persistently out of stock,

or a store behavior has changed. iControl uses this data proactively to help retailers and distributors fix problems before they fester, maintaining confidence – and therefore adequate supply.

But why do these differences matter, especially to Retailers?

The 64,000 question is, indeed, why should a retailer even *care*? After all, newspapers are a convenience item, not a major category. Some would even call it a *loss leader*. If a retailer is able to pay for its newspapers on scan, then does it matter what distributors have to do on their end to comply? And more specifically, does it have any bearing on what matters *most* to any smart retailer, which is growing its sales and profits and satisfying its customers in the process?

The answer, of course, is that it does. As the author Robert Heinlein wrote in *The Moon is a Harsh Mistress*, his 1966 novel, *there ain't no such thing as a free lunch*. The question, therefore, is *why and how* does it matter, and what does it mean for a retailer contemplating its options.

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First, know and weigh *all* the factors

"When a business buys goods and services, the calculus of "a good deal" is straight forward, and it is made up of a number of variables," said Gordon Bloom, a business professor at Virginia Commonwealth University and former Director of Circulation Planning and Software at The Washington Post Company. "A business may, and often will, break down costs to a granular level - in other words know the cost of the parts. But ultimately, to weigh how good a deal is, a business must add all of the costs involved to come up with a *total cost*. The risk to doing it any other way is that you'll save on the pizza box, but pay more for the dough and the cheese!"

When buying scan based trading aggregation services for newspapers, it is tempting to focus on the aggregation fee in isolation. However, much like Bloom's example of the pizza box versus the dough and cheese, the aggregation fee itself is the smallest part of the cost equation. Using the fee itself as the sole or even primary metric of "a good deal" and "value" misses far weightier variables, chief among them *the wholesale cost of the newspapers themselves.*

With over 2,000 newspaper distributors nationwide, many of whom carry some of the same newspapers, there are cost variances across the nation. Multiple price comparisons performed by iControl on behalf of retailers across the nation have revealed that the two aggregators do not have the same cost of goods from distributors, and that the differences are not trivial. In seven out of seven instances where a price comparison was done, including six performed in 2014, iControl's costs for the newspapers were lower overall, by an average of 1.77%.

"We have lower costs because our software and process helps distributors cut their own costs without compromising accuracy," says Zlotnitsky. "Distributors can be confident that they'll be paid correctly, be able to pay *their* suppliers – the publishers - correctly, and therefore be in more control of their business. Consequently, distributors trust us more, and charge our customers less."

"When we were looking at making the switch from Nexxus to iControl in 2011, we asked iControl to look at our sales per item, by store, and we discovered a cost difference of 3.42% overall between what we had been charged by Nexxus, and what our cost of goods would be under iControl," said Greg Huls, Director of Strategic Sourcing at SUPERVALU.

"It wasn't a difficult decision from there," he added.

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"A retailer has to look at their *price*, per item, by distributor, and multiply that by their actual sales for at least the prior 12 months, to determine their *blended actual cost of goods*," says Zlotnitsky. "Considering the cost of the newspapers represent 96-98% of the total cost to a retailer, when combined with any fees, ignoring this variable to focus strictly on the aggregation fees is tantamount to buying a container of soda 6-packs on the basis of the delivery surcharge, *and ignoring the cost of the soda*."

And even that, alas, isn't the whole of it.

"When distributors face risks, they respond by reducing the risk," wrote Professor Bloom. "Other than raising the price to the retailer, the most common way to mitigate risk is to cut supply, aiming for a sell out."

By aiming for a sell out, a distributor remedies the reconciliation challenge of reverting scan sales into the "deliveries less returns equals sales" format of their route accounting software. The reason is simple – the sales nearly always *equal* the delivery, *because the returns are zero*. Therefore, there is no reconciliation to do with the data.

In some cases, particularly in the Northeastern United States, distributors have been known to sometimes refuse to service some or all stores, altogether.

The impact on retailers is much greater than the loss of some newspaper sales and hassle to the store; the loss is of other goods that are bought alongside by a loyal and habitual newspaper customer.

"A national retailer who loses 5% of supply could stand to lose 500,000 sales a year," said Zlotnitsky. "At $1.50 a paper, on average, the impact on newspaper revenues is the least of a retailer's problems. But using the newspaper buyer's basket value of $15.60 daily and $23.00 on Sunday, the cost of losing 500,000 sales is about $10 million in sales, and $2-3 million in profits. Not to mention, those customers are across the street buying from your competitor, increasing the competitor's sales by the amount you lost."

Newspapers are not what Robert Heinlein thought of when wrote his *free lunch* line; he was literally speaking of free lunches... but quite evidently, the same logic applies to newspapers!