



*Scan Based Trading*

*Voluntary Suggested  
“Best Practices”*

*Wholesaler Supplied Model*

*International Periodical Distributors Association, Inc.  
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*Confidential*

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## **Overview**

In 1996, the concept of Scan-based trading (SBT) was formally defined when the Grocery Manufacturers of America (GMA) convened a task force of its members to participate in a Scan-based Trading test with HEB Stores in San Antonio, Texas. The participants included major retailer suppliers such as Anheuser-Busch, Coca-Cola, Nabisco, Frito-Lay and Pepsi-Cola. While the test showed that SBT could provide significant operational cost savings for both suppliers and HEB, it is noteworthy that none of those major manufactures have any significant SBT relationships with retailers today<sup>1</sup>. A recent study also shows that in order for an SBT relationship to be beneficial for all parties, business practices must improve and information systems' capabilities must be expanded<sup>2</sup>. The fact that the major suppliers of product to retailers that participated in the SBT test have not as of 2005 expanded their SBT relationships, points strongly to the conclusion that most retailers have not as yet improved their systems capabilities to an acceptable level.

In 1999, the Magazine Industry began studying the effects that SBT could potentially have on the three major distribution channel members, publishers, national distributors and wholesalers. The Magazine Publishers of America (MPA) contracted with Mercer Management Consulting Group to perform that study.

Mercer also determined that the Magazine industry could realize several benefits in an SBT environment, including operational costs savings for wholesalers, more timely sales data for publishers and national distributors, and a determination of the accountability of shrink<sup>3</sup> among channel members. However, the Mercer study also reached the conclusion that for those costs savings to take place, both retailers' and wholesalers' systems capabilities had to be enhanced<sup>4</sup>.

In 2001, the Magazine Retail Advisory Committee (MRAC), a sub-committee sponsored by IPDA and MPA, developed guidelines for Pilot-Testing the application of scan-based trading to magazines. Three wholesalers who serviced Wal-Mart participated in a SBT test with a small number of Wal-Mart stores with the approval of the National Distributors.

Publishers and National Distributors, for the most part, did not embrace any of the principles of the Mercer report or the suggestions of the MRAC study. Many believed that Scan-based trading was a retailer/wholesaler matter since those two channel members had the direct financial relationship. However, several major retailers began using scan-based trading as a requirement for wholesalers who were bidding for their business.

Some wholesalers began offering scan-based trading to retailers in the bidding process to establish a competitive advantage. Today it is estimated that there are over 20,000 retail locations that are involved in a scan-based trading relationship with either tradition wholesalers or direct distributors.

However, over the last six years, as SBT relationships between retailers and magazine wholesalers have increased, for the most part, publishers and national distributors, acting independently, have not established appropriate guidelines or Best Practices pursuant to which retailers and wholesalers could

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<sup>1</sup> Based upon conversations by IPDA personnel with representatives of certain of these suppliers and major retailers

<sup>2</sup> Prime Consulting Group SBT Feasibility Study 2000

<sup>3</sup> Shrink is a term used by industry participants to describe an unaccounted for loss of revenue which may be attributable to theft, missing copies, magazines being miskeyed at the register as general merchandise, or other circumstances. This occurs when a delivered magazine has not been returned by the retailer to the wholesaler as unsold, yet the retailer claims the magazine was not sold and therefore it is not required to pay the wholesaler for it.

<sup>4</sup> A Fresh Look Mercer Mgt Consulting 1999



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consider operating in a SBT relationship viable for all industry participants. As this document outlines, the International Periodical Distributors Association, Inc. (IPDA) believes that publishers and national distributors, because of their financial relationship with wholesalers, have a right to be involved in determining the manner in which the SBT relationship between a retailer and a wholesaler is conducted, if for no other reason than the fact that wholesalers' unsold copies are fully returnable, most often via affidavit, and wholesaler payments are based on the difference between invoiced and credited copies.

