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(strapline) the big issue: magazine distribution
(headline) Mayday! We're peering into the abyss
(standfirst) Neville Rhodes outlines some of the threats facing small retailers
if passive selling leads to an open market for magazine wholesaling

On 1 May the regulations underpinning the news industry's system of exclusive distribution territories will come to an end, opening up the possibility of legal challenges to the territorial monopolies that magazine publishers and distributors award to wholesalers.

Newspapers do not face this threat, because the Office of Fair Trading has decided, albeit provisionally, that their distribution contracts are compatible with the Competition Act.

The system of exclusive areas for newspaper wholesalers will therefore remain as it is now.

For the distribution of magazines, however, the OFT has decided, again provisionally, that "absolute territorial protection ...is unlikely to be necessary", and that wholesalers should be allowed to meet "unsolicited requests" to supply magazines to retailers outside their areas.

So, in less than a month's time, a retailer who currently receives his magazines from Wholesaler A, will be able to request supplies from an alternative wholesaler, and if the request is granted, Wholesaler A will have no legal grounds to prevent them coming into his area.

By giving this go-ahead to what is known as 'passive selling', the OFT is saying, in effect, that there can be a much more open market for the supply of magazines than we have at present.

Some retailers have welcomed this development, which the Association of News Retailing has described as "the biggest single change in the news and magazine industry for a decade" and one that offers retailers "their greatest opportunities". But although this change could undoubtedly bring benefits to the biggest retailers, it has a nasty and potentially deadly sting in the tail for tens of thousands of small newsagents and c-stores whose magazine sales amount to only a few hundred pounds a week.

For most of these retailers there will not only be no choice of wholesaler (because, to put it bluntly, their magazine business on its own would not be viable to an alternative wholesaler). They will also be the most vulnerable if the present system for distributing magazines starts to unravel and undermines the economics of newspaper wholesaling in the process.

The OFT, apparently, is not concerned about this. It has ignored the argument that distribution of newspapers and magazines is interdependent, using the same vehicles and contributing roughly 40% and 60% respectively to the wholesalers' gross incomes (excluding carriage charges), and it seems to have seriously misjudged the damage that passive selling of magazines could cause to the distribution system as a whole.

For a start, nearly every agreement to meet an unsolicited request for magazine supplies will involve additional costs for the wholesale sector, because it will mean the retailer's alternative magazine wholesaler delivering into the original wholesaler's territory – and two vans doing the job previously done by one.

Who is going to pay for this? Almost certainly not those retailers who are able to persuade an alternative wholesaler to supply them with magazines. If you have the bargaining power to change wholesalers, you also have enough clout to insist that you do not pay carriage charges for your magazines.

But somebody will have to pay, and the most likely outcome is that the additional distribution costs will be passed on to the retail trade as a whole in the form of higher carriage charges for newspapers, where retailers have no choice.

Loss of magazine business would also put wholesalers under financial pressure. A single magazine account worth £1,000 a week (at wholesale prices) produces, in ball-park terms, about the same amount of gross income for the wholesaler as four top-of-the-scale carriage charges. So if, say, a couple of dozen retailers with high-value newsbills for magazines were to take their business elsewhere, it could knock hundreds of thousands of pounds a year off the wholesale house's profitability. Admittedly, in the passive selling scenario it would probably not be all one-way traffic. Some of a wholesaler's existing magazine customers would go, while other retailers from outside the area would request supplies. But at what cost to the wholesalers? Offers of higher discounts to discourage big retailers from leaving? Agreeing to better terms for retailers in other areas that come calling?

Again, somebody would have to pay for this. Magazine publishers/distributors could give wholesalers a bit more margin, in an attempt to maintain an orderly market. But if passive selling started to run out of control, they might decide that it would be less damaging to pass the problem back to the wholesalers, by removing their traditional recommended 25% minimum discount for retailers and paving the way for variable terms.

And the 12,000 independents whose magazine sales are worth less than £100 a week would be the first to feel the draught.

None of this may happen, of course. The OFT could change its mind about passive selling (it is allowing a short consultation period following the publication of its provisional advice, and is planning to produce its final opinion shortly afterwards); wholesalers may feel there is little to be gained by supplying magazines to retailers outside their area, especially if, by doing so, they place their newspaper contracts in jeopardy; and retailers could decide that it is better to stick with the devil they know and do a deal on terms.

However, the lessons of recent history suggest otherwise. Five years ago WHSmith Retail, Tesco, and other major retailers were planning 'national distribution' of magazines, and although those plans were eventually shelved, demand for radical reform of the supply chain has never gone away.

Removing restrictions on passive selling opens the floodgates of market forces, and will surely bring about the transfer of control over the supply chain from publishers to retailers – or rather to the five biggest retail chains that account for more than 45% of all magazine sales.

The supermarkets, mindful that they are already under pressure over their dominance of the grocery sector, may not be in a hurry to rock the newstrade boat, but they are unlikely to hold back if other retailers seek to gain an advantage.

And judging from the vehemence with which the retail trade associations have been attacking the present system, it will not take some retailers long to seize the opportunities that passive selling offers, once the OFT has cleared the way.

Then, the newstrade will be in uncharted territory, subject to forces of a kind that it has never experienced previously. Regulations and restrictions have created a level(ish) playing field that has not only served consumers reasonably well, but has enabled thousands of small newsagents to stay in business, while their butcher, baker and greengrocer counterparts have been wiped out by competitive pressures. Reasoned arguments that such pressures within the newstrade could lead to thousands of small retailers being forced out of business, with knock-on effects on newspaper circulations and the diversity of the magazine market, have been dismissed by the NFRN (of all people!) as scaremongering and self-serving.

But any small news retailers – or their trade association - who are not scared of what could happen after 1 May are, in my view, being far too complacent.