### Reasoning for Recommendations

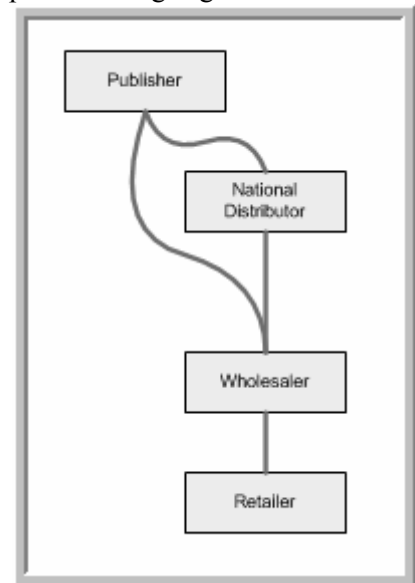
This document will outline many of the suggested voluntary “Best Practices”<sup>5</sup> that IPDA believes should be considered by participants in the Magazines<sup>6</sup> Industry's supply chain when evaluating implementation of an SBT relationship. IPDA is a trade association of National Distributors, with many associate members in the publishing community, whose mission is to research and suggest Best Practices to channel participants to improve the overall efficiency and effectiveness of the magazine distribution channel. IPDA's members represent over 98% of the magazines sold through the supermarket, chain drug, convenience stores and discount store channels. IPDA is not itself involved in the magazine or book distribution or sales process.

The overall economics of the magazine industry in large measure are dependent upon how its products are sold and distributed through the supply chain. Typically, the industry operates using a guaranteed sales financial relationship; and publishers and national distributors generally allow wholesalers to provide affidavit returns for credit instead of physically returning stripped covers. Publishers and national distributors each have a significant interest in ensuring that the status of this formal relationship is a sound one because SBT financial relationships between retailers and wholesalers may also significantly affect the other supply chain members.

Any change to the historical and fundamental methodology of how retailers pay their wholesalers for product and how credit for unsold copies is issued, should seek to satisfy the logistical and financial requirements of all the channel participants. Prior to reviewing the Best Practices, an understanding of the typical structure of the supply chain and the financial relationships that usually exist between the trading partners is useful.

There are four major distinct trading partners relationships in the Traditional Supply Model each with its own unique characteristics (see Figure 1). The following outlines some of the processes performed at each level:

- Publisher – manufacturers the physical product by integrating editorial and advertising content. Usually required to guarantee the advertiser that a specified number of units will be sold to justify its ad page rate. It is imperative that publishers receive accurate data on the number of copies sold at



**Figure 1 - Supply Chain**

<sup>5</sup> The voluntary suggested “Best Practices” discussed in this memorandum are not intended nor should they be construed as being a comprehensive or complete identification of the subjects or issues that arise in SBT relationships. Rather, these are “Best Practices” recommended by the IPDA to be considered by each national distributor or publisher for possible inclusion when preparing its own individual policy statements regarding SBT relationships.

<sup>6</sup> Although IPDA represents both magazines and books, this document will focus on the magazine component.

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retail. Without this data, the publisher would be unable to certify their sales to advertisers for rate base as required by the Audit Bureau of Circulation. Therefore any change to how sales are determined and reported at retail in the retailer/wholesaler relationship, should ensure that the publishers need for accurate sales data is properly addressed.

- National Distributor – typically acts as the publisher’s marketing and sales representative, which includes managing, coordinating and facilitating (with the publisher and wholesaler) the allotment process<sup>7</sup>, the traffic process, the billing and collection process, and the return of unsold copies process. The National Distributor also is typically involved in coordinating promotional programs and title marketing on behalf of its publisher clients. In addition, the National Distributor maintains sales statistics at the wholesaler level, audits circulation, as well as usually providing financial support to the publisher with the monetary advances which are generally used to defray a portion of the publisher’s production costs. The National Distributor typically, on behalf of its publisher clients, has the financial, billing and collection relationship with the wholesaler.
- Wholesaler – typically determines the number of copies to be sent to its retail customers; physically handles the delivery of new titles and the pick-up of unsold off sale copies to/from their retail customers; provides their retail customers with in-store merchandising<sup>8</sup>; maintains the sales statistics at the retail store level; provides the national distributor with the actual sale information concerning the title/issue by issuing an electronic affidavit aggregating the number of unsold copies they physically picked up from their retail customers; provides sales data to the national distributor to facilitate promotional payments; and provides the national distributors with the distribution and sales statistics by geographical area to support the circulation audit process. The wholesaler is generally responsible for the Vendor Managed Inventory activities associated with their retail trading partners. In almost all cases the wholesaler makes payment for copies of a title<sup>9</sup> to the national distributors instead of directly to a publisher.
- Retailer – typically provides the selling space for the sale of magazines; manages the item synchronization process used for both the back room/DSD and scanner systems; and pays the wholesaler only for copies sold<sup>10</sup>. The majority of the handling of the physical copies is performed by the wholesaler. Most often, the Retailer’s direct financial relationship for all copies purchased and sold in their stores is with the wholesaler. Retailers also may have a financial relationship with publishers for display and promotional allowances, but usually not for the purchase and sale of titles. That relationship almost always is with the wholesaler.

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<sup>7</sup> The process of determining the number of copies to be allocated to wholesalers.

<sup>8</sup> Placing of new issues into the racks, removal of off sale copies from the racks and keeping the racks in a stocked and presentable manner

<sup>9</sup> Generally for small and/or regional titles.

<sup>10</sup> In the current paradigm, the wholesaler invoices the retailer for all copies delivered and credits the retailer for all returned/unsold copies.



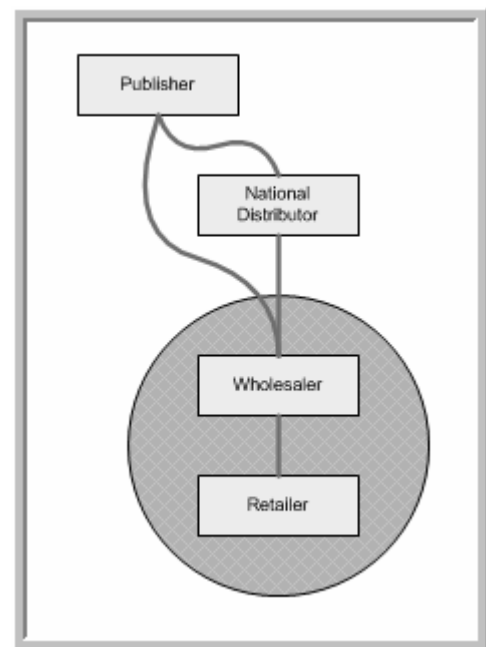
## Wholesaler Supplied Scan Based Trading Model

After analyzing the most likely ramifications of a wholesaler and retailer SBT relationship on the supply chain, and considering the current level of those relationships, the IPDA makes the following voluntary recommendations to national distributors and publishers for consideration. It should be noted, however, that the following recommendations have not attempted to address the full array of issues presented to national distributors and publishers when wholesalers and retailers adopt an SBT relationship. These recommendations are intended to address suggested Best Practices that national distributors and publishers could voluntarily choose to include, in whole or in part, in any wholesaler SBT requirements policy. Publishers and national distributors should also consider the more complex issues and potential significant effects that an expansion of wholesaler/retailer SBT relationships could have on the magazine distribution system as it is currently constituted. Those are presented in the last section of this memorandum.

The Wholesaler Supplied Scan Based Trading model (“SBT”) operates directly between two trading partners, the retailer and its supplying wholesaler<sup>11</sup>, with all other channel partners performing subsidiary roles (see Figure 2). In this scenario, the supply channel to the wholesaler operates in the same manner in which it does in the Traditional Supply Model. The retail level sales, financial, and operational relationship would remain directly between the wholesaler and the retailer. Currently publishers and national distributors are not a party to any of the financial and/or operational issues associated with wholesaler/retailer trading relationship, including but not limited to: the price and terms under which the wholesaler and retailer operate; the profit generated from sales; the financial credits provided for any delivery shortages or overages; any retailer and/or wholesaler loss of revenue due to operational, accounting or theft issues, or any accounts receivable, billing and/or payments issues.

In an SBT relationship between a retailer and wholesaler, the national distributors’ and publishers’ financial relationships with their trading partners are not typically directly affected. Therefore, even in the new SBT model being addressed in this paper, the publishers and national distributors are not envisioned as having a direct financial relationship with the retailer for the sale of product. This paper proceeds to discuss voluntary suggested “Best Practice” for the possible implementation of an SBT relationship where only the retailer and wholesaler, who have the direct financial relationship, share in the loss of any revenues experienced in their SBT relationship.<sup>12</sup>

If a wholesaler enters into an SBT relationship with a retailer, the wholesalers’ financial relationship with the National Distributors is not necessarily altered. Wholesalers should likely expect to continue the individual relationships with national distributors under their individually agreed terms and conditions. Wholesalers would likely be expected to continue to pick up unsold copies from their retail customers’ stores and process and destroy them in their normal manner. The terms and conditions in a typical



**Figure 2 - Financial Relationship**

<sup>11</sup> Although there may be examples of other types of trading relationships, this document addresses only the direct Wholesaler and Retailer model.

<sup>12</sup> This is not to suggest that there are not a variety of other potential SBT models involving different loss sharing approaches, they are just not the subject of this “Best Practices” memorandum.

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wholesaler/national distributor relationship gives the national distributor the right to eliminate the wholesalers' affidavit privilege for various reasons if the national distributor has a basis to conclude that the integrity of the affidavit process has been or may become compromised and is therefore inaccurate.

In a Retailer/Wholesaler SBT relationship, the retailer will be paying the wholesaler only for copies that it has registered as being sold, which is different from the manner in which payments are based in the current Retailer/Wholesaler financial relationship. This change in the method and basis of retailer/wholesaler reporting of sales could potentially negatively impact the accuracy of title and sales data furnished by wholesalers to the national distributors and subsequently from the national distributors to the publishers. This could ultimately undermine the publishers' certification of sales to the Audit Bureau of Circulation.

National Distributors and Publishers need to continue to have a valid method for determining accurate title sales information when a retailer and wholesaler decide to implement an SBT financial relationship.

The IPDA recommends that national distributors and publishers consider as an accurate method to ensure title and issue sales integrity requiring wholesalers to strip all covers and return them to the national distributors for credit, if they enter into an SBT relationship with a retailer. However, national distributors may alternatively consider other options to guarantee the integrity of the sales and returns process that seek to avoid adding any extra handling and other costs to the wholesaler system.

The following is the IPDA voluntary recommended "Best Practice" for consideration by publishers and national distributors designed to enhance the integrity of the single copy sales and returns process when a wholesaler and retailer enter into an SBT relationship.

1. The Auditable Wholesaler Supplied SBT Model: Voluntary Recommended "Best Practice" Procedures
  - (a) Recommended Retailer Responsibilities:
    - i. The retailer should electronically manage<sup>13</sup> its Item Synchronization utilizing any process that is agreeable to each of the national distributors acting independently. The retailer should further ensure that these Item Maintenance records are transmitted to and loaded into the individual store's systems without the store having the ability to reject all or any portion of said transmission.
    - ii. The retailer should provide daily register scanned data via an X12/852 or other accepted formats to a magazine industry sanctioned repository ("POS Repository"). These transactions should identify the supplying wholesaler at the same level in which that wholesaler is claiming their returns. These transmissions should occur daily or at a frequency of not less than weekly. Each transaction would need to contain, at a minimum, the retailer identification, the store identification, the GTIN<sup>14</sup>, date, and net quantity of each title sold<sup>15</sup>. The retailer should provide the POS Repository with a certification that all sales for all stores have been included and that no store's sales were omitted as a result of equipment and/or transmission malfunctions. It is suggested that the retailer's system should keep all transaction data available for a period of not less than 13 months to facilitate same period year-to-year comparisons.

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<sup>13</sup> The GTIN and title attribute information would automatically be updated into the retailer's system without being re-keyed.

<sup>14</sup> If the retailer stores its barcode as a UPC, it should be converted to a 14 digit GTIN prior to transmission.

<sup>15</sup> Optionally it could include the issues add-on code, accumulated sales value and the number of register transactions.



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- iii. The retailer should eliminate the use of any generalized “dummy” key for any product that does not scan. It should ensure that the checkout person enters in the full GTIN and identifies it as a magazine. The retailer should subsequently send their supplying wholesaler a list of all such unrecognized items. The retailer upon receiving corrected data from the wholesaler and/or via the normal Item Synchronization process described in section i above should enter such data into their systems and allocate the sales of these unrecognized scans to the appropriate wholesaler. If this correction process is completed after that period’s sales have been reported, the retailer would send a secondary X12/852 file to the POS Repository for all such items.
- iv. The retailer should provide the POS Repository with their item maintenance exception reports and any changes made to their authorization lists.
- v. In preparation for moving into an SBT model and to ensure that the process is accurate and workable for the specific wholesaler/retailer combination, the retailer should provide a live historical six month sample of the data described in section ii above which should be audited against the wholesaler’s order regulation data described in section (b)iii below.
- vi. The retailer should work individually and collectively with the magazine industry to grow its magazine and books sales in its stores. This would include the retailer using its best efforts to implement industry Best Practices for the display and sale of magazines and books. The retailer should commit to having mainline fixtures in at least 80% of its stores. The retailer’s authorized list should be reasonable in the number of titles and publishing categories it includes.
- vii. The retailer should be encouraged to assign personnel to straighten and merchandise the magazine titles on the checkout and mainline fixtures.
- viii. The retailer should check and verify the number of totes of new product and returned product in each store on each delivery.
- ix. The retailer should implement controls and share the procedures they will utilize to safeguard the consigned inventory in their stores. These safeguards should satisfy the requirements of the outside accounting firm of any publicly held wholesaler with regards to the Sarbanes-Oxley Act of 2002.
- x. It is recommended that the retailer consider paying the wholesaler quicker to offset the financial effect of the added inventory carrying costs of the SBT relationship imposed upon the wholesaler.
- xi. The retailer should permit publishers to price test in their stores.
- xii. The retailer should permit publishers to have different cover prices in different stores, based on the store’s demographic profile.

**(b) Recommended Wholesaler Responsibilities:**

- i. The wholesaler should continue to send in an electronic affidavit.
- ii. The wholesaler should provide the national distributors with their Order Regulation data either directly or through POS Repository.
- iii. In preparation for moving into an SBT model and to ensure that the process is accurate and workable for the specific wholesaler/retailer combination, the wholesaler should provide a live historical six month sample of the data described in section (a) ii above which should be audited against the retailer’s



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POS data described in section (a)v above. If the comparison of the retailer's POS data and the wholesaler's O&R data show differences, each national distributor, acting independently, may determine whether to delay its acceptance of a proposed SBT relationship until the involved wholesaler and retailer improves their systems and are able to operate at an acceptable level to be determined by each national distributor independently and unilaterally.

- iv. To allow the national distributor to determine the issue that was sold, the wholesaler should provide, and continuously update to the national distributors via electronic transmission to the POS Repository route schedules and delivery days for all stores that are operating under an SBT arrangement.<sup>16</sup> By providing this information, which will help the national distributors and publishers determine when the new issues are placed on sale, the retailers' registers would not need the capability of reading issue codes<sup>17</sup>. The wholesaler should share with the national distributor agreed upon reports that help both determine the loss, if any, associated with the SBT process.
- v. The wholesaler should capture and archive all line item transactions<sup>18</sup> pertaining to any store on the SBT model. The information should include, at a minimum, the wholesaler account number, retailer id, store id, transaction date, GTIN, Add-on code, and quantity. This information should be made available to the national distributor during any audit described in section vi below.
- vi. The wholesaler should allow representatives of national distributors and publishers to conduct periodic audits of its systems, Order Regulation Data, Line Item Transaction Level data, processes and procedures that relate to their affidavit processes and their SBT relationship with a retailer.
- vii. To facilitate accurate information among channel participants affected by the wholesaler/retailer SBT relationship, the wholesaler should provide to national distributors or publisher representatives upon receiving a request (1) access to a copy of the protocol agreement with all prices and other terms of sale information omitted. The protocol agreement provided should include the shrink reconciliation process, scanned data transfer process and the item file maintenance process, and (2) any information which arises during the wholesaler/retailer relationship which bears upon or relates to the operational or economic functioning of the SBT relationship, such as data integrity issues or the unexplained loss of revenues retailers and wholesalers are experiencing which relate to the SBT relationship.
- viii. The wholesaler should have a "perfect pick" system that ensures complete accuracy of the delivered copies. The system should include a weighing process that can verify that the amount of copies placed in each tote is accurate. Each tote should be secured with a numbered security seal to ensure that the tote is not tampered with during transport to the retailer.

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<sup>16</sup> This would not be needed if the retailer scans the add-on code and reports on same.

<sup>17</sup> Publishers may consider using a GTIN rotation method to more accurately determine the correct issue from POS data.

<sup>18</sup> Transactions should include draw, reorder, shortage and returns.



## **Cover Returns**

If a retailer and wholesaler do not adopt an adequate data integrity system, such as one that includes the “Best Practices” recommended herein, then it is recommended that a wholesaler be responsible for sending covers back to the national distributor to receive credit. Each cover should have the UPC, issue, cover price and title. The covers should be batched by title and issue and should be banded in stacks of 100 cover headings. A summary form should be included that would be provided by the national distributors. The wholesaler should also include an affidavit report for comparison purposes as well as transmitting a synchronized electronic affidavit.

## **Publisher and National Distributor Considerations**

Publishers’ and national distributors’ businesses could be significantly impacted by an expansion of SBT relationships between wholesalers and retailers that have not been established with adequate procedures to achieve the data and financial integrity objectives addressed in this memorandum. Consequently, when publishers and national distributors individually develop their own company’s SBT requirements, each may want to consider the following issues:

- A. In most cases, the national distributors have the direct financial relationship with wholesalers. It is common knowledge in the industry that wholesalers’ financial positions have been and continue to be on unstable footing. Several industry sources estimate that wholesalers’ net profit, on average, is no more than one percent of their sales.<sup>19</sup> If wholesalers continue to expand SBT relationships with retailers and agree to share in any lost revenues experienced in those relationships it could make wholesalers’ financial positions even more precarious. It would be reasonable for national distributors to be concerned about collecting their receivables or having their wholesalers’ payments slowed even further because of additional wholesalers’ financial strain caused by an expansion of SBT relationships.
- B. In an SBT relationship, in most cases, a retailer shifts the accounting responsibly for its inventory costs back to its supplier. It is thus likely that a wholesaler might have to buy back the inventory that is in the retailer’s stores when an SBT relationship commences. This might result in a significant one time negative cash flow impact on the wholesaler. It would be reasonable for a national distributor to consider what effect, if any, this may have on the future timeliness of receiving payments from such wholesalers.
- C. It would be reasonable for a national distributor to consider the possibility that a wholesaler, faced with a consignment sale relationship with their SBT retailers, may insist on paying its national distributor consistent with the manner in which it is paid by its retailer. It is entirely possible that the wholesaler may want to pay the national distributor on a consignment basis, paying the national distributor for copies only after the wholesaler is paid for those copies by the retailer. This could affect a national distributor’s cash position unless the timing of payments to its clients is adjusted.
- D. Since the largest four wholesalers are responsible for nearly ninety percent of all single copy sales, even one deciding to declare bankruptcy or close its doors, would significantly affect the

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<sup>19</sup> The New Single Copy Newsletter



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publishers' and national distributors' abilities to have their titles properly distributed for at least a six month period of time.<sup>20</sup>

- E. Publishers may also consider sharing in the lost revenues that wholesalers and retailers may experience in an SBT relationship. It could, for example, consider doing so in exchange for better services, expanded retailer coverage, increased distribution of copies, etc. If a publisher made a decision to do so, managing the process could prove difficult and costly for the publisher, its national distributor and even the wholesaler involved. It is very likely that the publisher or its national distributor would have to operate dual accounting systems, one for SBT retailers, where the payments to the publisher may be on a consignment basis, and the other for sales from all other retailers serviced by that wholesaler where payments would continue to be made in the traditional manner.
- F. National Distributors and publishers may also consider requiring retailers' scanners to read the issue codes on magazines. Having the retailers provide scanned register data that includes title and issue codes is the only currently known way to ensure that the sales information being reported is totally accurate for a specific issue. Publishers and national distributors, having only scanned register data provided by the retailers by title and not issue will have to subjectively determine what issues of the titles were actually sold when they are comparing the information to the wholesalers' O&R records. For those retailers that do not currently have the capability to read issue codes but have already entered into SBT relationships with wholesalers, the publishers and national distributors may consider providing some phase-in period within which those retailers may comply with the new requirements.

These are only some of the major issues that publishers and national distributors should consider as wholesalers and retailers enter into SBT relationships. While it may be highly unlikely that wholesalers would expand SBT relationships to all of the retailers they service, it is extremely likely that major retailers will continue to demand SBT relationships. Given the existing and growing importance of the SBT issue to the distribution channel for magazines, publishers and national distributors should each independently consider preparing and implementing an individually designed policy establishing its own Wholesaler SBT requirements.

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<sup>20</sup> When Unimag ceased doing business it took approximately six months before the distribution to the retailers serviced by Unimag returned to normalcy.

